

The Korean Social Welfare System Issues in the New Context of Development¹

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Abstract: The welfare state issue has captured great interest in the field of political economics from a number of developed countries ever since the Second World War. The characteristics of welfare systems and welfare policies and the role of the welfare state in economic development are among the issues of most concern. The literature has categorised welfare states into three models - liberal, conservative, and social democratic regimes - following Gosta Esping-Andersen's concept (Esping-Andersen, 1990). Recently, research works on East Asian social welfare have however, considered East Asia as a particular regime differing from the three above models, which Holliday (2000) named as a "productivist" regime. Being an East Asian country, over the past few decades, Korean social welfare has had a number of "productivist" characteristics. However, after the Asian financial crisis in 1997, Korea experienced a significant reform in its welfare system (Kim, 2006). What are the factors that forced the Korean welfare system to reform? What are the distinguishing characteristics of the Korean welfare system? What are the challenges facing Korea regarding the improvement of the welfare system in order to fit in with the new development context? These are the questions that this paper would like to explore and to develop some possible answers.

Keywords: East Asia, Korea, reform, social welfare system, welfare model.

1. Introduction

The East Asian countries economic development, such as that of Japan, Korea, Taiwan, and Singapore, has been a favored topic of comparative political economics over the last several decades. Their path to economic

growth has attracted the greatest concern of researchers. The distinctiveness of this development has been termed the "developmental state", the essence of which is the foremost and single-minded priority of state policy in economic development [1]. Within this developmental paradigm, a strong commitment to "protective" social welfare is regarded as inefficient. Since the early stage of industrialization to the early 21st century, aggregate government social expenditures in East Asia have been much lower than in most other regions of the world [2, 3, 4].

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The distinctiveness of social welfare in those countries, however, is not only the low level of government spending but also the pattern of social policy expenditure. Compared to other advanced capitalist societies where social welfare is the major policy area for public expenditure, East Asian states spend more on human capital formation such as education, focusing on the “productive” function of social policy. Deyo describes this feature as “developmentally supportive social policy” and considers that social policy in East Asia is driven by the needs of developmental economic strategies [5]. To conceptualize this unique nature, Holliday proposes the so-called “productivist welfare capitalism”, describing how East Asian states use social policy as an important instrument to facilitate economic growth [6].

Being an East Asian country, over the past few decades, Korean social welfare has had a number of “productivist” characteristics. For several years, Korea successfully managed to combine remarkable economic growth with a low tax rate and low welfare spending. The achievement of a productive welfare policy in Korea was to equip Koreans with a basic social welfare system. The four major social insurances, such as pensions, health insurance, employment insurance, and workers’ accident compensation insurance began to legally cover the majority of Korean people. However, productive welfare had internal limitations, in spite of its achievement. The productive welfare system has a two-tier structure of benefactors and beneficiaries, and welfare was thought to conflict with economic growth. Thus, Korean governments gave priority to growth, the economy, and productivity. From the last decade of the 20th century, especially after the Asian financial crisis in 1997, Korea

experienced a significant reform in its welfare system [7]. This paper aims to clarify characteristics of the Korean welfare system, and the factors that forced the Korean welfare system to reform in the early 21st century.

This paper is divided into three parts. The first part will present a broad review of welfare state models in East Asia; the second part introduces the development of the Korean welfare system as well as pointing out distinguishing characteristics of the system; and the last part will discuss several driving factors which forced the Korean social welfare system to reform in the new context of development.

2. The welfare model in East Asia

One of the most influential writers on welfare states is Gosta Esping-Andersen. In the comparative welfare state literature, Esping-Andersen’s [8] three ideal types of welfare states - *liberal*, *conservative*, and *social democratic* models - are broadly accepted as the most common approach [9]. However, unlike the European case, Esping-Andersen’s typology does not fit the reality of East Asia. The primary goal of social protection in the East Asian context is not the promotion of social rights itself but rather the promotion of economic productivity. For this reason, East Asia’s social policy development is considered distinctive, as much as its remarkable economic growth [4]. Indeed, during the industrialization period, social welfare provisions such as pensions, health, unemployment, and education were largely subordinated to the imperatives of labor production, human capital accumulation, and rapid economic growth. In particular, this strategy has been widely used as part of nation-building efforts.

To explain this feature of East Asia welfare capitalism, studies approach the matter from different perspectives. One of the convincing arguments comes from examining the role the state plays in the process. According to Deyo (1992), in East Asia, welfare policies were used as a “tool for economic development.” Following this view, scholarly works on East Asian welfare states have been greatly influenced by the hallmarks of the “developmental state” thesis [5]. In explaining the characteristics of East Asia’s welfare regime, the state-centered approach has highlighted three important features, such as low government expenditure on social welfare, social security benefits for selected groups of industrial workers, and the priority placed on education [10].

Holliday described this pattern in his model called “*productivist welfare capitalism*” [6]. According to this author, unlike advanced capitalist societies where social welfare generally embodies the successes of social democratic politics, East Asia’s social policy is strictly subordinate to the overriding policy objective of economic growth. In this regard, the productivist welfare state thesis was obviously an extension of the developmental state theory. Holliday asserted that social welfare in East Asia has been mainly

determined by productivist principles of minimal social rights with extensions linked to productivist activity, reinforcement of the position of productive elements (e.g., education and job training) in society, and state-market-family relationships directed towards growth. According to him, the core principles of productivist welfarism were derived from East Asia’s “growth-first-and-distribution-later” strategy. With the belief that the government’s social welfare spending brings a burden to the economy and consequently undermines international price competitiveness, family welfare and/or occupationally segregated corporate welfare have become a major method of social security provision in East Asia [11]. As such, Holliday and the advocates of productive welfare capitalism believed that East Asia’s economic strategies have led the governments to avoid any strong financial commitments to social welfare while expanding investment in education to encourage individuals to participate in the market place, and eventually to contribute to national economic development. This is why, they believe, universal social welfare programs could not develop during the high-speed industrialization period from the 1960s to the 1980s [12].

Table 1. Government expenditure on social and economic policies in East Asia
% of total government expenditure

	Education				Health				Social security				Economic affairs			
	80s	90s	00s	Avg.	80s	90s	00s	Avg.	80s	90s	00s	Avg.	80s	90s	00s	Avg.
Japanese	9.3	15.0	12.4	12.2	13.6	20.6	22.2	18.8	18.8	18.6	23.6	20.3	7.4	8.9	9.3	8.5
Korea	18.5	17.9	14.9	17.1	1.7	1.1	0.8	1.2	7.0	9.6	17.1	11.2	19.3	22.0	21.9	21.1
Taiwan	5.2	9.2	11.5	8.6	1.6	0.6	1.3	1.1	15.2	22.3	23.8	20.5	16.7	18.4	19.2	18.1
Singapore	17.0	20.3	20.9	19.4	4.8	6.4	6.0	5.7	1.2	3.3	5.8	3.4	16.6	13.4	13.1	14.3

Source: Kim , 2013 [4]

3. Characteristics of the Korean welfare system

Similar to other East Asian countries, Korea followed the model of a minimal public social welfare system during the period of rapid industrialization. Growth-first policies were quite prominent between 1960 and 1990. Policies toward economic growth took priority over policies promoting distributions. Moreover, welfare policy in Korea has been influenced by the political factor of a military government during that period of time.

Productive welfare programs in Korea have been developed with the need for cultivating a workforce that was believed to further economic development. In the 1960s and 1970s, the Korean government began to increase public support for education and provide social security benefits for state employees and industrial workers. The overriding concern, however, was not only how to protect strategic human resources for economic growth, but also how to minimize the financial burden of the state. To address this puzzle, the Korean government created a limited productive welfare system in which a significant portion of financial responsibilities was transferred to companies and families. Korean firms, especially big manufacturing industries, were not reluctant to provide the company-sponsored risk-pooling benefits to their workforce, because they needed to secure a stable supply of skilled workers [13]. As such, a combined contribution of firms and employees became the major funding source for social welfare in Korea. Based on this policy initiative, several compulsory social insurance programs were created, without any significant expansion of public spending on general welfare. During the industrialization period, the productive welfare state in Korea thus focused

less on the provision of comprehensive “protective” benefits, limiting its role to a regulatory function.

After 1961, the military regime pursued economic growth as the principal goal of the new regime and started a series of 5-year economic plans to promote economic growth, providing financial subsidy and tax benefits to some companies in strategic industries. The welfare policy of the military Government was influenced by political factors. The main concern of the government was to stabilize the regime and introduce welfare programs to get support from the major occupational groups strategically important to maintain power. Those were Government employees, military personnel and teachers. A pension program was introduced first for those groups. The Government employees’ pension was introduced in 1960. The military personnel pension was separated from the Government employees’ pension in 1963. The pension for teachers in private schools was established in 1973 [14]. The military regime needed support from core social groups and those groups were instrumentally important to govern civil society.

Meanwhile, a national pension program for private-sector employees was proposed in 1972 by the Korea Development Institute (KDI) - a government think-tank of the Economic Planning Board. Considering social development as part of economic policy, the KDI began to engage in social policy-making from 1972 and proposed an idea that social policy would be able to facilitate economic growth within the given economic policy paradigm. Because in the 1970s the government made an important change in its grand economic strategy from export-led industrialization coupled with import-

substitution, to heavy-chemical industry, it was required to mobilize a substantial amount of national resources and domestic capital. The KDI proposed to use the national pension as a means of capital mobilization to fund the heavy-chemical industrialization drive of the military regime (Yang, 2000)[15].

As industrialization began, industrial accidents on a large scale began to occur and casualties and injured employees became social problems, and so the Korean military government institutionalized the Industrial Injury Insurance in the early state of industrialization in 1963. Industrial Accident

Insurance did not impose a great financial burden on the government, because the government simply introduced insurance as a mechanism, which would pool the risks of employers who were already liable for industrial accidents. At first, the Industrial Injury Insurance was introduced in companies with more than 500 employees in the manufacturing and mining sector. This was then extended to companies with more than 300 employees in 1965. The Insurance continuously extended its coverage up to companies with more than 20 employees as labor disputes became acute among the small firms [14].

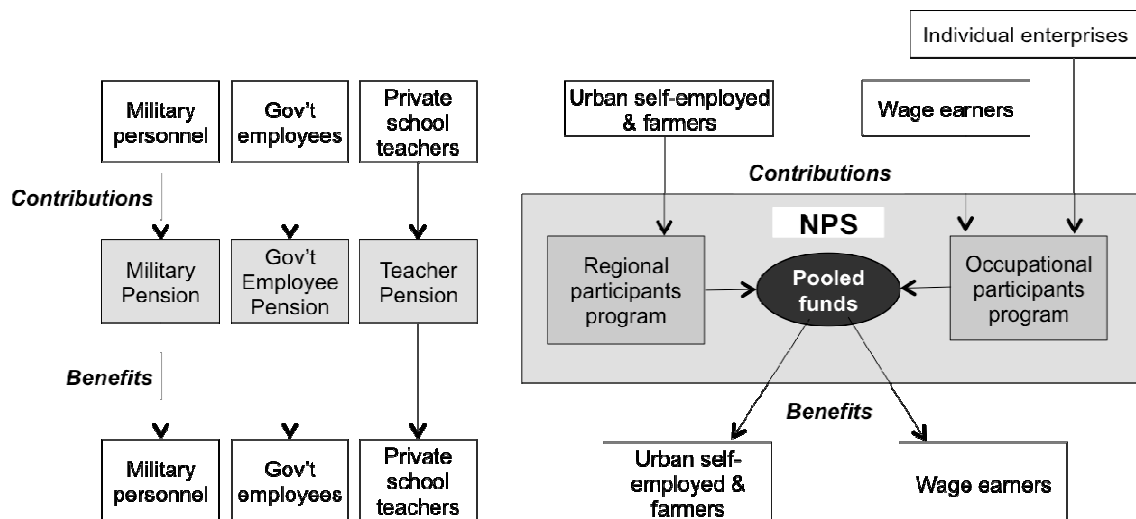


Figure 1. The Pension Insurance System in Korea.

Source: Kim, 2013 [4]

Health insurance was the next welfare program introduced by the military government. Though the health insurance law was already passed in 1964, it was not implemented until 1970. Employer and employee were responsible for half of the financial contribution. The government did not have the financial burden of the health insurance but the managerial responsibility. However, the health insurance was restricted to

government employees, the military and employees in large companies. Thus, the coverage of the health insurance was only 0.2 percent of the population in 1975 [14]. It became a mandatory health insurance in 1977. The Health Insurance was segmented by occupation and region. In 1981, the national health insurance was divided into occupational health insurance and regional health insurance. The segmented health insurance system was

maintained until 1999 when health insurance reform was successful in establishing a unified national health insurance.

The welfare policy of the Korean government in the period 1960-1980 revealed two features. First, the target group of welfare policy was the privileged social groups rather than deprived social groups such as the poor, the unemployed, the elderly and the handicapped. In the case of the National Health Insurance and the National Pension Program, industrial workers employed in big business were the first group of people to be protected, while more vulnerable people were left unprotected. The welfare policy had been considered as an instrument for promoting political support from the core social groups. The political strategy of the military regime was to introduce the welfare policy in limited areas such as industrial accident insurance and occupational health insurance. Second, the welfare programs had been introduced in such a way as to minimize the state's financial burden and labor cost of business [16]. These welfare programs were based on the arrangement of social insurance, in which the government did not take responsibility for financing. The government enforced the rules that made those programs compulsory. For example, both employers and employees had full responsibility for the finance of the occupational health insurance. The self-employers who belong to the regional health insurance were fully responsible for the finance of the regional health insurance. The financial burden of the state was to pay the cost of management of organizations responsible for each of the health insurances. In the case of occupational health insurance, the government lowered the corporate tax in order to alleviate the financial burden of private corporations. Furthermore, the government allowed the

National Health Insurance Association, a branch of the Federation of Korean Industry, the association of big corporations in South Korea, to take charge of management of the national health insurance. Interests of big corporations were more represented by the health insurance in this period [17].

4. Factors that made the Korean welfare system reform

Since the mid 1990s, Korea has experienced fundamental socio-economic and political changes that have broken down the traditional 'developmental state' approach to governance [18]. A successful transition towards political democracy was achieved with the inauguration of the Kim Dae-Jung government (1998-2002), and a drive for rapid economic globalization, provoked by the financial crisis in 1997, which impacted on the wider Korean society. Moreover, there were changes in the social environment - such as the ageing of the population which increased at an unprecedented rate, the birth rate declined markedly and the change of family structure accelerated. Such issues became critical on the national agenda in the early 21st century, and led to the re-examination of the existing social and economic policies.

Political factor: Democratization

The Korean military government employed productive welfare policies as one of the methods to garner political support to overcome its lack of constitutional legitimacy. However, the establishment of pension and health insurance programs was mainly for civil servants, military personnel, public school teachers, and industrial workers who were viewed as critical for the regime's survival. After 1987, under pressure of democratization

movements, the government began to substantially expand social welfare programs.

As democratization proceeded with the successful struggle for democracy in 1987, the political environment significantly changed. During the period of transition from authoritarianism to democracy, worker's strikes erupted across the nation. The major goal of labor strikes was wage increase and worker's basic rights to organize unions and for free union activity. Most of the major unions in big corporations were organized in that period in Korea. The level of corporate welfare significantly improved due to the introduction of collective bargaining. The corporate welfare expenditure increased from 1986 to 1988 by 47.1% and most was with the intention to prevent labor disputes (Shin, 2006). Collective action of workers changed the welfare system at the company level because the corporate welfare sharply expanded among big corporations with unions.

The rising influence of trade unions for more equal distribution has also gained more political attention. Regarding state welfare, the health insurance was extended to agricultural and fishery sectors in 1988 and it was further extended to the urban self-employed in 1989, even though the government did not have financial responsibility for the health insurance. There was also the introduction of a national pension for regular employees in private companies with more than 10 employees, and it was further extended to private companies with more than 5 employees in 1992. A noticeable change during this period of time was a new welfare policy introduced in 1995. Under the pressure of the two biggest labor unions in Korea, the Government announced implementation of unemployment insurance in

its "5 Year Plan for the New Economy". At first, it only applied to companies with more than 30 employees and some companies with more than 70 employees engaged in human resource development programs organized by the government. Thus the proportion of employees who joined the unemployment insurance was only 31.4 percent in 1997. It was much lower than expected since non-standard employees, comprising almost half of the total labor force, did not join it either. The coverage of unemployment insurance extended to employees of all companies in 1999 [17].

Economic factor: 1997 financial crisis

The productive welfare policies in Korea revealed their limitation more clearly in 1997 when the Asian financial crisis shook the Korean economy severely. Limited welfare programs were not sufficient in protecting the general public from the unprecedented socioeconomic blow. As part of efforts to overcome the crisis, the Korean government started to further extend the existing welfare benefits to almost the entire population, including those who would have otherwise been left outside the social protection system. As a result, the population coverage rates of the national pension scheme, national health insurance, and unemployment insurance have remarkably increased since the late 1990s [18].

The economic reform in the period 1998-2002 included privatization of the public enterprises, opening of the financial market, enhancing flexibility of the labor market and reform of the governance structure of the *chaebols*. The economic reform exposed the vulnerability of the working class population to unemployment as more firms engaged in structural adjustment in an attempt to stay more

competitive. The immediate impact of the policy for labor market flexibility was massive unemployment and a sharp increase in non-standard workers. According to National Statistical Office (2008), about 100 thousand employed employees lost their jobs in every month in 1998 [19]. The unemployment rate increased from 2.1% in October 1997 to 7.7% in July 1998. The drastic change in the labor market worsened the welfare of the employees and the unemployed. Because the non-standard workers were exempted from any welfare benefits, many of the non-standard workers fell into the working poor. The economic reform guided by the IMF contributed to lower the level of welfare of the employed and expand the number of working poor.

As well as pursuing economic reform, the Government had to reform welfare policies. The National Minimum Livelihood Protection System (NMLPS) was an institutionalization of the ideology of productive welfare in 2000. The Government replaced the Law of Life Protection with the Law of the National Minimum Livelihood Protection in 1999 and implemented it in July 2000. The NMLPS provides public assistance to poor people under the condition that recipients who are able to work should participate in the program for job training and self-help. Thus the welfare provision is linked to work in the labor market. Welfare reform was necessary for Korea to lessen the impact of structural adjustment and the economic crisis and to lower the social cost of structural adjustment. This was also the requirement of the World Bank and IMF in providing The Second Structural Adjustment Loan to the Korean government.

Social factor: Demographic and family structure changes

Along with the four main social insurance programs, there was *The poor relief program*, established in the early 1960s, which provided livelihood protection, medical assistance and institutional care to those in absolute poverty. This program provided welfare services only to specific groups consisting of those who were exceptionally disadvantaged and could not survive in the market economy without the help of family members. Such characteristics of the welfare services in Korea reflect its socio-demographic structure during the industrialization period, which has a relatively young demographic composition. This composition is based on the traditions of family responsibility for its members, particularly the elderly and the young. The percentage of the elderly over the age of 65 exceeded 7 percent in 2000. In 2002, only 6.5 percent of the population over the age of 60 lived on public pensions; 40.1 percent depended on transfer incomes from their families [19]. Thus, due to the traditional family-based support system, there was relatively less pressure for the government to expand social welfare services until the mid 1990s.

Throughout the 1990s, the selective nature of social service provision was rapidly collapsing due to the fundamental changes in the socio-economic environment. The factors contributing to the increasing need for more universal services replacing the family's traditional role as a care provider consisted of: the rapid aging of the population, the drastic decline in the birth rate, and the gradual decline in the traditional function of the family as caregiver.

Firstly, Korean society started to get older due to longer life expectancy and the rapidly increasing trend of low fertility. The improvement in nutrition, sanitation, and medical care has increased life expectancy. As a

result, the number of elderly (aged 65 and older) has been continuously growing. The advancements in medicine and health outcomes have contributed to extending life expectancy to 80.1 years in 2008 from 62.3 in 1971. Currently, senior citizens account for 11.0 percent of Korea's entire population, and they are expected to make up 38.2 percent of the population in 2050, among the highest percentage in the world.

A second major change is the drastic decline in the fertility rate. Actually the aging process of Korea is directly due to the decrease

in the number of childbirths. The typical three-child family in the 1970 diminished to two children in the 1980s. Recently the inclination among younger generations is to hold off on marriage and childbirth. The low birth rate phenomena is due to various factors such as the increase in childcare expenses, the change in people's values, the low level of family welfare, and the increased participation of women in the labor force. The total fertility rate continuously decreased from 4.53 in 1970 to 1.08 in 2005 to the current level [19].

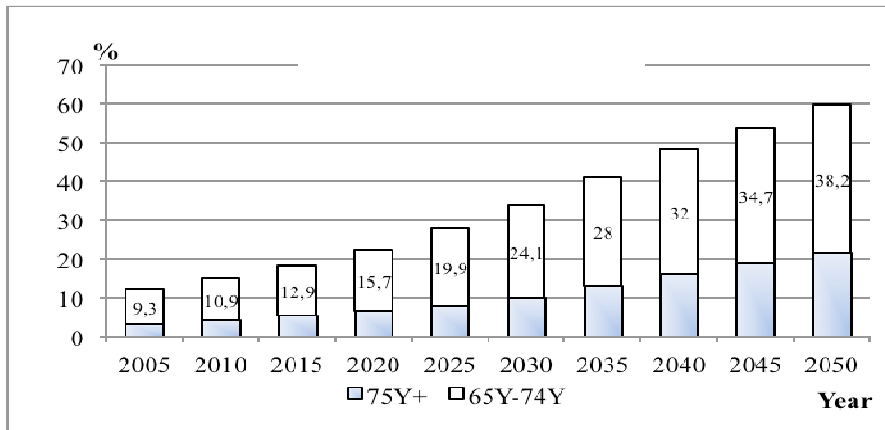


Figure 2. Elderly population.

Source: Population Prospects (Korea National Statistical Office, 2005), Population and Housing Census (Korea National Statistical Office, 2006)

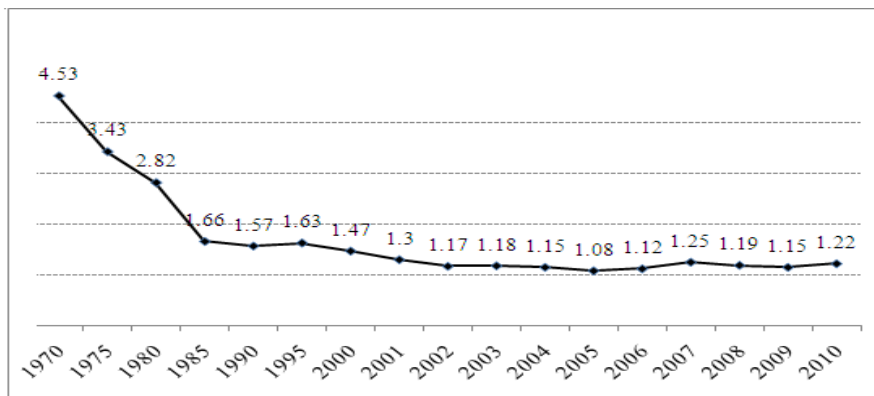


Figure 3. Total fertility rate (in 10,000 persons).

Source: Childbirth Trend (Korea National Statistical Office, 2008)

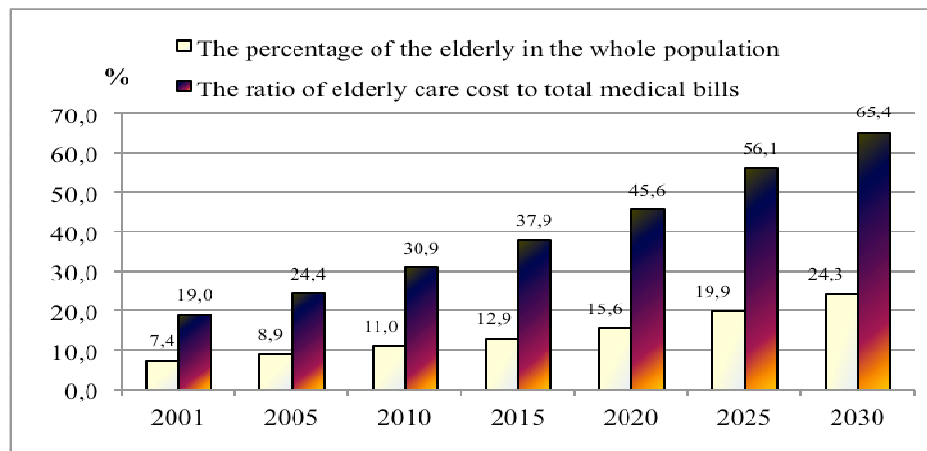


Figure 4. The percentage of the elderly in the whole population and the ratio of care cost to total medical bills in the National Health Insurance.

Source: National Health Insurance Corporation, 2008

If the current trend continues, younger generations will find it unbearable to continue to support the older generation, and the sustainability of the National Pension System will be undermined as the number of pension recipients continues to increase while the number of pension plan holders will decline. As a result, the National Pension System will go into a critical situation in the near future.

Rising medical cost for elderly care will affect the fiscal structure of National Health Insurance. Senior citizens, who will make up 24 percent of the entire population in 2030, are projected to account for 65 percent of all medical bills.

Thirdly, the traditional function of the family as caregiver has gradually declined. It is evident that day-to-day family care functions, such as childcare, senior citizen support, and family services, gradually weakened throughout the 1990s. The average number of household members dropped from 3.7 in 1990 to 3.1 in 2000. The percentage of female-headed households also continued to grow, from 15.7 percent in 1990 to 18.5 percent in 2000. The female participation rate in economic activities increased from 47.0 percent in 1990 to 48.9

percent in 2003, and the number of employed married women increased by 1.29 million: the figures read 5.57 million in 1990, and 6.86 million in 2003 (National Statistical Office, 2004). Such changes have clearly weakened the traditional care-giving functions of the Korean family.

The continuing transitions in demographics and family structures can be a challenge for the development of the Korean welfare state. Social insurances such as pensions and medical care are part of the expenditure that will largely increase with the aging population. Since long-term illnesses will increase, it is a requirement to establish a support system that can provide long-term medical care.

Challenges in reforming the social welfare system

Studies of social welfare reform in Korea revealed several challenges faced by the system in the process of reforming. Regarding the National Pension Program, the pension fund was unsustainable. Although applying different methods, research provided a similar conclusion that the level of pensions was too high to sustain in a society with an aging

population [20; 21]. According to projections, the fund for the program will run out by the year 2033 [22]. In other words, either the National Pension Program would not be able to deliver pensions as it had promised, or the Korean government would have to put money into the Pension Fund, unless the existing condition of low economic growth was changed.

Regarding the National Health Insurance, there was a similar situation. After becoming universal, the finance of the National Health Insurance fell into deficit because patients could now use health services all year round instead of up to a limit of 300 days as previously and because of the government decision to increase fees for physicians and hospitals and then medical doctors in 2000. The government had to provide emergency funding in 2001 to prevent financial bankruptcy of the National Health Insurance [22]. It is a challenge for the government, and the National Health Insurance Corporation, to find a sustainable formula for financing National Health Insurance.

In addition, there was an issue of inequality in burden-sharing for the welfare programs. Because social insurance premiums were decided by a person's ability to pay, it is important to have correct information about the income of the insured person. However, there is a tendency to underreport income, particularly in the case of self-employed workers. In Korea, it is believed that a great number of the high earning self-employed, and professionals such as practicing lawyers and physicians, pay far less tax and social insurance contributions than they should do, while wage and salary earners taxes and contributions are directly deducted from their pay cheques. This is also because of the outdated Korean tax system. This problem will cause great concern in the future unless the necessary steps are taken [22].

5. Conclusion

Korea's social welfare development was based on a period of rapid industrialization led by a development-driven government during the 1960s-1980s. Economic growth had been the most important goal of the state policy for maintaining the authoritarian regime. Bearing characteristics of a "Productive welfare regime", Social policy was not intended for social protection or redistribution itself but rather for the promotion of economic productivity. During these three decades, welfare programs introduced by the military regime tended to give privileges to social groups strategically—necessary for the military rule.

Since the 1990s, welfare systems in Korea have faced new socio-economic and political pressures never experienced before. Firstly, because of the democratic transition from 1987, many social groups could convey their social welfare demands. The civilian government had to find social policies to reduce mass discontent. An extension of the health insurance to social groups, which were excluded from welfare programs before, was an outcome. Secondly, globalization requires extending labor market flexibility, which is followed by greater job insecurity that requires the expansion of social welfare to protect low-skilled workers in the deteriorating labor market, and especially irregular workers and workers in small and medium-sized enterprises. After the 1997 Asian financial crisis, the Korean government has attempted comprehensive economic reforms and social reforms. Thirdly, the demographic and family function changes were also pressures on the welfare system that lead to the need for new welfare policies. While the number of elderly,

who depend on social benefits such as living support and health care is increasing, support from families has diminished. Since the elderly are becoming more dependent, this increasing trend indicates that the elderly dependence on pensions will increase. To address the above issues, the Korean welfare system needs to be extended, as well as preparing the fiscal capacity to maintain financially sustainable for the system.

Historically, the Korean government has not preferred high welfare spending. Some of the biggest changes in welfare policies and welfare spending were made under the Kim Dae-Jung administration. The Kim Dae-Jung government maintained that social expenditure should not be a constraint on economic recovery, though it was inevitable for the government to expand welfare programs due to massive unemployment, an expansion of the poor, and the aging population. As the Korean social insurance programs have been extended and integrated, there has been the need to reform tax rather than reform only the welfare system. However, most Korean governments have been hesitant to take up such a challenge.

Facing challenges in the new development period in 21st century, the Korean government needs to make more effort to establish a positive interaction between growth and distribution, understanding both while anticipating harmony in terms of distribution and growth, and likewise with respect to the welfare and economic aspects.

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