Economic Viewpoint

BY ROBERT J. BARRO

SOUTH KOREA: HOW TO KEEP THE MIRACLE GOING

AT RISK: The danger is that, to promote growth, the government may move away from the market and toward Euro-style policies that stifle it

South Korea has been one of the champions of economic growth, with annual growth of almost 6% in gross domestic product per person. As a consequence, the level of per capita GDP in the past 40 years has advanced tenfold. By comparison, it took the U.S. 130 years, from 1870 to 2000, to raise its per capita GDP by a factor of 10. Aside from a few other East Asian economies, such as Taiwan and Singapore, South Korea's accomplishments in the past four decades are unmatched in history.

The rise in South Korea's GDP was accompanied by improvements in social indicators: Life expectancy rose from 54 to 73 years, and the rate of infant mortality fell from 8% to 0.8%. Moreover, income is fairly evenly distributed. The distribution in recent years has been more equitable than in the U.S. or Japan, and similar to the pattern in Britain and Sweden. Distribution in South Korea also changed little from the 1960s to the 1990s. Therefore, the multiplication of per capita GDP by 10 has meant that the typical person's income also rose about tenfold. Hence, the share of persons living in poverty plummeted. Given all this, I am puzzled that recent policy discussions in South Korea have been so preoccupied with income inequality.

One important point is that the great improvements in human welfare took place while South Korea was practicing capitalism without apology. It was not "compassionate capitalism" or "social market economy" or "the third way" or "growth with equality" or other euphemisms sometimes proposed by left-wing governments.

Now, the new Roh Administration is debating which policies to implement to promote further growth, perhaps to catch up with the per capita GDP levels of Japan and eventually the U.S. It would be wise to start with the policies that worked so well over the past 40 years. These included substantial investments in human capital, reasonable maintenance of the rule of law, a basic orientation to the market (despite occasional lapses into industrial policy that subsidized favored sectors), high and increasing openness to international trade, high saving rates, and a relatively small government.

The other important ingredient for growth was that South Korea was so poor in the 1950s. Empirical research shows that poor countries that have reasonably solid policies, such as South Korea around 1960, tend to grow rapidly and so converge with the world's rich countries. However, now that South Korea has become upper-middle income—almost half the per capita GDP of the U.S. on a purchasing-power adjusted basis—the opportunities for growth are less abundant. To come close to matching its previous performance, South Korea's policies and institutions will have to get even better.

One good option is to raise the quality of education, especially by introducing opportunities for private schooling at the secondary and primary levels. That would promote efficiency and get around the rigidity of the public system. Also, financial markets and corporate governance could be improved, as we learned especially from the financial crisis of 1997-98. However, regulatory policies should focus on promoting transparency, rather than allowing the crusade against the *chaebol* to stifle business productivity and investment. In addition, the financial sector should be strengthened by removing barriers to foreign investment in banking and insurance.

The danger is that South Korea will move away from the market and toward European-style policies that retard growth. For example, the previous Administration dramatically expanded welfare programs, which diminish the incentive to work. Similarly, the current government has been pro-labor unions, even though international evidence indicates that union power tends to reduce the flexibility of labor markets and hamper productivity.

Looking ahead, the major economic issue will probably involve the integration of the North into a unified Korea. Such integration has proved difficult for Germany, although West Germany's income level was only three times that of East Germany's. South Korea's income is at least 10 times that of North Korea's. The German unification emphasized subsidies for individuals and industries in the East. These policies, promoted by West German labor unions, were designed partly to discourage migration of cheap labor from the East to the West. The result has been persistently high unemployment in eastern Germany, high taxes in western Germany, and weak overall economic growth.

It is unclear how South Korea will face its more daunting unification challenge, but the recent emphasis on social programs, union power, and income inequality does not make me optimistic. The main hope of South Korea seems to be that the North will maintain a separate political regime, albeit one that is more peaceful and rational. It may be that a more relevant issue will be the design of workable economic policies for a unified Korea, once unstoppable political forces make that reunification a fact. ■

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