

# **K**ERI **E**CONOMIC **B**ULLETIN

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Korea Economic Research Institute

# Executive Summary

## **Korea's 2014 GDP growth is projected at 3.4%**

Korea's economic growth for 2014 is projected to be higher than that of 2013 with gradual improvement in global conditions, but is expected to fall short of the potential growth level (approx. 3.5%). This is attributable to a slower recovery of the global economy as well as to a heap of risk factors such as uncertainties surrounding the US Fed's tapering, Japan's "Abenomics" and China's economic reform, the fall of USD/KRW, and deepening of trade competition, all of which will drag down the pace of Korea's export recovery. Domestically, beginning of household "deleveraging" (debt reduction) and legislation related to economic will continue to dampen private spending and investment sentiment.

## **Consumer price grows at 2.2%, USD/KRW to show a gradual fall**

Consumer prices in 2014 are projected to slightly increase comparable to the average rate at 1.2% in 2013 due to the upward pressure of public utility charges and base effect. However the rise is expected to be slowing at a lower end of the 2 % range, attributable to steady but slow recovery, fall of USD/KRW and the stabilizing trend of the international prices of raw materials. Despite a short fall due to reversal of services account into deficit, Korea's current surpluses are expected to sustain a surplus level of US\$60 billion next year. USD/KRW is expected to show a gentle descend as strong-won factors, such as current account surpluses are offset by strong-dollar factors following the US Fed's QE tapering.

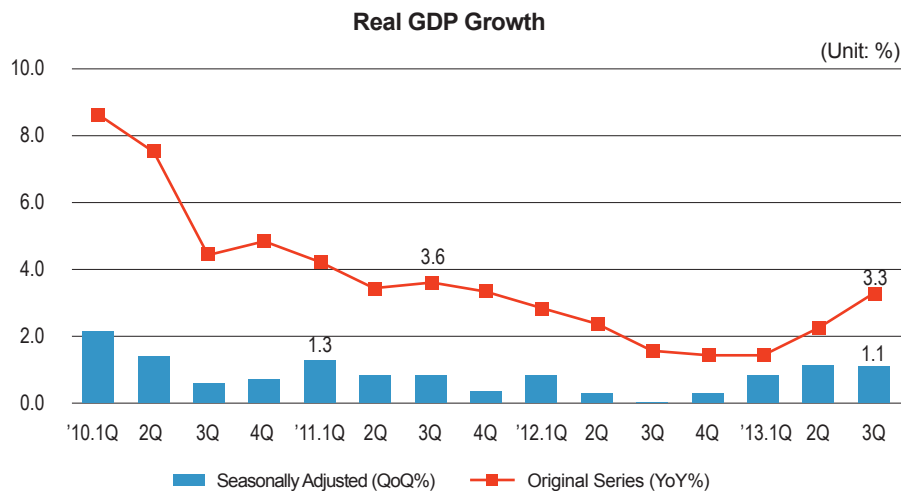
## **Restructuring wage system is urgent in order to ease the tension following institutional shift in the labor markets**

Restructuring wage system is urgently needed in order to mitigate adverse impacts on employment and investment, instigated by recent passage of labor-related bills such as extension of retirement age, expansion of the scope of base salary, spread of part-time employment. The platform of wage system restructuring should include policies targeted for improving job opportunities and income expansion for low-income households, overcoming a dichotomy in the labor market that centers on large businesses, regularized workers and labor union, duty-, performance-, competency- and responsibility-based workplace, overcoming institutional rigidity and overcoming tensions between the management and regular worker-centered labor union.

## Recent Developments

**GDP growth records 1.1% (QoQ) in 3Q, upbeat for two consecutive quarters and 3.3% (YoY)**

Thanks to the lessened fear for a prolonged slow-growth, Korea's economy continued to expand for two consecutive quarters after eight consecutive quarters of slow growth at about 0 % range (seasonally adjusted, QoQ). The Korean economy turned around to record 1.1% growth in 2013 2Q and 3Q.



Source: The Bank of Korea

**Growth led by public finances, such as government expenditure and construction investment**

Public expenditure recorded 0.4%p contribution ratio; the ratio is also shared by private expenditure whose size is three times bigger. Construction investment maintained 0.5%p contribution ratio in 2Q and 3Q, affected by the expansion of SOC and early execution of planned budget. Contribution from private expenditure, such as facility investment and export has diminished.

### Contribution to GDP by Expenditure

(Unit: %p)

	2012				2013		
	1/4	2/4	3/4	4/4	1/4	2/4	3/4
Final consumption expenditure	0.9	0.2	0.5	0.3	0.0	0.8	0.5
Private consumption	0.4	0.2	0.4	0.4	-0.2	0.4	0.5
Government consumption	0.5	0.0	0.1	-0.1	0.2	0.4	0.0
Gross fixed capital formation	0.8	-1.0	-0.4	-0.4	1.0	0.6	1.1
Construction	-0.2	-0.2	0.1	-0.2	0.6	0.5	0.5
Facilities	1.0	-0.8	-0.5	-0.2	0.2	0.0	0.1
Exports of goods and services	2.2	-0.2	1.1	-0.6	1.7	1.1	-0.8
Imports of goods and services	2.2	-1.0	1.0	-0.4	1.3	0.6	-0.3
GDP expenditure	0.8	0.3	0.0	0.3	0.8	1.1	1.1

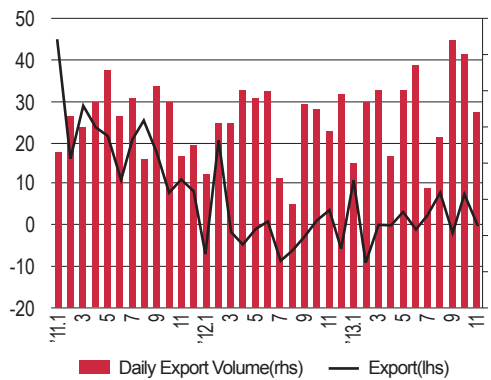
Source: Bank of Korea

**Exports growth (on a custom clearance basis) picks up as it recorded 0.4% in 1Q, 0.7% in 2Q, 2.8% in 3Q and 3.7% between October and November**

A monthly average of exports in October and November 2013 increased 4.7% (YoY) or US\$2.12 billion. By region, exports to US and EU started to take a favorable turn, while exports to Japan struggled.

**Export Growth and Daily Average Export Volume**

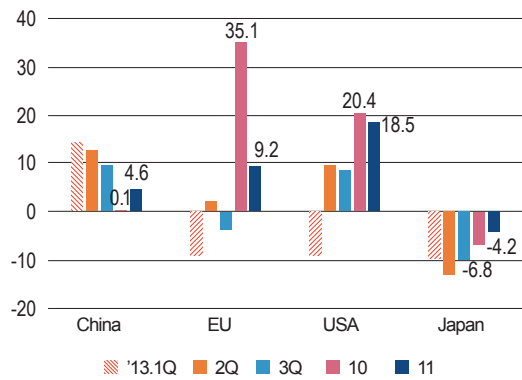
(Unit: left-YoY%, right-US\$100mil)



Source: MOTIE, Korea Customs Service

**Export Growth by Destination**

(Unit: YoY%)



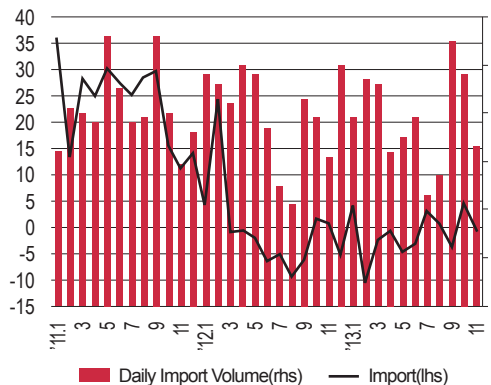
Source: Korea Customs Service

**Imports growth (on a custom clearance basis) recorded -3.0% in 1Q and -2.8% in 2Q but rebounded to 0.2% in 3Q and expanded to 2.3% between October and November**

Daily average of imports during October and November recorded US\$1.85 billion or 3.2% increase (YoY). By sector, raw material imports, which constitutes the largest share of total imports, finally turned around and are gradually picking up. Imports of capital goods and consumer goods widely expanded as well.

**Import Growth and Daily Average Import Volume**

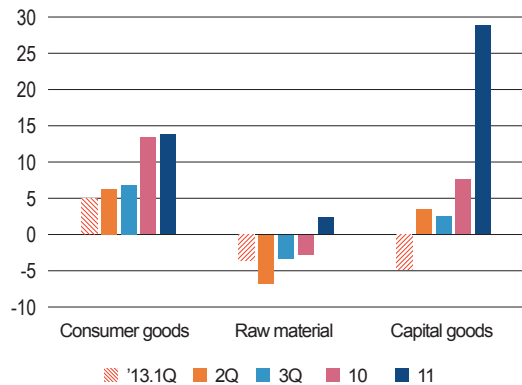
(Unit: left-YoY%, right-US\$100mil)



Source: MOTIE, Korea Customs Service

**Import Growth by Use**

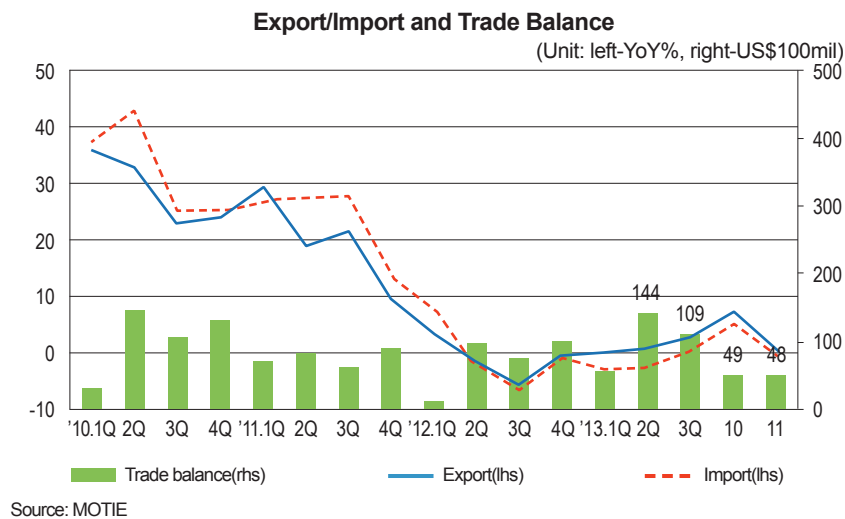
(Unit: YoY%)



Source: Korea Customs Service

**Trade account records surplus of US\$9.69 billion in the periods between October and November, 2013 (improved 15.6% compared to US\$8.13 billion in between same months, 2012)**

Both export and import growth rate accelerated, with the speed of export growth rate outstripping that of import growth rate, widening the trade account surplus.



**Current account continues to record a huge surplus; accumulated surplus of US\$58.26 billion between January and October, 2013**

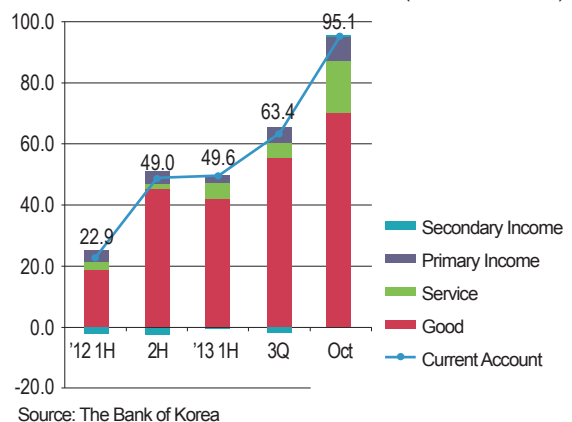
Current-account continues to record a huge surplus for the 21<sup>st</sup> consecutive months since February 2012. The amount of surpluses between January and October, 2013 is expanded by US\$20.1 billion (YoY), comparable to US\$38.2billion between January and October in 2012. Monthly average surplus continues to increase.

**Current Account Trend**  
(Unit: US\$100mil)

	2012		2013		
	1H	2H	1H	3Q	Oct
Current Account	163.6	317.2	297.7	189.8	95.1
Goods	132.0	266.1	251.8	166.2	70.3
Services	20.4	37.0	32.8	13.3	16.5
Primary Income	28.7	28.5	14.4	15.7	7.9
Secondary Income	-17.5	-14.3	-1.2	-5.4	0.5

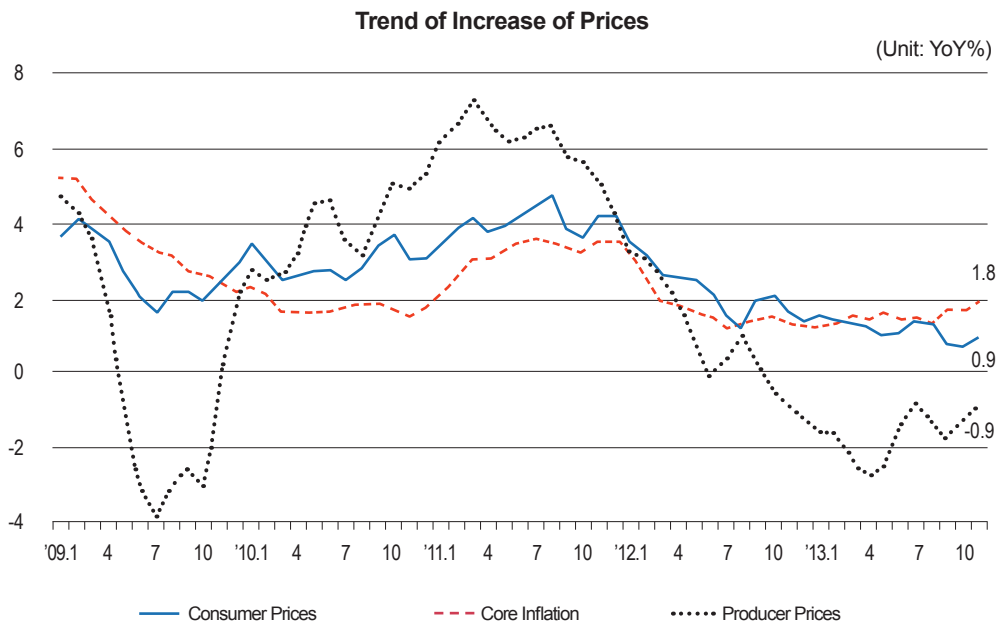
Source: The Bank of Korea

**Monthly Trend of Current Account**  
(Unit: US\$100mil)



## Consumer prices maintain at a close to the deflation line

The rate of inflation maintained at 1% range for the 10 consecutive months since November 2012 and is maintaining at 0% range since September 2013. This is mostly attributed to the fast-diminishing upward pressure of the supply side, such as fall of raw material prices including international oil prices, and stabilization of prices of agricultural, livestock and fishery products. Continuation of slump in the demand side pulls down the upward pressure of consumer prices as well. Producer prices continue to fall for 14 consecutive months since October 2012.



Source: Korea Customs Service, The Bank of Korea

## Employment grows both among the youth and elderly; unemployment rate continues a downward trend

The net number of employed (QoQ) sustained a rising trend with 578,000 employed in November 2013. In particular, youth employment rate has finally picks up during October and November (QoQ) while the employment rate among the elderly expands as well. Unemployment rate showed a declining trend since February, recording 2.8% in October and 2.7% in November, 2013.

## Employment-related Indicators

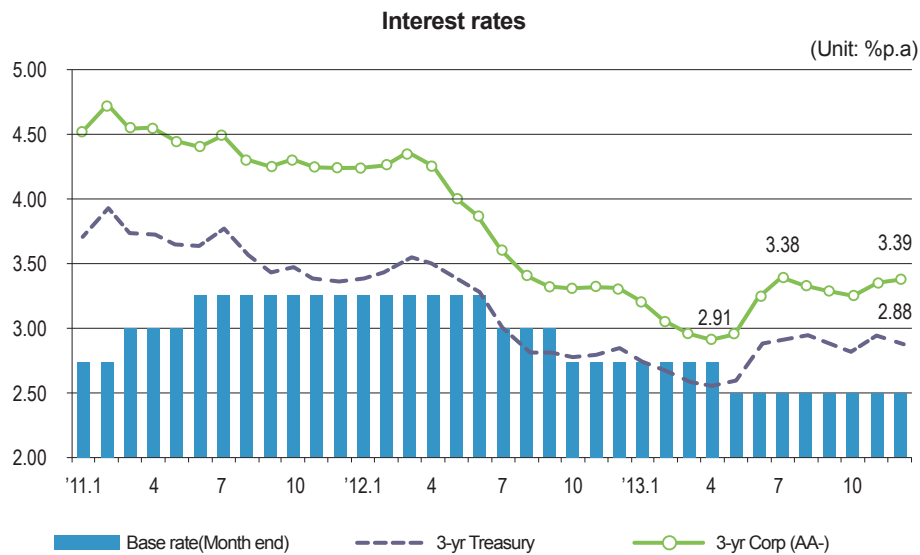
(Unit: thousand persons chg over year ago, %)

		2012	2013				
		Year	1Q	2Q	3Q	Oct	Nov
Changes in number of employed persons		437	257	324	421	476	588
Age	- 15 ~ 29	-36	-117	-89	-41	32	54
	- 30 ~ 39	-31	-15	8	-34	-78	-36
	- 40 ~ 49	11	12	-6	30	42	58
	- 50 ~ 59	270	196	254	279	288	277
	- 60 years and older	222	181	156	187	191	235
Unemployment rate (%)		3.2	3.6	3.1	3.0	2.8	2.7

Source: Economically Active Population Survey (Statistics Kores)

### Market interest rate is on the rise since November

With a certain degree of lessened uncertainty in financial market since August 2013, interest rate showed a brief descending trend. However widespread vigilance at the expectation of impending Fed's tapering and weakened expectation on the base rate cut have driven the interest rate rebounded.

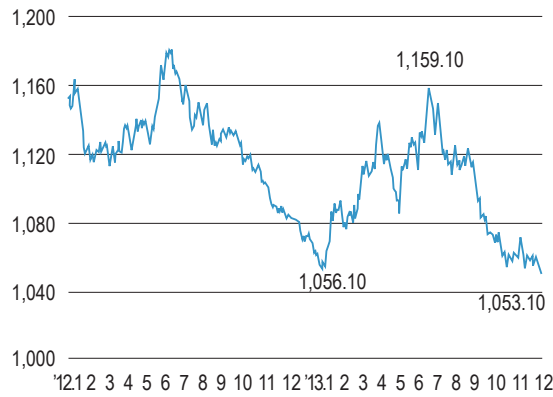


Source: The Bank of Korea

## USD/KRW continues a falling trend since June 2013

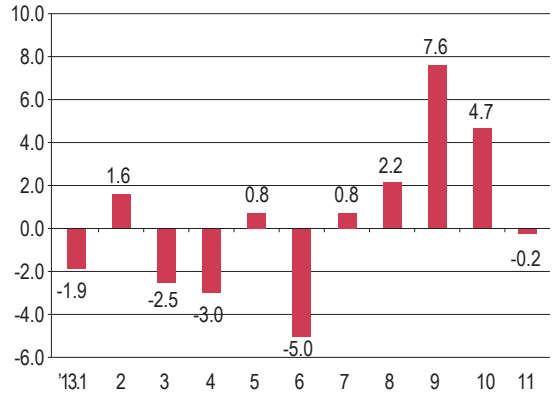
As surplus of current account expanded in the second half of 2013, net foreign buying of equities once again expanded, pushing USD/KRW down.

**Exchange Rate Trend of the Korean Won**  
(Unit: KRW/USD)



Source: The Bank of Korea

**Net Foreign Purchase of Korean Equities**  
(Unit: Tril Won)



Source: The Bank of Korea



# Outlook for 2014

## 1. Internal and External Environments

**(World Economy) Despite slow economic recovery among the emerging economies affected by QE tapering, overall economic growth is gradually on the rise, anchored by the developed economies**

(United States) Despite somewhat sluggish recovery in the private sector, the government's firm willingness to economic recovery is expected to trigger an upward swing in growth.

(Eurozone) Amid lingering risks associated with high unemployment rate and deflation, the Eurozone economies are forecast to grow at 1.0% buoyed by the recovery of Economic Sentiment Indicator (ESI) and the Industrial Production Index (IPI), and political wiliness to sustain the level of QE.

(Japan) Export growth following the weak Yen is firm and steady; domestic production and sales and inflation rates are on the rise. However the growth rate for 2014 is expected to be slower than that of 2013, attributable to the public's falling sentiment on the current economy as well as Japan's impending consumption tax hike.

(China) Domestic demand and trade surplus continue to maintain a moderately favorable trend, but its upward movement is expected to slower in 2014 owing to recent structural reform centered on the domestic growth.

**(Oil Prices) Increasing demand by the non-OECD economies is forecast to push global demand for crude oil to some degree in 2014. However the ascending pressure is outpaced by rising supply of the non-OPEC production. In overall, the oil prices are forecast to fluctuate at the range of prices slightly lower than that of 2013.**

(Demand side) Non-OECD demands from such economies as China (+4.1%), India (+2.7%) are forecast to lead the global crude oil demands; but gradual and moderate dollar appreciation is expected to put a damper on speculative demands for oil.

(Supply side) Non-OPEC production increase boosted by the US, rapprochement with Iran on nuclear issue, and increase of crude oil inventory are expected to drive a supply side recovery. However, risk factors linger as upcoming 2<sup>nd</sup> round of nuclear negotiation with Iran and political instability in Libya, Syria and Egypt will bring uncertainties.

**(Foreign exchange rate of major economies) Midst of gradual appreciation of the US dollars, relief in political uncertainties of major economies will expect to slow the value at which the Yen and Euro are dropping**

(US dollar) Omission of the recent debt ceiling raise on the budget bill and issues surrounding the timing of tapering will expect to weaken the dollar in the short-term. However, with a firm stance from the political realm that the quantitative easing will remain until unemployment rate is alleviated and real economy recovered, the dollar is forecast to show a gradual appreciating trend in long-term, despite its fluctuating value within a small range. (Euro) Prospect for economic recovery in 2014 is expected to be on the rise; however the euro is forecast to descend moderately due to prevailing political risks and slower recovery pace than that of the global rate, led by the US. (Japanese yen) To mitigate adverse effect of consumption tax hike on its economic resilience, the central bank is expected to maintain its large-scale asset purchases; the yen is forecast to stay weakened in 2014, although the rate at which it is dipping will be slower than that of 2013. (Chinese yuan) With the growing expectation that the Chinese economy will succeed in making a soft landing and prompted by continuous upward pressure, the yuan is expected to just barely appreciate.

## 2. Outlook for Korean Economy in 2013 – 2014

**Growth: 2.7% in 2013 → 3.4% in 2014**

The Korean economy's export rate is expected to be limited to the 5% range, with growth rate at 3.4%, owing to a slower than expected global recovery, and challenged by a heap of downward factors such as glooming forecast of the global growth rate at 3.6% in 2014 (IMF) and numerous risk factors associated with the Fed's tapering and Japan's "Abenomics." Current domestic conditions such as debt "de-leveraging" and reduction in corporate investment will act as major barriers to a rebound in domestic consumption. The growth trend is expected to show a "high-first half, low-second half" trend, led by exports rather than domestic consumption.

**Private consumption: 2.7% in 2013 → 3.4% in 2014**

Debt "de-leveraging", fall in housing prices, price hikes of lease deposit are some of the pulling factors to keep the private consumption level low. A household's average propensity to consumption (household expenditure/income) which was maintained an average 81% since 2003 has fallen by 2 to 3% since 2012 and is showing a descending trend at a range of 78% to 79%.

**Facility investment: -3.0% in 2013 → 4.8% in 2014**

Although facility investment is expected to show a rising trend, its effect is expected to be limited at around 5% increase. This is attributable to slow recovery of external conditions and possibility for investment cost hikes caused by an upward trend of interest rate following QE tapering. Amid delay in recovery of domestic consumption, policy implications relating to economic democratization expect to further discourage investment sentiments.

**Construction investment: 6.5% in 2013 → 1.9% in 2014**

Midst the mid- to long-term structural reform in the real estate market, an SOC budget cut for 2014 is forecast to dampen the rate of increase in construction investment in 2014, comparable to that of 2013. Construction order, a leading indicator for construction investment, displayed a decline since 2Q 2012, indicating a slowdown of construction investment growth.

**Export growth (BOP basis):  
3.1% in 2013 → 5.3% in  
2014**

Boosted by a gradual recovery of major economies, including the US, export growth is forecast to show a rising trend at around 5% range annually. However the rate at which it is rising is sluggish at best due to negative factors of QE tapering, uncertainties in the emerging markets, structural shift in China and weakening yen.

**Import growth (BOP basis):  
-0.5% in 2013 → 4.8% in  
2014**

With economic recovery at home and abroad gradually becoming tangible and due to base effect (negative growth for two consecutive years), import growth is expected to be on the rise. However the rate of import growth is forecast to be outpaced by that of import growth again in 2014, given factors such as downward stabilization of raw material prices, including crude oil and low growth.

**Current account surplus:  
US\$69.1 billion in 2013 →  
US\$63.3 billion in 2014**

Despite of prolonged large-scale goods balance surpluses, services balance turned within narrow deficit, resulting in the overall current account surplus to a deficit by a small degree. In terms of goods balance, affected by factors such as slow domestic recovery and fall of raw material prices, import growth is expected to fall short of export growth, maintaining a large-level surplus. Services balance is forecast to show a downward trend in 2014, attributable to low productivity of the service industry, depreciation of foreign exchange rate and the weak yen.

**Consumer prices: 1.2% in  
2013 → 2.2% in 2014**

The rate of inflation is expected to be limited around the low 2% range in 2014, attributable to falling trends of raw material prices and foreign exchange rate, two main variables for domestic price fluctuation. With low level of growth, GDP gap is expected to maintain its negative growth.

**Corporate bond yield (3-yr,  
AA-): 3.2% in 2013 → 3.8%  
in 2014**

QE tapering, normalizing trend of domestic base interest rate are some of the ascending pressure expected for interest rate. QE tapering is expected to further raise the global interest rate, which will bring the domestic interest rate up as well. Gradual increase of domestic growth rate and inflation rate are expected to increase the pressure for normalizing the base rate.

## Economic Trends and Outlook

**USD/KRW: 1,098 won in 2013 → 1,072 won in 2014**

Affected by a high level of current account surplus, sound level of foreign reserves, sovereign credit rating upgrade, the won is expected to show an ascending trend (USD/KRW will fall). However the won's revaluation is forecast to be offset by such downward pressure of Fed's QE tapering.

### Outlook for Korean Economy in 2013 ~ 2014

(Unit: %YoY, US\$100mil(Balance of Payment))

	2012	2013		2014			
	Year	1H	2H	Year	1H	2H	Year
GDP	2.0	1.9	3.3	2.6	3.5	3.3	3.4
(SA, QoQ%)		1.5	1.8		1.7	1.6	
Private consumption	1.7	1.6	2.1	1.9	2.9	2.3	2.6
Construction investment	-2.2	5.2	7.7	6.5	1.5	2.2	1.9
Facilities investment	-1.9	-8.2	2.7	-3.0	4.9	4.6	4.8
Export(Goods and Services)	4.2	4.6	3.6	4.1	4.8	6.5	5.6
Import(Goods and Services)	2.5	3.2	3.2	3.2	4.3	5.8	5.0
Consumer prices	2.2	1.3	1.1	1.2	1.7	2.7	2.2
Current Account Balance	481	298	394	691	287	346	633
Goods Balance	398	252	343	595	293	362	655
Export(BOP base)	5,542	2,797	2,916	5,713	2,941	3,076	6,018
Growth rate%	0.4	1.6	4.6	3.1	5.2	5.5	5.3
Import(BOP base)	5,144	2,545	2,573	5,118	2,648	2,715	5,363
Growth rate%	-1.1	-2.9	2.0	-0.5	4.0	5.5	4.8
Service and Other balances*	83	46	50	96	-6	-16	-22
FX rate(avg. won/dollar)	1,127	1,103	1,092	1,098	1,066	1,078	1,072
Corp. bond yield (3-yr, AA-)	3.8	3.1	3.4	3.2	3.6	3.9	3.8
Unemployment rate(%)	3.2	3.4	3.0	3.2	3.2	3.0	3.1
Employment level changes(000)	437	290	409	349	347	329	338

\* Sum of service balance, primary balance, and secondary balance

## Policy Issue:

### Wage System Restructuring Plan to Enrich the Labor Market Quality

**(Research Background)**  
Major issues regarding the changes of labor related policies shall be examined and the processing direction of wage system restructuring plan and countermeasures would be suggested.

Recently, labor related bills such as extension of retirement age, expansion of the scope of base salary, and proliferation of part-time employments have passed or are on the brink of passing the National Assembly. Although abovementioned bills are only restricting the quantity of labor usage and thus enhancing the labor costs, the pernicious debate over wage system restructuring or salary adjustment is scanty. This research shall deliver basic processing direction of restructured wage system plan which minimize the side effects of it to employment and investment. The countermeasures of government and corporates would be suggested as well.

**Key Points and Issues**  
regarding Recent Changes  
over Labor Market Policies

#### 1. Enactment of Bill on Retirement age of 60

On April 30<sup>th</sup>, 2013, the revised ACT ON PROHIBITION OF AGE DISCRIMINATION IN EMPLOYMENT AND AGED EMPLOYMENT PROMOTION has passed the National Assembly. The revised act suggested the necessity of both making the retirement age extension compulsory and restructuring the wage system. If the retirement age be extended to 60 years old, the cost burden of enterprises will rise and the high positioned elder human resources would be superabundant. For the successful settle down of the bill, we suggest that several other policies be applied together. The peak salary workshare program should go along with the bill on retirement age of 60, and the wage system should be restructured considering labor productivity. Also, an effective management system would be constructed to successfully manage the high positioned elder workforces.

#### 2. The Expansion of the Scope of Base Salary

On December 18<sup>th</sup>, 2013, the Supreme Court adjudged that the wage paid after the salary computing period could be included as base salary. If various kinds of benefits and regular bonuses count as base salary, the labor costs of corporates will jump and thus investment and employment are predicted to be daunted. In order to minimize the dispute over base salary, the simplification of wage system through labor and management agreement seems to be necessary in advance.

### 3. The Proliferation of Part-time Employment System

The proliferation of part-time employment system should be designed in two platforms. The 'quality part-time job system strategy' should focus on improving the working quality of short time workers. Meanwhile, the 'part-time employment strategy' would be conducted with the view based on flexible working hour system. For the smooth implementation of the part-time employment system, relevant conversation about stipulating the applying scope of both working time proportional principle and prohibition on discrimination may be critically carried out in advance. Also, the claim of working hour reduction should be guaranteed and additional support plan would be introduced for the promotion and successful expansion of part-time employments.

**(Policy Implications) Prior to labor related policy reforms, the igniting debates over many-sided issues of wage system restructuring should be necessarily conducted.**

First, the restructuring of the wage system should be processed in direction of enhancing the possibility of low income employments so that income inequality may narrow down. Second, the restructuring of the wage system wisely needs to respond to the dichotomy in the labor market. Third, the wage system should be organized based on duty, performance, competency and responsibility. Fourth, the institutional rigidity should be overcome by revising the complex salary system and employment regulations. For the last, the labor management relationship which is usually centered with the regular workers should be widened to embrace the whole workforce.

## An Evaluation & Analysis Model of Personal Tax

Research Monograph 13-02

Sanghyun Hwang, Jin Sung Yoo, Won-jea Huh and Youngshin Kim

This study develops an “evaluation & analysis model of personal tax burden” using the Korean tax system and survey data and also presents the personal tax burden from various taxes that Koreans would face in conjunction with various economic activities during their lifetime. To put it more concretely, this study first investigates the “personal taxes”, with which individuals would be eventually burdened, in the Korean tax structure for the year 2010 as the benchmark year. Then, this study combines the personal taxes with the National Survey of Taxes and Benefits, which includes the information about the individual economic activities such as earnings, purchase of houses, cars and other durable goods, usual consumption activities, gift and inheritance, in order to construct the model and calculate the personal tax burden.

The results from the model constructed in this study are as follows. Global income tax turns out to be progressive showing that the percentage of global income tax amount to gross household income on the first decile is 0.95 percent while the percentage on the tenth decile is 8.4 percent. However, value added tax, which is one of the typical indirect taxes, seems to be regressive since the percentage of value added tax amount to gross household income on the first decile is 6.4 percent while the percentage on the tenth decile is just 2.9 percent. The results show that acquisition tax, registration tax and local income tax, all of which include global income tax, are relatively progressive. On the other hand, liquor tax, education tax, local consumption tax, tobacco consumption tax, city-planning tax and common facilities tax, all of which include value added tax, are relatively regressive. In addition, selective excise tax, transportation, energy and environment related taxes, residence tax, automobile tax, motor fuel tax and local education tax are found to have the inverse U shape. This finding indicates that the tax amount / household income ratio would increase up to a certain quantile only to decrease subsequently.

In this study, the evaluation & analysis model of personal tax burden has a feature that could broaden the public perception and the understanding of tax burden because it is based on the concrete contents of various taxes that individuals could face and also it directly calculates the tax burden at individual level by using micro data. In addition, the model covers almost all the taxes levied on individuals and generates the personal tax burden; thus, it can do a comprehensive evaluation on the tax system.

Furthermore, the model is very useful in evaluating and analyzing a change in tax burden that brings a corresponding change in the tax system. Ranging from the tax revision bill announced by the government every year to the plans for financing welfare programs issued by politicians, the model can evaluate and analyze the effects of various tax policies on personal tax burden. Thus, the model constructed in this study is expected to make many applications going forward.



## Cost Estimation and Economic Effect of the Park Geun-hye Administration's Welfare Policies

Research Monograph 13-03

Gyeong Lyeob Cho and Jin Sung Yoo

This study attempts to estimate the cost of the welfare policies planned to be carried out during the Park Geun-hye Administration and analyzes the effect of the policies on the economy with respect to GDP and employment. In addition, this study proposes a desirable direction for the future Park Geun-hye Administration's welfare policies by evaluating and prioritizing the main welfare policies.

The cost of the Park Geun-hye Administration's welfare policies based on policy agenda, presented by the Transition Committee for President-elect Park Geun-hye, was estimated at 104 trillion KRW in terms of direct cost only, and at 157 trillion KRW including direct cost and indirect cost.

With regards to income redistribution effect, the study shows that the policy on national basic livelihood security policy was the most effective, followed by the policy on protection of vulnerable social groups. However, policies regarding free high school education, halving university tuition, expansion of coverage rate for the four major diseases, and expansion of the elderly long-term care insurance were found to be not very effective.

In terms of effects on GDP and employment, only the housing policy showed positive effects on both GDP and employment while the others showed negative effects. Basic livelihood security policy and protection of vulnerable social groups showed the least negative effects in relation to free high school education, halving university tuition, expansion of coverage rate for the four major diseases, and expansion of the elderly long-term care insurance, which showed relatively substantial negative effects.

In order to improve income inequality while minimizing GDP loss, the Park administration needs to focus on the basic livelihood security policy and protection of vulnerable social groups while increasing the expenditure on growth-friendly policies (e.g. housing policy) and decreasing the expenditure on the other welfare policies. As the study shows that free high school education, halving university tuition, expansion of coverage rate for the four major diseases, and expansion of the elderly long-term care insurance have relatively low effects on income distribution and huge negative effects on GDP and employment, it is recommended to take slow approaches on the execution of such policies or reconsider the scopes of the welfare policies, giving low priorities to these policies.

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