



7

Korea's Path of Development in Retrospect

Historical Background, Liberation and State Building

There is an advantage in studying the Korean case of development because it provides a clear-cut picture of economic transition due to its 'compressed' story or timeframe of dynamic economic development spanning only 50 years. There are different ways to describe and analyse its phases of development. First, it can be divided into decades: (1) the 1950s: post-war reconstruction; (2) the 1960s: laying the groundwork for a self-supporting economy; (3) the 1970s: upgrading industrial structure and rural development; (4) the 1980s: transition to an open and liberal economy; (5) the 1990s: globalization and structural adjustment.¹ Or we can divide the period into: (1) liberation and state-building (1948–1959); (2) export promotion and industrialization (1960–1979); (3) stabilization and liberalization (1980–1997); and (4) economic crisis to the present day (1997–).² Another way of defining the phases can be as follows: (1) state-building; (2) economic take-off; (3) policy adjustments and liberalization; and (4) new challenges and policy responses.³

At this juncture, it would be useful to briefly sketch Korea's historical heritage. One thing that stands out on the global map is that Korea is a nation in the Far East surrounded by neighbours much bigger than itself. Moreover, it is the divided nation and there is a psyche among Koreans and outsiders that Korea is a small country. But when the area of the Korean Peninsula, South and North Korea combined, which is about 220,000 square kilometres, into account, it is not actually under-sized as it approximates the size of the UK or Italy. In terms of population, South Korea's population is over 50 million and North Korea has over 24 million, making a total of 74 million, which is larger than that of UK, France or Italy and a little less than Germany, which stands at 81 million.

Historically, Korean society is a composition of varied peoples who gradually forged together culturally and ethnically as a homogeneous nation. Scholars point out that the core cultural traditions of Korea are shamanism and Confucianism: its shamanism was able to survive into modern times and has influenced the Korean way of life in general and its 'sub-consciousness', while Confucianism (or Neo-Confucianism to be more precise) has heavily influenced the social consciousness and cultural orientations of the majority of Koreans for many centuries.⁴ Kyong Ju Kim points out that: 'In Korean Shamanism, the notion of absolute truth and goodness is denied. Everything is placed on a continuum ... and everything can change depending on the vicissitudes of society and nature.'⁵

Korea has only been divided since 1945, when it was effectively partitioned by the US and the Soviet Union following the end of Japanese colonial rule. Before this division, Korea was one of the oldest continuously unified states in the world. The Korean Peninsula became unified in 676 and remained so until the mid-20th century. And today, it is considered as one of the most homogeneous nation on earth. Korean people merged into a single ethnicity sharing one language. It was their language in particular that bound them together and distinguished them from their neighbours.

There were times when China seemed to wield considerable influence over Korea, and Korea imported China's ideas about government and

politics, as well as its culture, but Korea maintained its independence, cultural distinctiveness and national identity:

Koreans were fiercely independent. Much of their history has been the story of resistance to outside intruders. Korea's position as a tributary state was usually ceremonial, and for Koreans it did not imply a loss of autonomy. Chinese attempts to interfere in domestic affairs were met with opposition. Indeed, some today view the Korean past as a saga of the struggles of a smaller society to resist control or assimilation by larger, more aggressive neighbours.⁶

Another notable feature of Korea is the remarkable continuity of its history:

From seventh to the twentieth century only three dynasties ruled Korea. The second ruled for almost five centuries and the third for more than five centuries; both were among the longest-ruling dynasties in history. The two dynastic changes that did take place did not bring about a vast upheaval. Elite families as well as institutions were carried over from one dynasty to another. This, along with a Confucian concern for examining the past, contributed to a strong sense of historical consciousness among Koreans.⁷

In the nineteenth century, Korea remained a 'Hermit Kingdom' adamantly opposed to Western demands for diplomatic and trade relations. Over time, a few Asian and European countries with imperialistic ambitions competed with each other for influence over the Korean Peninsula. Japan, after winning wars against China and Russia, forcibly annexed Korea and instituted colonial rule in 1910. The colonization process stimulated the patriotism of Koreans. Korean intellectuals were infuriated by Japan's cultural assimilation policy, which even banned Korean-language education in schools. On 1 March 1919, a peaceful demonstration demanding independence spread nationwide. Although it failed, the 1 March independence movement created a strong bond of national identity and patriotism among Koreans, and led to the establishment of a provisional government in Shanghai, China, as well as an organized armed struggle against the Japanese colonialists in Manchuria.

Koreans rejoiced at Japan's defeat in the Second World War in 1945. However, their joy was short-lived as the liberation did not instantly bring about the independence for which the Koreans had fought so fiercely. Rather, it resulted in a country divided by ideological differences wrought by the emergence of the Cold War. Korean efforts to establish an independent government were delayed as the US forces occupied the southern half of the peninsula and Soviet troops took control of the northern half.

In November 1947, the UN General Assembly adopted a resolution calling for general elections in Korea under the supervision of a UN commission. But the Soviet Union refused to comply with the resolution and denied the UN commission's access to the northern half of Korea. The UN General Assembly then adopted another resolution calling for elections in areas accessible to its commission. The first elections in Korea was carried out on 10 May 1948 south of the 38th parallel, and accordingly the new government was inaugurated on 15 August. Meanwhile, the communist regime was set up on 9 September with the support of the Soviet Union.

The American military government, which was in charge of South Korea between 1945 and 1948, tried to introduce a modern market economy system there. The sale of confiscated Japanese-owned properties during the US military rule was an important first step towards establishing a market economy based on private property ownership. Divestiture continued under the newly established Korean government and sales reached the peak during the Korean War in the early 1950s. By 1958, as a result, most Japanese-owned properties were converted into privately owned assets. Such an achievement is deemed significant in light of the tendency towards socialism, even on the part of right-wing politicians, at the time.⁸

It is said that the colonial government's land surveys and registration conducted in the 1910s established the first modern system of property rights in Korea, which significantly reduced land transaction costs. But measures to protect small farmers were not followed, leading to a wide disparity in land holdings. After independence, the Korean government tackled the increasing demand for agricultural land reform by

enacting the Farmland Reform Act in 1949 and revising it in 1950. The land reform was based on the principle of 'compensated forfeiture and non-free distribution', whereby the government bought farmland from landlords at predetermined prices and sold it to farmers at below-market prices.

Agricultural land reform contributed not only to state-building, but also to redistributing wealth and reducing income inequalities. Everyone was now placed on a more or less equal footing, and individual effort and ability rather than family wealth became the most important determinant for people's success. Many believe that the Koreans' typical diligence and their emphasis on education were motivated by this perception of equal opportunity. However, on the negative side, restrictions on farmland holdings hampered the growth of large-scale farming and contributed to the low productivity growth of the agricultural sector in later years.⁹

Syngman Rhee, an intellectual educated in the US and former independence fighter, was elected as the first President of the Republic of Korea in 1948. His foresight was instrumental in establishing a separate government in South Korea, laying the groundwork for a democracy and a market economy. He strived to rebuild the economy with a series of reconstruction plans aimed at expanding economic infrastructure, building key industries like cement and steel, and increasing the production capability of manufacturing.

Rhee's desire to construct a self-sufficient Korean economy with such plans was in direct conflict with the US government's intention to rebuild an East Asian economic bloc with industrialized Japan at its centre. The US urged Korea to liberalize its market, stabilize the value of the Korean currency and expand cooperation with Japan. To Rhee, this implied nothing but the revival of the Greater East Asian Co-Prosperity Sphere and the re-colonization of the Korean economy. Rhee made full use of Korea's geopolitical value to frustrate America's efforts, while promoting import-substitution industries through reconstruction plans.¹⁰

The Korean government also differed with the Americans on the issue of what kind of foreign aid it would receive. The Korean government preferred project assistance, while the US government wanted to

provide non-project assistance to private enterprises for civilian use. In the end, the preference of the US prevailed, with non-project assistance making up 73% of the total, while project assistance made up only 27%. In any event, various reconstruction plans envisioned by Rhee's administration failed to spark economic growth in Korea, as they were not substantively executed.¹¹

On 25 June 1950, North Korea launched an unprovoked invasion into the South, triggering a three-year war that devastated the nation, with millions losing their lives. In the South, 42–44% of manufacturing facilities and 40–60% of power-generating capacity were destroyed. Basic infrastructure like housing, schools, health centres, water and sewage, roads and communication facilities were utterly razed. The scale of total civilian damage reported was bigger (1.05 times) than Korea's GNP of 1953.¹²

Hence, the economic policy objective was then to bring the nation back to life from the ashes of war, restoring and rebuilding basic infrastructures, and stabilizing people's livelihoods. In order to do this, massive funding was necessary, but the only thing Korea could do was to turn to foreign assistance. From 1945 to 1960, South Korea received a total of \$2.94 billion in aid, of which the amount provided by the US accounted for over 80%.¹³ Although the government tried hard to build the necessary structures for industrialization, there was an inherent limitation in that Korea's economic performance in the 1950s was wholly dependent on foreign assistance, the vast majority of which came from the US

The US aid comprised projects, non-projects and technical assistance: projects were mainly for the restoration or expansion of social infrastructure like power, communications, transportation, education and health facilities; non-projects mainly included the supply of necessities such as wheat, oil, fertilizer, raw rubber, spun rayon, medicine, etc.; technical assistance was minimal in terms of scale and involved training and consulting. The ratio of projects to non-projects was around 4 to 1 on average.¹⁴

In the post-war reconstruction period, the government's economic policy focused on rehabilitation following destruction, and its efforts to curb inflation was largely successful. The assistance provided by the US was crucial, but there were also friction between Korea and the US over

the usage of aid funds. While the Korean government wanted to use the resources to purchase more equipment and build factories, the US insisted on allocating them primarily for commodities and raw materials to increase the counterpart fund. Non-project aid (the commodities), were sold to civilians and the profits were turned into a counterpart fund that was in turn used for reconstruction projects.

Rhee was finally ousted from power in 1960 by student demonstrations protesting against his protracted rule and election frauds as he was strengthening his authoritarian rule. The situation deteriorated when many demonstrators were shot by the police. Rhee announced he was stepping down and took refuge in Hawaii. Shortly afterwards, the Constitution was amended and the cabinet system and bicameral national assembly were adopted.

Under the new Constitution, the regime led by Prime Minister Jang Myeon was launched, but the political situation became extremely fragile with political struggles and protests by students continuing unabated. In May 1961, a group of young army officers led by General Park Chung-Hee seized power in a military coup. In the presidential election that was held in October 1963, after two years of military rule, Park Chung-Hee, having retired from the military, was elected President and was inaugurated in December.

The Economic Take-off Period

The government led by President Park set up a five-year economic development plan under the slogan of 'modernization of the fatherland' and achieved rapid economic growth by implementing an export-oriented policy. Subsequently, a heavy and chemical industries (HCI) plan was boldly but successfully launched.

In the following decades, Korea achieved unparalleled economic growth. It was one of the poorest countries in the world in 1948 when the government was formed following independence from Japan. Korea is considered a unique case of an aid recipient having successfully turned into an advanced country in terms of full-scale economic

transformation and democratization in the latter half of the 20th century. Korea's rapid development has been dubbed 'the Miracle on the Han River'. This began with the all-out efforts launched in the 1960s. The country vigorously pushed ahead with the development of national land, the construction of the Gyeongbu Expressway and subway lines, the Pohang Iron and Steel Company (POSCO), and the creation of heavy and chemical industry.

After having become President, Park proclaimed that economic development would be the central feature of his administration. He and his policy team were well aware of the importance to reaping economic success in order to legitimize their seizure of power by force. The new government set out to depart from the foreign aid-dependent economy and lay the groundwork for a self-sustaining economy so as to terminate the vicious cycle of poverty and to realize high economic growth. Although Korea at that time was a predominantly agricultural nation and food shortages were serious, the government focused on industrialization. In the early 1960s, over 40% of the Korean population was suffering from absolute poverty and the government believed that the only way to offset this was by achieving high growth through industrialization.¹⁵

It seemed that the regime did not have a clear ideology or scheme on free market economy from the very outset, but somehow it managed to adopt active export promotion, which in effect turned out to be a critical factor for its resounding performance. Initially, export promotion was pursued in response to the rapid depletion of foreign exchange reserves.¹⁶ Exports began to quickly increase following the devaluation of the currency in 1960 and, encouraged by the success, the government undertook more serious efforts to promote exports in 1964–1965. First, a new exchange rate regime was put in place in 1964, and various ad hoc export subsidies and the export-import link system were phased out, while a comprehensive and consistent export incentive mechanism was introduced. Key measures were export credits that were extended to exporters who turned in letters of credit, and tariff exemptions on imports of intermediate inputs. And these incentives were reinforced by administrative measures like 'export targeting', the holding of monthly

export promotion meetings, the establishment of the Korea Trade Association and the Korea Trade Promotion Agency, etc.¹⁷

Industrialization was the focus of the five-year economic plans that began in 1962. With the first five-year plan (1962–1967), the government laid out its ambition to modernize the industrial sector and enhance its international competitiveness by rapidly expanding the key areas (cement, fertilizer, industrial machinery, oil refineries, etc.).¹⁸ The government promoted exports, but maintained restrictions on imports to contain current account deficits and protect domestic industries. Tariff rates began to decline slowly in the early 1970s, but their levels remained high until the early 1980s.

In the early 1960s, the government increased its intervention in domestic financial markets to support the economic growth strategy. It took full command of commercial and special banks, while strengthening its grip on the central bank. The primary role of the monetary authorities during the government-led growth period was to supply 'growth money' and price stabilization was treated as being a far lower priority. One of the key measures was the credit programme: by controlling the financial sector, the authorities were able to provide vast amount of directed credit with low interest rates and share the investment risk with private enterprises.

In pursuing the five-year development plans, the most fundamental problem the Korean government confronted was the question of how to come up with the funding. To encourage domestic savings from which capital can be funnelled to development projects, interest rates were raised substantially in 1965 to match the demand and supply of capital. Accordingly, savings grew rapidly. In addition, the taxation system was reformed and strengthened in 1966, greatly increasing revenues. These encouraged an active pursuit of development projects and government expenditure was greatly enhanced.

But the major injection of the necessary funds had to come from abroad and there was a large increase in foreign borrowing during this period. While foreign capital inflow was encouraged to fill the gap in domestic savings, capital liberalization remained selective and partial. What was of significance in terms of the accumulation of capital funds was the agreement reached between Korea and Japan in 1966

to normalize their diplomatic ties in return for Japan's reparation payments of \$500 million and commercial loans of \$300 million. The payments were used to build the POSCO and make investments in various sectors.

The success of the first five-year plan encouraged the government to continue pushing ahead with its ambitious plans. The emphasis of the second five-year plan (1967–1971) was placed on HCIs, including the steel, machinery and petrochemical industries. The Steel Industry Promotion Act was enacted in 1969 to support the construction of a large-scale integrated iron and steel mill and other kinds of mills by granting them tax exemptions. For other industries, similar laws were introduced to provide financial and tax incentives: the Machinery Industry Promotion Act (1967), the Shipbuilding Industry Promotion Act (1967), the Textile Industry Modernization Act (1967), the Petrochemical Industry Promotion Act (1970) and the Nonferrous Metal Producing Business Act (1971).

What the government considered as particularly important then and which later proved to be a strategic move was the construction of an integrated iron and steel mill and a petrochemical complex. The Pohang Iron and Steel Company (currently POSCO) and Ulsan petrochemical complex, which were built in the early 1970s, had to rely almost entirely on foreign technology and capital, and they faced a multitude of difficulties at the outset.¹⁹ Meanwhile, a Korean oil refinery had already been built as early as 1964.

In hindsight, Korea undertook a very bold and seemingly inconceivable number of projects of such magnitude despite of its 'capacity', but it successfully undertook what other developing nations were not able to do, which is the 'synchronization' of all fronts of industrialization. And this was done despite doubt, disapproval and reluctance on the part of donors. But scepticism turned into praise as Korea continued to deliver results that far exceeded the international community's as well as its own expectations.

Projects were also vigorously pursued to ease the shortage in the economic infrastructure, like power and roads. What is remarkable is the fact that soon after electric power development projects were launched from 1962, the supply of electric power came to exceed demand by

the mid-1960s. Another major accomplishment to facilitate economic activity was the construction of roads, the most noticeable being the completion of major expressways: the Seoul-Incheon, Seoul-Busan and Honam Expressways were opened in 1968, 1970 and 1973, respectively.

The economic achievement in the 1960s was a resounding success in view of the situation in which Korea found itself. Despite various challenges, Korea was able to fulfil the first and second five-year development plans with a level of performance exceeding targets and expectations. The GDP growth registered 8.5% and manufacturing sector growth 17.0% on average during the 1960s; per-capita income jumped from USD 82 in 1961 to USD 253 in 1970, a threefold increase. Unemployment rate fell from 8.1% in 1963 to 4.4% in 1970. The driving force behind rapid industrialization was strong exports. During 1962–1971, exports increased annually by 38.6% on average. And the timing was just right, with the favourable international trade environment in the 1960s.²⁰

Korea made good use of labour, which it had in abundance, and also financial capital, which was scarce and had to be borrowed from overseas. The light industries of labour-intensive manufacturing such as wig-making, clothing and footwear absorbed the surplus labour force discharged from rural areas. As these industries launched their production in industrial complexes near urban areas, they also contributed to the growth of large cities and the urbanization of the population.

The success in building up a manufacturing industry in Korea was due to a number of factors, including the entrepreneurial skills of early generations of pioneering businessmen who started as small traders, and the unlimited supply of labour from the agricultural sector that generated explosive growth in the light industry sector. Wage levels in Korea were one of the lowest in the world, and the workers were relatively well-educated and diligent, making labour-intensive industries of Korea competitive.²¹

Rather than restraining its ambitions, the government launched a full-scale drive towards HCIs in 1973. Six strategic industries—steel, nonferrous metal, machinery, shipbuilding, electronics, and chemical engineering—were selected under the HCI initiative.²² The committee to drive forward HCIs was created and the targets were set to achieve

per-capita income of USD 1000 and annual exports of USD 10 billion. The reasons for adopting HCI drive were twofold: national security and the need to upgrade industrialization to ensure exportation. First, concerns about national security grew with North Korea's increased military provocations and US government's announcement in 1968 that its ground troops would be gradually pulled out of Korea. Second, the government felt it was necessary to upgrade the industrial structure to compete with newly industrializing countries over export markets.²³

In the 1970s, compared to the 1960s, the level of wages, savings and exports all increased, along with the heightening of industrialization. As wage levels rose and competition from low-wage economies intensified, capital-intensive, high-productivity manufacturing assumed importance over labour-intensive, low-productivity manufacturing. The share of services increased continuously in terms of both value-addition and employment, while that of agriculture declined. Within manufacturing, HCIs increased their share at the expense of light industries. Meanwhile, the domestic saving ratio increased from an average of 15 in 1961–1970 to 23% in 1971–1980, while the investment ratio increased from 19 to 29% respectively in these periods.

The focus of industrial policy shifted from the export drive in the 1960s to the building of HCIs in the 1970s. To successfully undertake an ambitious task of upscaling industrialization, the government intervened more forcefully in the economy in the 1970s. The HCIs required not only enormous capital but also significant technological expertise. Very few, if any, Korean firms were able to take up such a task without the proactive support of the government. The Vietnam War became another source of foreign currency income to support industrialization as Korea received US economic aid for its military participation in this war. The government's bold intervention and active support led to the inflow of investment in HCIs. The growth of HCIs registered an average of 20.0% over the period from 1971 to 1979, driving the growth of the overall manufacturing sector, which stood at 18.2% over the same period.

In summary, what Korea was able to achieve in the 1960s and 1970s is unique and unmatched in the history of industrialization and development. The growth was led by the manufacturing sector, the output

of which grew annually by 17% in the 1960s and 16% in the 1970s. Korea was considered to be a high-risk country in the international capital market, so it experienced difficulties in terms of finding lenders. Furthermore, because its natural resources were not abundant, Korea only had human resources to rely on to build the economy: an abundant labour force and the hard work of the people.

The role of the government was critical in accelerating the growth of manufacturing. During the first and the second five-year economic development plans that were undertaken in the 1960s, the government invested heavily in physical infrastructure to lay the foundations for export-driven industrialization. It established state-owned enterprises in key industries and mobilized other policy measures, involving foreign exchange, taxation, finance and customs regulations to promote exports.

The export structure underwent dramatic changes. In 1970, the primary industries amounted to 17%, the light industries 70% and the HCIs 13% of total exports. By 2008, these shares changed to 2, 6 and 92% respectively. The share in the gross value addition of sectors also underwent huge changes (comparison between 1953–1960 and 2001–2009): agriculture 41.9 → 3.4%; manufacturing and mining 13.4 → 27.3% (it reached 30.0% in 1987); public utilities construction 3.7 → 9.6%; and services 41.1 → 59.6%.²⁴

This pattern of structural change is similar to that experienced in other developed countries. It has been pointed out that the industrial structure of Korea in the early 1960s was comparable to that of the UK in 1700, the US before 1880 and Japan in the early decades of the twentieth century. In all these countries, during the process of industrialization, the manufacturing and service industries replaced the agricultural sector in terms of their importance to the national economy. What sets Korea apart from these developed countries is the speed with which it achieved structural changes. Korea's industrial structure in 1990 came close to that of the UK in 1890, the US in 1950 and Japan in 1970.²⁵

Korea's phenomenal economic growth in the 1960s and 1970s, accompanied by economic and industrial structural changes, placed it on the path of transformation that other advanced countries had taken. Exports and industrialization are not the only things that were

pursued actively by the government; vigorous campaigns were waged for rural development (*Saemaul Undong*) and the promotion and application of agricultural technology (the Green Revolution and the White Revolution) that benefited and enhanced the productivity of this sector. All these measures contributed to the economic growth and modernity of the nation.

The pace and energy with which the massive mobilization of labour and capital, heavy investment in technology and the effective reallocation of resources from less to more productive sectors were carried out made the difference. But what Korea was always conscious of and targeting was foreign trade and markets. For Korea, foreign trade played a pivotal role by encouraging innovation and accelerating resource reallocation, learning from advanced countries and taking advantage of the rapidly expanding global market.

The Period of Policy Adjustments and Liberalization

The 1980s marked an important turning point in the economic development strategy of Korea. The government's deep intervention in allocating resources in the 1960s and 1970s was the crystallization of a state-led economic development strategy. The impetus behind the five-year economic development plans was the role played by the government, with markets playing 'supplementary' roles. This was deemed inevitable in the early stages of development where the market mechanism was imperfect.

However, as Korea's economic scale grew and the role of the private sector increased, it became harder for the decision-making of bureaucrats alone to manage the allocation of resources. Thus, entering into the 1980s, the thinking in the government was that the greater involvement of the private sector and markets was necessary. Among other things, this was especially so in light of the side-effects of the HCI drive in the 1970s: misallocation of resources (excess and duplicate investments), inflation and income inequality.

Tackling inflation had been a concern of the government as early as 1978, but the new government formed in 1980 took up the task of stabilizing the economy much more prominently.²⁶ A radical departure from the past was made in the early 1980s, as the government emphasized price stability over economic growth. The 'growth-first' strategy gave way to 'consolidating growth on the basis of stability'. Private initiatives were encouraged and liberalization of the market began. Greater attention was paid to social policies, and public spending on health, welfare and education was increased.

Of course, there were downsides to such an aggressive growth strategy. Reconciling rapid growth, concentration of resources and efficiency on one the hand, and equality, stability and fairness on the other would not be an easy task in any case, and all the more so for a newly developing country with scant resources. Still, a factor that was in Korea's favour was that the transitions were swift and progressive, in effect considerably mitigating the overall 'costs' of fast-paced development.

The commonly cited problems faced by Korea during this period are as follows: financial repression since the 1960s that held back the financial sector from developing into a fully competitive service industry; large business conglomerates, namely the *chaebols*, increasing their influence on the back of government support; increasing economic disparity amid the phenomenon of concentration of economic wealth and power; and a failure to establish sound worker–management relations (until labour movements arose in the mid-1980s).

Corporations also wanted greater autonomy from economic institutions. The financial market became increasingly liberalized in the 1980s and early 1990s, particularly as many *chaebols* that were the proprietors of non-bank financial institutions demanded deregulation. Deregulation began to emerge as an important priority in the late 1980s and continued to be addressed seriously in the 1990s.²⁷

Meanwhile, import liberalization measures were announced in 1978, but progress proved sluggish owing to the second oil shock that picked up speed in 1984. In 1986, Korea registered a current account surplus for the first time and the surplus increased in the following years. In 1989, the government began to reduce quantitative restrictions amid

intensifying trade conflict with the US. As Korea's trade performance and economic status improved, in January 1990, it moved into a different category of the General Agreement on Tariffs and Trade (GATT) provision and was no longer allowed to impose trade restrictions for balance-of-payment purposes. The average tariff rate dropped from 34.4 to 9.8%, while import liberalization from quantitative restrictions increased from 60.7 to 92.0% between 1981 and 1995.²⁸

Compared to trade liberalization, the opening of the capital market was markedly slow, as there was a major concern over the control of the domestic money supply and the real exchange rate movement. When the current account showed large deficits in the late 1970s and early 1980s, restrictions were strengthened on capital outflows. But when the current account moved into a considerable surplus in the latter half of the 1980s, the government relaxed restrictions on outward FDI while tightening other regulations. The public sector halted borrowing from abroad and started to repay foreign debts. Then in 1990–1993, the government began liberalizing long-term capital inflows.

In November 1997, a foreign exchange crisis hit the country, forcing it to turn to the IMF for a bailout. This was the first ordeal Korea had to face after decades of rapid economic growth. The crisis was such a great shock as it was totally unforeseen. Even immediately before the outbreak of the crisis, there were no warning signs or abnormalities that could be detected. Foreign exchange reserves were quickly depleted and a drastic devaluation of the currency ensued as international creditors rushed to withdraw their loans to Korean banks. Many explanations have been put forward for this, ranging from the weak fundamentals of the Korean economy, including 'crony capitalism', to the intrinsic instability of international financial markets.²⁹

At the time, Korea's macroeconomic indicators were sound, but there was an external shock coming from a worsened terms-of-trade shock wrought by plummeting semi-conductor prices and a substantial increase in external liabilities (especially short-term ones). The increase in non-performing loans and the low profitability of businesses led to the bankruptcy of *chaebols* and the general shortage in liquidity afflicted businesses. The Asian regional financial crisis exacerbated the situation for

Korea, so that the international credit rating agencies began to downgrade Korea, causing the financial crisis fallout at the end of November 1997.

The crisis inflicted extreme hardship on the Korean people, but worked as a catalyst for improving the fundamentals of the economy. The IMF bailout required Korea to undertake austere economic measures and wide-ranging structural reforms. The sudden depreciation of the Korean currency wreaked havoc on businesses and the austerity policies were difficult to bear and unpopular. But the nation, led by the new administration of Kim Dae-Jung, faced the challenge head-on. Poorly performing businesses were driven out of the market and industrial restructuring was pushed ahead. In just two years, the country recovered its previous growth rate, levels and current account surplus. In the process, some 3.5 million people joined in the campaign to collect gold to help the government repay the fund borrowed from the IMF, something unheard of in global history.

The Korean economy came out of the crisis in an entirely different shape: it became much more open to international capital flows; transparency of corporate management was substantially enhanced; and the functioning of financial market improved substantially.³⁰

New Challenges and Policy Responses

Despite Korea's remarkable economic success in the past, concerns have been raised on the growth potential of the Korean economy. Economic growth began to slow down in the 1990s with the decelerating growth of the working-age population. Income distribution also started to deteriorate in the early 1990s, with the expansion of the knowledge-based economy and globalization leaving low-skilled workers at a disadvantage. At the same time, productivity gaps between manufacturing and services, between HCs and light industries, and between large and small companies widened, and access to quality jobs has become more difficult.

In 2008, Korea was hit by another financial crisis, this time a global one, coming from the heart of Wall Street, the global financial centre. Korean financial markets were thrown into disarray. The sudden capital

outflow led to a plunge in the stock market and domestic banks faced serious difficulties in foreign debt servicing. A precipitous fall in exports and investment also battered the industrial sector. But the repercussions were considerably less painful than had been the case in 1997, as Korea's economic output went back into positive growth in the first quarter of 2009. This time Korea was able to recover from the crisis even more rapidly because, among other reasons, the vulnerability of the financial and corporate sectors had been reduced as a result of the reforms and restructuring that had been undertaken following the 1997 crisis.

From the standpoint of maintaining economic competitiveness, Korea has confronted two basic challenges since the 1990s: technology development and market opening. Korea had to tackle the reality of developed countries not wanting to transfer advanced technology to newly industrialized nations like itself, while also having to worry about new competitors. It decided that the best way to respond was to develop new industries based on new technologies, while improving the technology for existing industries so that their productivity could be boosted.

In the early phases of development, Korea was able to benefit from learning technology from developed countries, but as this became increasingly difficult, the government and industry had to gear up technology development of their own. Since the mid-1990s, Korea has relied more on technologies that it developed on its own than on foreign-adopted technology. In the 1960s and 1970s, state-financed research institutes had already been established to foster development in key industrial sectors, and full-scale efforts were launched in this field in the 1980s. And since the 1990s, Korean enterprises were able to expand their own research and development (R&D) activities and set up private-sector research institutions.³¹ Not only the Ministry of Commerce and Industry but also the Ministry of Science and Technology actively supported technological development. During the period from 1982 to 1991, the Ministry of Science and Technology invested a total of 964.2 billion won, of which 65% was allotted to core industrial technology (semi-conductors, computers, etc.), 18% to public technology and 17% to basic technology.³²

The major investment in corporate R&D was vital for the Korean firms to develop core technologies in order to attain self-reliance in such

new areas as semi-conductors and telecommunications in addition to existing industries. The rise of the ICT industry in the 1990s, which was possible due to developments in technology, marked a key turning point in the industrial development of Korea.³³

A series of developments like the launch of the World Trade Organization (WTO) in 1995, Korea's entry to the OECD in 1996 and the 1997 Asian financial crisis pushed Korea towards the full opening of its market. Korea has constantly adapted to international markets and globalization trends: at an early stage, Korean manufacturers were encouraged to focus on export markets rather than depend on a limited domestic market; and later, in the era of full-fledged globalization, Korean manufacturers took the next step of 'industrial globalization' by diversifying partnerships, establishing production facilities overseas, etc., which has contributed to the increased competitiveness of Korean industry in its respective sectors. This brought Korea into the top five rankings of countries in the fields of automobiles, shipbuilding, electronics and steel.

The IMF financial crisis in the late 1990s forced the Korean industrial sector to restructure, and some industries, like ICT, came out stronger and more competitive following the crisis. However, the primary industries faced great difficulties. By the 2000s, the challenge was how to go about restructuring industries, yet being mindful that while some were able to handle changes in terms of market opening and technological advancement, others were having trouble meeting these challenges. Also, there was the question of how to effectively select and promote future engines of growth.

After the era of rapid economic growth followed by the liberalization and stabilization period, since the turn of the century, Korea has been pursuing 'new growth engines' that will sustain economic dynamism and growth in order for it to secure the status of an advanced economy. Up to the 1980s, Korea successfully implemented an 'industrial targeting' policy for economic transformation. But with the advent of the WTO regime in the mid-1990s, the government's direct fiscal and monetary support for businesses was no longer possible and only its indirect support in R&D was allowed. Hence, Korea's industrial policy turned into technical development policy, and from the 2000s, the

government started to nurture new growth industries by focusing on technological development.

In 2001, Kim Dae-Jung's government promoted the so-called 'five technological industries': IT, biotechnology (BT), nanotechnology (NT), environmental technology (ET) and cultural technology (CT). In 2003, the Noh Mu-Hyun administration announced ten industries that would spearhead growth: robots, future cars, next-generation semi-conductors, digital TV and broadcasting, new-generation mobile communication, display, intelligent home networks, digital contents/SW solutions, next-generation batteries, new biomedicine and organs. In 2009, the Lee Myung-Bak administration presented a vision for a new growth engine and strategy, with emphasis on green growth, high-tech fusion and a high value-addition service industry. The overall performance of these initiatives was mixed, showing partial success.³⁴

Then, the Park Geun-Hye government laid out the vision of achieving a 'creative economy' and planned to develop future engines of growth in 2013. In 2014, the government announced economic goals of a 4% economic growth rate, USD 40,000 GDP per capita and a 70% employment rate.³⁵ This was to be realized through a three-year plan for economic innovation built on the three pillars of 'strong fundamentals', a 'dynamic and innovative economy' and 'balancing domestic demand and exports'.³⁶

However, this administration came to a halt with the impeachment of President Park in March 2017, before these goals could be attained. What should be noted is that since Korea recovered from the Asian financial crisis in the late 1990s, it has experienced a steady slip in its economic growth rate, which reflects the typical trend in developed economies. During the four years of Park's administration (2013–2016), GDP growth averaged 2.9%, the lowest ever. Since the late 1990s, when Korea suffered the IMF crisis, the administrations had achieved an average growth rate of 5.1% (Kim Dae-Jung 1998–2002), 4.5% (Roh Mu-Hyun 2003–2007) and 3.2% (Lee Myung-Bak 2008–2012).³⁷

The new President Moon Jae-in, who was inaugurated on 10 May 2017, pledged to enhance the livelihood of ordinary people, taking care of employment, reforming business conglomerates, reining in collusion

between political and business circles, and promoting equal opportunities.³⁸ Evidently, Korea has already entered the phase of slow growth, given its industrial structure and income level and the size of its economy. But managing the economy and meeting people's demands is likely to be increasingly difficult with heightening global and domestic competition, and an increase in people's demands and expectations amid the enhancement of their living standards, socio-political awareness and rights.

Besides upgrading technology and focusing on developing new growth engines, Korea's task is to nurture development and enhance the competitiveness of existing industries which are vital for the overall socio-economic stability of the nation. The issue becomes tricky in the case of the primary industries, especially the agriculture sector.

What characterized Korea's economic development for some 50 years was its exceptionally high economic growth: for the period from 1961 to 2004, the average GDP growth rate for Korea was 7.1%, compared to a global average of 4.0% (83), 3.3% for developed nations (22), 5.7% for East Asia (5), 3.7% for Latin America (22) and 4.9% for South Asia (4).³⁹ What was the key to Korea's high growth was the accumulation of capital, and until the IMF financial crisis, the accumulation of capital led the economic growth; however, since the IMF crisis, the per-capita accumulation of capital rate dropped sharply and increases in productivity led the growth.

Manufacturing drove Korea's rapid economic growth. Over the period from 1953 to 2000, Korea's manufacturing averaged a high growth rate of 13.1% annually. Although Korea maintained one of the highest industrialization ratios in the world of close to 30% even after it dipped slightly in the 1990s, it is deemed to have reached its limits.⁴⁰

But as Korea achieved high growth, the problem of 'bipolarization', the widening of the disparity between large corporations and small and medium-sized enterprises (SMEs), and between exporting and domestic-oriented industries, has surfaced. Too much concentration of economic power in the *Chaebols* and their overexpansion alongside such problems as moral hazard, loose management and bad debt have rekindled debates and deliberations over how to appropriately regulate and control their activities. How to deal with low growth and worsening wealth distribution,

balancing or simultaneously pursuing economic growth and strengthening welfare remain fundamental tasks for the nation. In addition, matters such as revamping the ever-growing service sector and fostering innovative SMEs to attain a position of global competitiveness are drawing increased attention.

Recapping the Overall Achievements

In 1962, when Korea launched its first five-year development plan, its per-capita income was only USD 87, lower than most African countries at that time. Korea's drastic economic transformation is summed up in its attainment of '20-50 club' status in recent years. This is a measurement of economic development that combines population size and the level of per-capita income. Literally, it means having a per-capita income of over USD 20,000 at the same as having the population of over 50 million. When Korea entered this club in 2012, it was only the seventh country in the world to achieve this feat. The other countries are Japan (1987), the US (1988), France (1990), Italy (1990), Germany (1991) and the UK (1996). Furthermore, Korea has reached another milestone of the '30-50 club' in 2018. As of 2017, Korea is the eleventh-largest economy.

In terms of trade volume, Korea was the fifth-largest exporter and the seventh-largest importer as of 2014. In 2012, Korea has achieved, for the first time, a landmark total trade volume of over 1 trillion dollars, making it the eighth major trading nation. In terms of foreign reserves, Korea ranks sixth in terms of foreign exchange reserves with 369.6 billion dollars (2015), while it ranked thirteenth in the Human Development Index (2013). In addition, it topped the rankings in the Bloomberg Innovative Country Index for five consecutive years (2014–2018).⁴¹

By every account, Korea has already entered the threshold of advanced economies, which is also symbolized by its joining of the OECD DAC in 2009. This has all taken place without Koreans themselves being well aware of their achievements. The work to be done is how to explain the reasons for success and draw lessons from it.

Coming up with a credible 'Korean model of development' that can be benchmarked in practice by the African countries will be an even more significant task, but the purpose of this book is to try to invite and provoke greater deliberations in this field in the years to come. In this vein, making sense of what has transpired and what indeed were the key factors that drove Korea to success is deemed to be important.

In my view, the essence of the Korean model of economic development in its simplest terms can be broken down into two main elements: (1) compressed economic growth; and (2) effective social mobilization for change. Korea's development is considered so impressive and unique because it has somehow found a way to 'accelerate through' industrial transformation and also has been able to instil the 'can-do spirit' into its people and has induced them to be active agents of development.

This has taken place against the backdrop of positive role of the government. And there were four fundamental cornerstones upon which compressed economic growth and effective social mobilization were realised: land reform; empowerment of the people; revolution in education; and governmental reform. These seemingly basic but 'profound' reform measures were taken at appropriate moments, in some ways helped by 'pressures'—constraints, limitations and adversities Korea faced as a nation. Of these, I think land reform and empowerment of the people were most crucial.

Based on such measures, Korea's economy evolved, but the whole picture of Korea's development will not be complete without adding to it the important aspect of social dynamics, that is, the formation and evolution of social or popular mindset change and action-oriented campaigns. Addressing Korea's development from a purely economic dimension misses the point entirely. With regard to East Asian developmental states, so many academics and experts have already mentioned the key role of the state. But in the case of Korea, besides the government's critical intervention, the people's mindset and action-oriented movements played an equally important part in Korea's overall development.

Korea in the 1950s, after having gone through the Korean War, focused on reconstructing the war-torn nation, relying heavily on foreign aid, mostly from the US, and employing import-substitution as

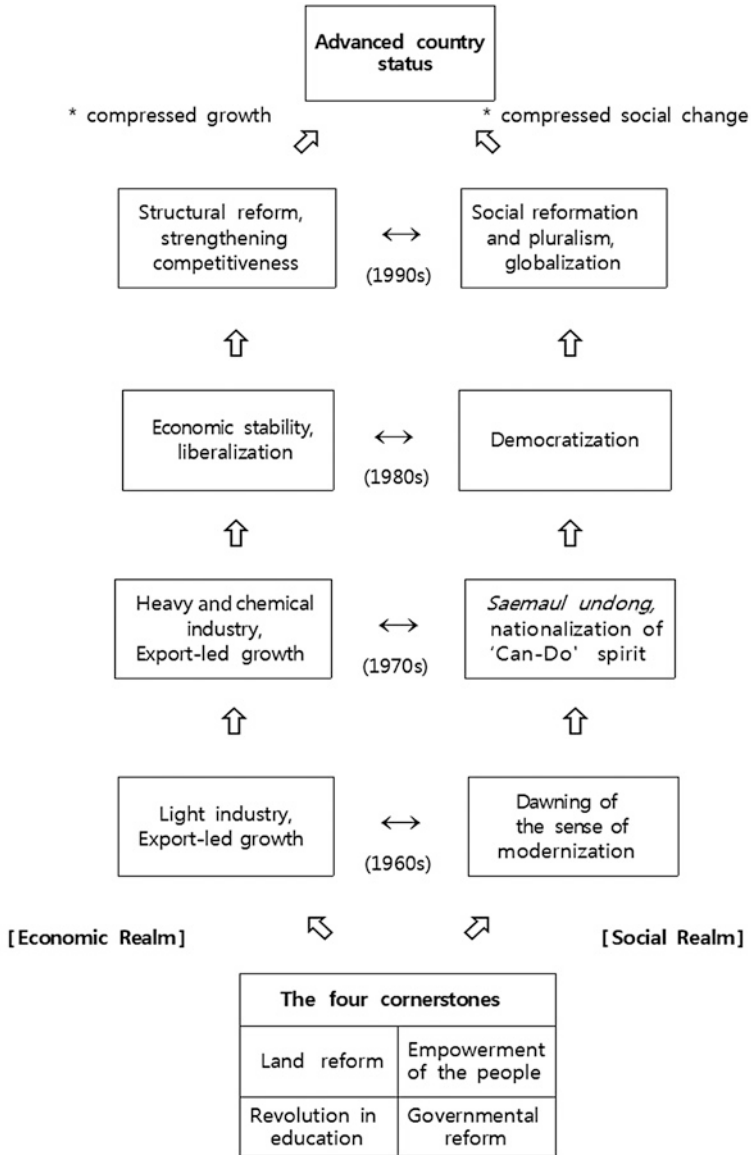


Fig. 7.1 Schematic itinerary of Korea's development

a mainstream economic policy. It was in the early 1960s that Korea embarked on a full-scale and systematic effort to develop its economy. But earlier, in the 1950s, a number of crucial measures such as land reform and government-driven campaigns to empower the people were enacted. Broadly speaking, we can say that the compressed economic growth of Korea lasted until the end of the 1990s, with Korea achieving the status of an advanced economy at the turn of the new millennium. Figure 7.1 above provides an illustration of a summary of Korea's path of development that I have mentioned. This cannot be considered as a road map because Korea did not pre-plan the scheme of development over a period of decades to achieve compressed growth.

Notes

1. Chuk Kyo Kim, *Korean Economic Development*, 2nd ed. (Seoul: Parkyoungsa, 2016) (Korean Edition), p. 11.
2. Il Sakong and Youngsun Koh (ed.), *The Korean Economy: Six Decades of Growth and Development* (Seoul: Korea Development Institute, 2010).
3. In this book, I will freely use different categorizations where it is deemed suitable for the sake of convenience and ease of explanation.
4. Kyong Ju Kim, *The Development of Modern South Korea: State Formation, Capitalist Development and National Identity* (London: Routledge, 2006), pp. 44–47.
5. *Ibid.*, p. 45.
6. Michael J. Seth, *A Concise History of Korea* (Lanham, MD: Rowman & Littlefield, 2006), p. 2.
7. *Ibid.*, p. 4.
8. Sakong and Koh (2010), p. 11.
9. *Ibid.*, p. 12.
10. Jung-en Woo, *Race to the Swift: State and Finance in Korean Industrialization* (New York: Columbia University Press, 1991), p. 52. It is argued that Taiwanese government was much more cooperative than Korea with the US.
11. Sakong and Koh (2010), p. 13.
12. LEE Dae Geun, *Korean Economy in the Post War 1950s* (Seoul: Samsung Economic Institute, 2002) (Korean), p. 253.

13. Edward S. Mason, et al., *The Economic and Social Modernization of the Republic of Korea* (Cambridge, MA: Harvard University Press, 1980), p. xxx.
14. Chuk Kyo Kim (2016), p. 17.
15. Ibid., p. 25.
16. Sang-cheol Lee, 'Switching to an Export-led Industrialization Strategy and Its Outcome', in Dae-geun Lee (ed.), *New Korean Economic History: From the Late Joseon Period to the High-Growth Period of the 20th Century* (Seoul: Na-nam, 2005) (Korean), p. 394. The decrease in US aid to Korea from 1958 is said to have contributed to Korea's foreign reserve crisis, prompting the government to shift from a fixed exchange rate system to a unitary fluctuation exchange rate system in 1964.
17. Sakong and Koh (2010), pp. 17–19. 'Export targeting' refers to a practice of setting a target for each year's total exports by adding up the export forecasts of individual firms. In the Monthly Export Promotion Meetings, government officials and business representatives gathered to monitor export performance, compared it to export targets, identified problems and sought solutions. The President himself chaired these monthly meetings. The Korea Trade Promotion Agency (KOTRA) took charge of building overseas networks, helped the marketing activities of domestic firms and collected market information.
18. The new government set an ambitious task of achieving 7.1% growth, but was confronted with various obstacles from the start, so that the target economic growth rate was later lowered to 5% for 1964–1966. The government tried to mobilize domestic capital through monetary reform in 1962, but failed, and in 1963 faced a foreign exchange crisis amid lukewarm support from the US for the Korean regime. However, at the end of the first five-year plan, Korea actually exceeded the goal of 7.1%.
19. Sakong and Koh (2010), pp. 20–21.
20. Chuk Kyo Kim (2016), p. 33.
21. Sakong and Koh (2010), p. 21. By deepening the industrial structure and upgrading the export mix, the share of HCIs in total industrial production was to be increased from 35 to 51% between 1972 and 1981, and their share in total exports from 27 to 65%.
22. Chuk Kyo Kim (2006), pp. 32–34. Governmental support to HCIs took various forms: providing long-term credit and tax incentives

to selected industries, establishing and expanding vocational schools and training centres to supply skilled manpower, creating government-funded research institutions to carry our R&D activities as a public good.

23. Sakong and Koh (2010), p. 104.
24. Bank of Korea, <http://ecos.bok.or.kr>.
25. Sakong and Koh (2010), pp. 87–90.
26. The need for change was initially brought up within the government, resulting in the announcement of the Comprehensive Economic Stabilization Program in April 1979.
27. The Fair Trade Commission, which was set up in 1981, formulated deregulation plans in consultation with the private sector and related ministries. In 1990, the Administrative Deregulation Committee was set up in the Prime Minister's Office to direct deregulation efforts across government in compliance with the Comprehensive Economic Vitalization Program. These efforts were carried on by the Kim Youngsam government from 1993.
28. Kwang Suk Kim, *Korea's Industrial and Trade Policies* (Seoul: Institute for Global Economics, 2001) (Korean), p. 82.
29. Some of the factors cited were that Korea failed to take appropriate measures to counter the reckless management of banks; moral hazard arising from business–politics ties; a failure to put in place a fair and transparent process; excessive dependence on foreign loans (short-term debts), etc.
30. With the lifting of restrictions on inward FDI at the end of the 1997, FDI flowed in and the accumulated amount of FDI inflows reached USD 100 billion in October 2004, making Korea the fifth largest foreign reserves–possessing country in the world. Corporate governance was strengthened by such measures as requiring *chaebols* to prepare consolidated financial statements and applying stiffer penalties. And, most importantly, interest rates were fully liberalized.
31. DoHoon Kim and Youngsun Koh, 'Korea's Industrial Development', in Il Sakong and Youngsun Koh (eds), *The Korean Economy: Six Decades of Growth and Development* (Seoul: Korea Development Institute, 2010), pp. 111–112.
32. Chuk Kyo Kim (2006), p. 165.
33. Kim and Koh (2010), p. 112. The success of the ICT sector also helped create a new development vision for Korean HCIs just as they were

- emerging from the period of industrial rationalization and were searching for ways to achieve future-oriented growth.
34. DoHoon Kim, 'In Search of Future Growth Engine: Tasks and Solutions', *Korea Economic Forum* 8, no. 2 (Seoul: Korea Economics Association, 2015) (Korean), p. 54.
 35. According to OECD Data, <https://data.oecd.org/emp/employment-rate.htm>, employment rates are calculated as the ratio of the employed to the working-age population. The employment rate is different from the 'unemployment rate', which refers to the percentage of the total labour force that is unemployed but actively seeking employment and willing to work. Thus, these two concepts are not the two sides of the same coin.
 36. These three pillars or strategic goals are in turn each composed of three sub-tasks. 'Strong fundamentals' consists of public sector reform, developing a principled market economy and building a strong social safety net. As for 'dynamic and innovative economy', the sub-tasks are developing creative industries, investing for the future and making inroads into overseas markets. 'Balancing domestic demand and exports' is composed of expanding domestic demand, de-regulating to improve investment, and job creation to stimulate domestic demand.
 37. *Yonhap News* (Korean), 10 March 2017, <http://www.yonhapnews.co.kr/dev/9601000000.html>. See also Evan Ramsdat, 'South Korea's Economic Challenges After the Park Geun-hye Era', *CSIS Newsletter*, 17 March 2017. In 2016, exports dropped by 5.9% to USD 495.5 billion, registering a decrease for two consecutive years. This marked the first time that Korea had experienced a two year-consecutive drop in exports since 1957–1958. Although exportation is showing signs of recovery, there is weariness that it is largely being driven by a limited number of products like semi-conductors. However, the employment figure improved with an annual increase of 388,600 thousand jobs compared to around 250,000 in the previous two administrations. But the employment rate (for 15–64 year olds) registered an average of 65.4%, falling short of the 70% target. On the other hand, the unemployment rate did not improve, being recorded at 3.5%, about the same level as Roh's (3.5%) and Lee's (3.4%) government. The 'youth unemployment rate (for 15–29 year olds)' was at a record high of 9.0%.
 38. 'Inaugural Address to the Nation by President Moon Jae-in', unofficial translation by the Ministry of Foreign Affairs, Republic of Korea,

- 10 May 2017. See also Mael Business News (Business Department), *Moon Jae-in nomics* (Seoul: Mael Business News Korea, 2017) (Korean).
39. Chin Hee Hahn and Shin Sukha, 'Understanding the Post-crisis Growth of the Korean Economy: Growth Accounting and Cross-Country Regressions', in Takatoshi Ito and Chin Hee Hahn (eds), *The Rise of Asia and Structural Changes in Korea and Asia* (Cheltenham, UK: Edward Elgar, 2010), pp. 97–110.
 40. The heavy industry ratio (the portion of heavy industry in the total manufacturing sector) continued to increase from 58% in 1980s to 88.5% in 2007, and Korea tops the world in this category.
 41. 'The U.S. Drops Out of the Top 10 in Innovation Ranking', *Bloomberg Technology*, 23 January 2018, <https://www.bloomberg.com/news/articles/2018-01-22/south-korea-tops-global-innovation-ranking-again-as-u-s-falls>.

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