

Economic Development in Korea: Some Characteristics and Problems during the Past Four Decades*

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Korean economic development during the past four decades can be characterized as a process of "late-comer's accelerated growth" which was made possible by a combination of rich manpower, foreign capital and technology. This process looks quite similar to what occurred in Japan and Taiwan which have also developed later than Western countries, with relatively few natural resources. But the degree of government intervention in Korea has been much higher, creating some unique features in industrial structure and behaviors of the people.

I. Introduction

This paper aims to evaluate the characteristics and problems of Korean economic development during the past four decades. One may wonder what new insights we can gain from adding a paper of this sort to the huge stock of papers describing the Korean economy. The Korean economy, however, is facing a set of new challenges brought about by the need for restructuring of its industries and firms, and the need for adjusting itself to the rapidly changing international environment. These challenges call for a fresh evaluation of its past performance from a new perspective.

In this light, this paper tries to understand the Korean economic development from the angle of the performance of economic agents, such as government, firms, and workers. Comparing its growth pattern with that of other Northeast Asian countries, we notice that the Korean economy has displayed two different features—some fea-

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tures are common to other developing countries in the region, while others are unique to Korea. The common features are mainly centered around the speed with which Korea and other countries have grown, while the unique features have to do with the roles of the government and other institutions.

The second section of this paper describes the main macroeconomic characteristics of the Korean economic development as compared with those of Taiwan and Japan. The third section deals with sources of Korean economic development, which has been accomplished in a more "accelerated" form than in advanced countries. The fourth section examines the government policies which have shaped structural aspects of the Korean economy. The final section concludes with some remarks on prospects for the future.

II. Overview of Korean Economic Development

Professor Simon Kuznets once characterized modern economic growth as i) rapid increase of per capita income, ii) rapid structural change, iii) rapid productivity growth due to technological progress, and iv) enhanced internationalization.¹ The Korean economic development has also shown these characteristics, and its speed of growth and structural change have taken a more accelerated form than that of advanced countries during their comparable stages of development.²

A. *The Growth Rate*

The economic growth rate in Korea had been relatively low up to 1961, but it increased sharply after 1962 when the First Five-Year Development Plan started (see Table 1). This growth record was unprecedented in economic history of developing countries, with the exception of Taiwan's case. The Latin American countries³ had shown considerable growth rates in the 1970s, but recorded negative growth rates in 1981-84, followed by a low rate of 4% after 1984.

Only Taiwan has grown as rapidly as Korea. Hong Kong and Sing-

¹Kuznets (1964, pp. 36-8).

²Professor Kazushi Ohkawa uses the term "compressed" growth to describe the economic growth of developing countries. See Ohkawa (1970, p. 33).

³They include Brazil, Mexico, Chile, and Argentina. The growth rate indicates the unweighted average.

TABLE 1
MAJOR STATISTICS OF THE KOREAN ECONOMY

(Unit : %)

	Annual growth rate	Inflation rate (Consumer price)	Rate of M2 increase	Average Unemployment rate
1954-56	2.7	42.6	—	—
1957-61	4.7	9.6	—	—
1962-66	7.8	19.7	32.3	7.6
1967-71	8.7	15.0	48.7	5.0
1972-76	9.5	20.9	31.2	4.1
1977-81	5.9	19.6	30.2	4.1
1982-87	9.2	4.2	17.2	3.9

Source: Bank of Korea, *National Income Account*.

Economic Planning Board, *Major Statistics of Korean Economy*.

TABLE 2
MAJOR ECONOMIC STATISTICS OF TAIWAN

(Unit : %)

	Annual growth rate	Inflation rate (Consumer price)	Rate of M2 increase	Average Unemployment rate
1952-56	8.1	10.1	—	4.0
1957-61	7.0	7.7	—	4.0
1962-66	9.9	2.4	21.9	3.6
1967-71	10.6	4.9	21.9	1.9
1972-76	8.9	12.2	28.2	1.6
1977-81	9.0	10.2	22.6	1.4
1982-87	8.2	1.7	24.1	2.5

Source: Council for Economic Planning and Development, Republic of China, *Taiwan Statistical Data Book*.

apore have also grown very rapidly, but these city states have many features that are not comparable to those of Korea and Taiwan. Until the late 1970s, Taiwan maintained a higher growth rate than Korea (see Table 2).

The high growth of these two countries is unprecedented in the development history of advanced countries. The record-high annual growth rates of advanced countries from the 1860s to the First World War were 4.3% in the USA, 3.7% in Austria, 3.6% in Japan,

TABLE 3
MAJOR ECONOMIC STATISTICS OF JAPAN IN 1878-1942

	A	B	C	D	E	F	G
	Nominal national income*	Wholesale price index (1928-32 =100)	(A / B) (million yen)	Increase rate of C (%)	Increase rate of B (%)	Nominal money stock (million yen)**	Increase rate of F (%)
1878-82	667	41.7	1,600			221.0	
1883-87	607	31.6	1,921	3.80	-5.40	227.0	0.53
1888-92	809	37.1	2,181	2.59	3.26	273.6	3.80
1893-97	1,208	41.7	2,897	5.84	2.36	449.7	10.45
1898-1902	1,978	53.1	3,725	5.16	4.95	797.3	12.14
1903-07	2,522	63.7	3,959	1.23	3.71	1,420.8	12.25
1908-12	2,366	68.5	4,914	4.42	1.64	2,133.8	8.47
1913-17	4,598	81.2	5,663	2.88	3.46	3,384.5	9.66
1918-22	11,385	150.4	7,570	5.98	13.12	9,820.5	23.75
1923-27	12,946	139.6	9,274	4.14	-1.94	12,625.1	5.15
1928-32	12,132	100.0	12,132	5.52	-6.46	14,824.5	3.27
1933-37	16,161	107.4	15,047	4.40	1.44	17,534.2	3.41
1938-42	34,547	184.6	18,715	4.46	11.43	30,788.2	15.15

Source: Shinohara (1967, p. 75, appended Table 1, 2).

Note: 1. *: Estimated by Ohkawa and others, *The Growth Rate of The Japanese Economy since 1878*.

2. **: Shohzaburo Fujino. "Estimation of Money Stock, Marshallian K, and Velocity of Income in 1874-1940." In Statistics Study Group, *Data on Capital Accumulation Study* 16.

and 3.0% in Germany.⁴ During the interwar period (1919-38), Japan's 4.5% rate was the highest, while the annual growth rates of other countries were less than 2%. From 1860 to 1941, Japan grew most rapidly among advanced countries. However, as shown by Table 3 which summarizes the Japanese growth rates of five-year sub-periods from the Meiji Restoration (1868) to the Second World War, none of the sub-periods showed the growth rate as rapid as that of Taiwan or Korea during the post-W. W. II period under study.

It is remarkable that the Japanese economy between 1955 and 1973 grew even more rapidly than Korea and Taiwan during the

⁴Shinohara (1961, Table 1). For the numbers for Austria and the United States, see Goldsmith (1953, p. 115).

TABLE 4
MAJOR ECONOMIC STATISTICS OF POST-WAR JAPAN

Year	Restoration period		Period of rapid growth		Adjustment period		Period of stable growth	
	1946-50	1951-55	1956-60	1961-65	1966-70	1971-75	1976-80	1981-85
Growth rate(%)	9.4	10.9	8.7	9.7	12.2	5.1	5.1	4.4
Inflation rate(CPI,%)	44.4	6.3	1.5	6.1	5.4	11.5	6.4	2.7
Unemployment rate(%)	1.0	1.7	2.0	1.3	1.2	1.4	2.1	2.5
Balance of current account(million\$)	634	524	115	-1,358	6,201	6,912	1,933	25,222
Trade balance	-939	-1,963	468	1,955	13,626	26,990	11,268	35,388

Source: Kosai (1986).

Note: All numbers in this Table are based on National Income Statistics.

same period. Table 4 shows that the annual average growth rate of Japan between the "Jimmu-boom" in 1956 and 1970 was as high as 10%. Thus, it would appear that the only instances of rapid growth comparable to Korea are the cases of Taiwan during the post-W. W. II period and of Japan during the 1955-73 period.

The speed and pattern of Korean and Taiwanese growth have been similar, in that the features of modern economic growth suggested by S. Kuznets appeared in both countries in an accelerated form. However, we must not forget that the Korean economy has many micro-economic features different from those of Taiwan or Japan because of factors unique to Korea.

B. Structural Change

In the process of economic growth during the past decades, the Korean economy has transformed itself from the traditional agricultural economy to a modern industrial one. Figure 1 depicts the structural change of industry during the period from 1953 to 1986. The most remarkable change is that the share of agriculture, forestry and fishery production in GNP decreased from 47% in 1953 to 13% in 1986, whereas mining and manufacturing production (the secondary sector) increased from 10% to more than 30%.

The similar structural transformation of Taiwan — increasing share of manufacturing and mining industries and decreasing share of primary industries — has been more dramatic than that of Korea

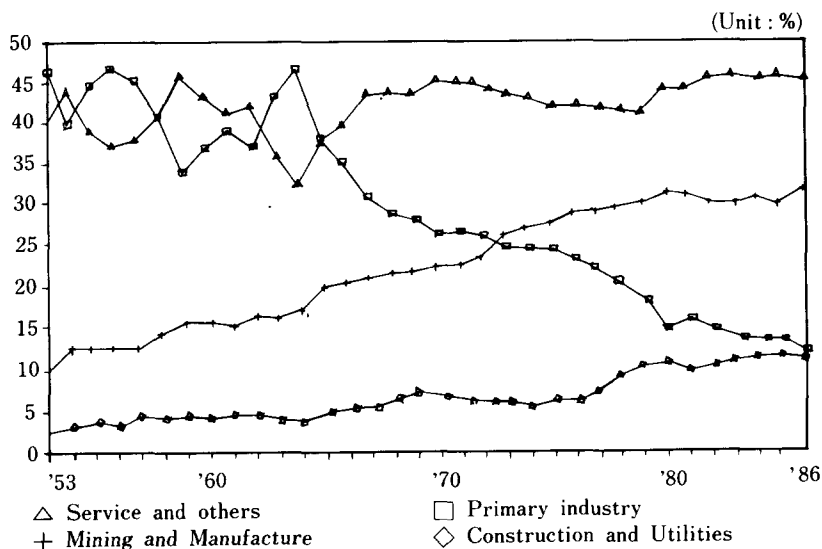


FIGURE 1
INDUSTRIAL STRUCTURE OF KOREA

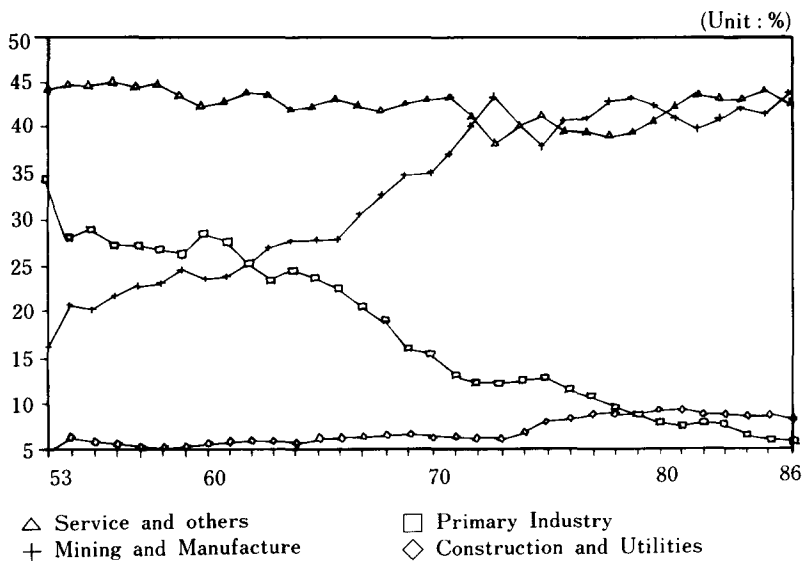


FIGURE 2
INDUSTRIAL STRUCTURE OF TAIWAN

(see Figure 2). Although the data of Japan are not shown here, one can notice that similar structural transformation took place in Japan during her high speed growth period. Though Japan was an indust-

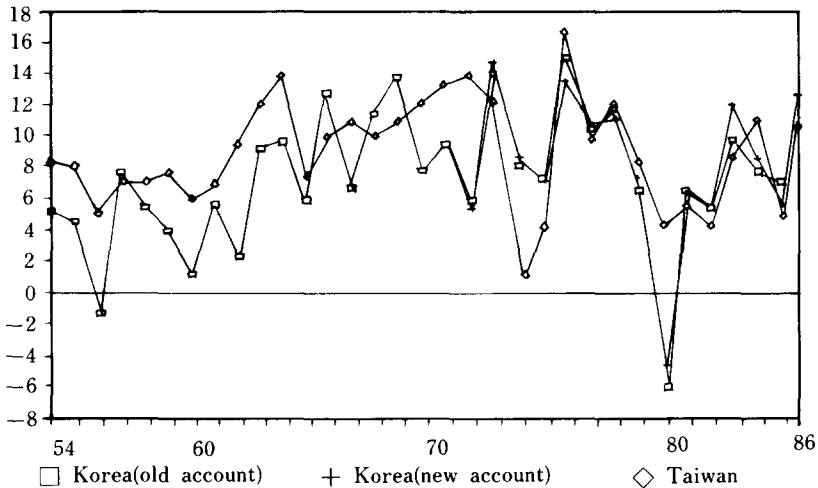


FIGURE 3
GROWTH RATE OF REAL GNP

rial country at the end of the W. W. II, the workers employed in the agricultural sector outnumbered those in manufacturing sector. It was only after the period of high speed growth that the industrial structure of Japan began to resemble that of advanced countries.

Because of the interdependent relationship between the primary and the secondary industry, the growth of one sector induces the growth of the other, although no causal rule about which sector comes first is found in the experiences of the advanced countries. In England, the agricultural sector developed first and induced the development of manufacture, whereas in Japan both sectors developed almost simultaneously in the 1870s. In Korea, the manufacturing sector developed and fostered the development of agriculture, by mechanizing agricultural technique, providing farmers with fertilizer and chemicals, and absorbing the labor force released from the countryside. In Taiwan, the agricultural sector grew considerably before the manufacturing sector started taking off in the late 1950s.

The industrialization during the high growth period in Korea also changed the structure within manufacturing industries. In the 1960s, light industry developed, on the basis of processing imported semi-final products and utilizing foreign capital. In the late 1960s, investment in heavy industry, such as steel, petroleum, chemicals and electronics, emerged. Investment in six industries, i.e. steel, shipping, non-ferrous metal, chemical, machinery and electronics indus-

try, was emphasized after the power of President Park Chung-Hee was solidified in October, 1972. As a result, the structure of the manufacturing industry was greatly "enhanced", and heavy industry provided the basis of later growth of GNP and exports, even though some side-effects were brought about, such as concentrated support of a few large corporations, inflation, and waste of resources.

The Japanese industrial policy in the 1960s seems to have served as a prototype for the Korean planners with respect to fostering heavy/chemical industries. Japan started developing the heavy/chemical industries around 1955, with the enactment in the 1960s of a series of laws stipulating the ways in which these industries were to receive the policy emphasis. At first, heavy and chemical industrial output was produced for domestic demand. They later became major export goods as they gained competitiveness in the international market due to increased productivity. In 1976, these products accounted for 83% of total exports. The heavy industrialization policy of the Korean government in the 1970s and its support of general trading companies after 1975 were modeled after the policies of Japan. Thus, the change of industrial structure in Korea had a strong resemblance to that of Japan's with a time lag of about 15 to 20 years. These policies give rise to the emergence of a few groups of affiliated forms, or "Chaebol", whose counterparts in prewar Japan with respect to organization and business behavior were "Zaibatsu".

In contrast, heavy industries in Taiwan are not carried out by private firms, but mostly by public enterprises. For example, petroleum, chemical, steel and shipping industries are domains of public corporations.

C. Inflation

A notable feature of Korean economic development in the 1960s and 1970s was that growth rates varied widely from year to year. Table 3 shows that Korea's growth rates were very high on the average, but wandered between very high and very low rate, in contrast to stable growth rates of Japan during the period from 1955 to 1975. This table also shows that the growth rates of Taiwan were relatively stable.

The other noticeable feature is that high inflation accompanied economic growth in Korea until the late 1970s. Calculating the inflation rate by averaging the annual rate for every five-year period,

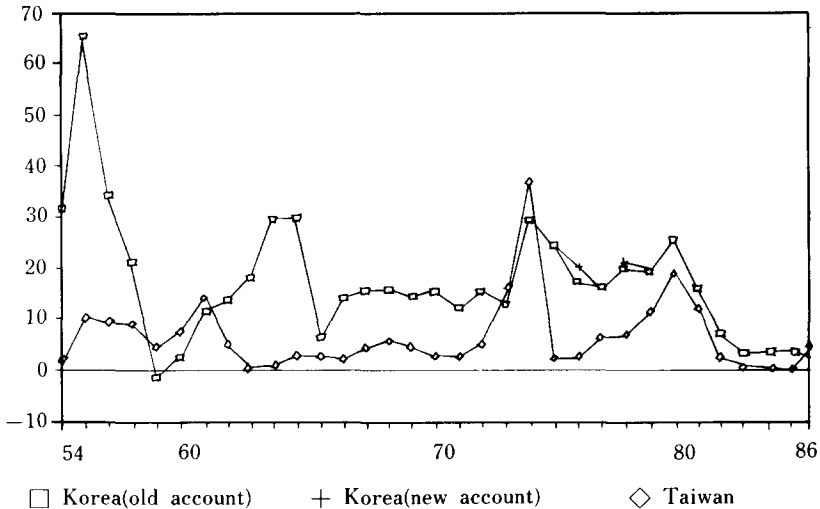


FIGURE 4
INFLATION RATE

one finds that the Korean economy has been plagued with double-digit inflation from the First Five-Year Plan period to the present, except during the brief period of 1957-61 and the 1980s.

The average inflation rate of Taiwan, however, remained fairly stable, except during the two oil-shock periods, i.e. 1972-77 and 1979-81 (see Figure 4). During both the pre-war and post-war periods, the inflation rate of Japan did not exceed the double-digit rate, and the price level was considerably stable, except during the war and the oil-shocks.

D. International Payments, Investment and Saving

One of the most striking features of the Korean economic development is its dependence on exports and imports. As is shown in Table 5, exports grew at the annual average rate of 44% during the First Five-Year Plan (1962-66) period, 35.3% during the Second (1967-71) and 49.6% during the Third Plan period (1972-76). As the total amount of exports increased, the growth rate of exports diminished, but it remained unprecedentedly high. The ratio of exports to GNP increased from less than 8% in the 1960s to about 40% in the 1980s.

Imports increased significantly together with exports, and the ratio of imports to GNP also increased. Until 1985, the current

TABLE 5
EXPORTS AND IMPORTS OF KOREA

(Unit : %)

	Export		Import	
	Annual increase rate	Export / GNP	Annual increase rate	Import / GNP
1954-56	-	-	-	-
1957-61	-	-	-	-
1962-66	43.9	7.9	23.2	16.4
1967-71	35.3	15.0	26.8	25.0
1972-76	49.6	27.8	34.2	34.5
1977-81	21.6	32.6	24.1	39.6
1982-86	15.1	39.8	8.6	40.5

Source: See Table 1.

account deficit was offset by a capital account surplus. As a result, foreign debt accumulated, reaching 54% of GNP in 1985. At that time, Korea became the fourth largest debtor country in the world.

In the mid-1980s the current account balance improved dramatically. Imports decreased due to the fall in oil price, and export goods became more competitive in the American and European markets due to rapid appreciation of the Japanese yen. The current account surplus reached 6 billion dollars in 1985, 10 billion in 1987. In 1988, the surplus was 13 billion, even though the Korean exports suffered from appreciation of the won and increasing wages.

The Taiwanese economy depends more heavily on international trade than Korea does. In Taiwan, policies for export-led growth were implemented earlier than in Korea. Along with the exports of manufacturing and agricultural goods, imports increased. The ratios of exports and imports to GNP reached 56% and 43% (see Table 6) respectively in 1987. As is shown in Figure 5, Taiwan has been enjoying trade surplus since 1971.

The imbalance in international payments is reflected by the imbalance of domestic saving and investment. Figure 6 shows that investment rate in Korea until 1985 was consistently higher than the saving rate. In the 1950s the saving ratio was extremely low, but increased steadily in the 1960s and 1970s. In 1986, saving began to exceed investment. The balance of payments surplus which began to

TABLE 6
EXPORTS AND IMPORTS OF TAIWAN

(Unit: %)

	Export		Import	
	Annual increase rate	Export / GNP	Annual increase rate	Import / GNP
1952-56	23.3	8.1	19.1	14.3
1957-61	22.7	11.5	22.8	18.4
1962-66	23.5	18.1	14.7	19.8
1967-71	31.2	27.3	24.5	27.9
1972-76	32.2	43.9	35.2	43.3
1977-81	21.9	52.0	22.9	49.4
1982-86	17.6	55.9	11.2	42.7

Source: See Table 2.

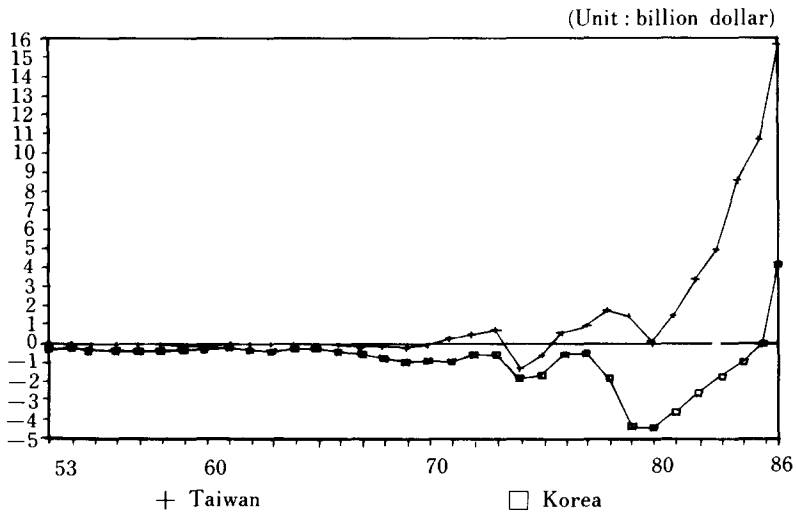


FIGURE 5
TRADE BALANCE

appear in 1987 indicates the excess of saving rate over investment rate.

The difference between saving and investment in Taiwan and Japan is much greater than in Korea. In Taiwan, domestic saving was less than investment in the 1960s, but in the 1970s saving consistently exceeded investment, except briefly during the oil

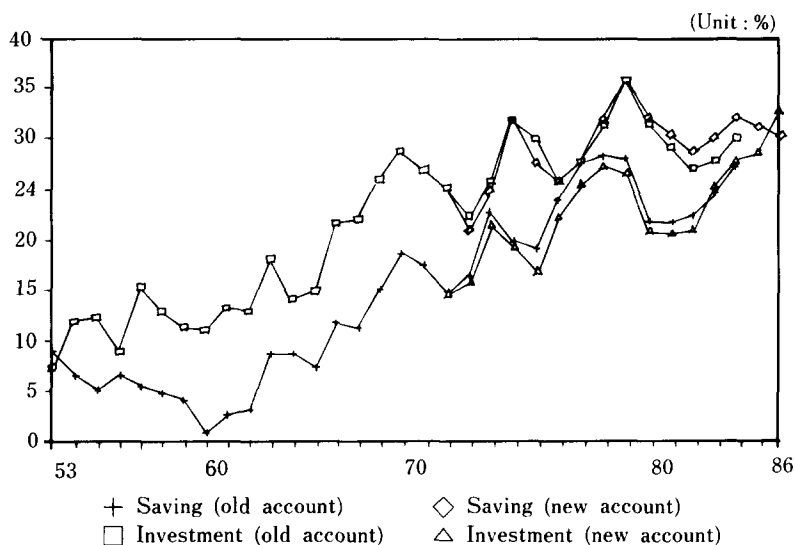


FIGURE 6
INVESTMENT AND SAVING IN KOREA

shock period. In 1986 the ratio of saving to GNP was as high as 38%, and the investment rate was 18%, the difference being reflected in the great current account surplus of that country.

III. Sources of Accelerated Growth

In a short time, Korea and Taiwan achieved what advanced countries accomplished over long periods of development. During 1955-70, Japan also accomplished an extremely high rate of growth; it was a great leap-forward to catch up with, say, the United States. It would appear that the accelerated growth of Korea and Taiwan owes primarily to the advantages of the late comers in industrialization — the advantages of making use of technological backlog imported from advanced countries. The Japanese economy was much more advanced than the Korean and Taiwanese economies, but nevertheless, there was an enormous gap between Japan and the U.S. in terms of their technological levels, so that Japan enjoyed advantages similar to those of Korea and Taiwan. In many respects, the Japanese high speed growth during the 1955-73 period was a sort of late comer's accelerated growth.

At the risk of repeating what many comparative studies have

pointed out, we will elaborate on four common factors of development, three of which are internal, and the other external: i) a strong "survival trait" with keen sense of competition which nurtures astuteness and doggedness — a trait which is often found in a people faced with hard circumstances, ii) traditional emphasis on the importance of education and investment in human resources, iii) the government's "development-oriented" policies, and iv) the post-war international economic order which removed the bottlenecks of industrialization of resource-poor and labor surplus economies. Let us elaborate on these factors.

A. *Survival Trait*

It is quite obvious that the Korean, Taiwanese and Japanese people have a strong "survival trait" due to tough *natural conditions*. The strong survival trait is not a monopoly of the three countries, but the people of these three densely populated and resource-poor countries have learned the importance of utilizing limited resources. These acquired abilities are conducive to industrialization. They stimulate the need to improve living conditions and emulate better lives, and strengthen what W. A. Lewis calls "the will to economize."

B. *Cultural Background*

One of the most important *cultural factors* which affects economic development is that people in these countries believe in the possibility of improving lives by means of education. Some argue that traditional thought in Korea is an obstacle to industrialization, because it contains an anti-industrial element in its thought in that it tends to belittle activities related to practical and economic matters. But anti-industrialism can be found in traditional thought, in every culture, including Western thought. The crucial question is whether traditional culture can adapt itself to industrialization and motivate and encourage people to pursue industrial activities. Although traditional thought in East Asian countries did not initiate the idea of industrialization, it does seem to contain in its basic thought those elements which are favorable to industrial development — respect for rationalism and pragmatism to achieve better lives by opposing fatalism.

Illiteracy rate in Korea is extremely low due to compulsory elementary education. Since the 1950s, the secondary and higher

education have been so extended to the populace that the average education level of the Korean people reached that of the most advanced countries, according to 1984 statistics of the World Bank.

C. Government as Innovator

Economic development especially in underdeveloped countries, cannot be accomplished without the leadership of development-oriented innovators⁵ who combines whatever natural resources that are available and make effective use of the cultural tradition. In Korea, Taiwan, and Japan, the government as one of these innovators, has played an active role in accomplishing late-comer's accelerated development. The expression "developmental state", which is used by Chalmers Johnson to describe the role of government of Japan, aptly characterizes the role of the Korean or Taiwanese governments as well. He argues that in Western countries, private entrepreneurs play a major role in economic development and government only regulate private economic activities,⁶ while the Japanese government plays a leading role in economic development and planning. He characterizes the Korean economic system as authoritarian capitalism, like that of Latin American countries. One may doubt as I do whether this characterization of the Korean system is valid, but at any rate it is undeniable that the role of Korean government since the 1960s has been development-oriented.

Since 1962, the Korean government has placed economic growth as the first national priority, and tried to eliminate all factors which were not conducive to economic growth. Its economic plans which have since been adopted by the Korean government, are, in all intent and purposes, meant to be carried out, and the extent of the power which the government exercised in implementing these plans might have easily been by far the most powerful in the free world. To achieve this planned goals, the central government took a wide range of measures, including price and non-price mechanisms such as control and "moral suasion." The industrial policies of the Korean government were even more forceful than those of the Japanese government which was regarded as its model.

The fact that the role of the government in Korea has been stronger than in Japan or in Taiwan may reflect that the aspiration of development in Korea has been stronger than in either of the two

⁵This idea corresponds to the Schumpeterian view of economic development.

⁶Johnson calls this type of state as "regulatory state".

countries, by virtue of the fact that the initial conditions of development for Korea were least favorable among the three countries.

The Taiwanese government has also been development-oriented. Its policies have focused on rapid growth, even though its policy objectives and methods were quite different from those of the Korean government. Since the leadership of Prime Minister Yoshida, the "development state" of Japan contributed much to bring about the Japanese miracle, through its unique organization and relation with the private sector.

D. The International Environment

For the past four decades, the international environment maintaining the system of free trade has been favorable to the development of Korea, Taiwan, and Japan. Without these favorable international relations, these countries with huge labor surplus would have faced bottlenecks with respect to both demand and supply of manufactured goods. On the supply side, the bottlenecks would have been the shortage of capital and resources and the low level of technology. On the demand side, economic activities would have been limited by the narrow domestic market.

For example, were it not for the favorable international environment, the shortage of capital could be overcome only after a long period of saving out of a country's own income. Technology could progress only after a long period of learning and practice. The shortage of resources could be compensated for only by exporting domestic surplus products, usually primary products. If Korea and Taiwan, and to a lesser extent, Japan, have been forced to develop their economies in isolation from the rest of the world, they would have encountered insurmountable difficulties.

Historically, late-comers in industrialization have enjoyed late-comer's advantage in making use of technological backlog which they take over from the advanced countries. In the 19th century, Germany, Japan, and Russia enjoyed such benefits, accelerating their rate of growth. The similar late-comer's accelerated growth was experienced by the post-W. W. II developing countries, such as Korea, Taiwan, Brazil (1967-74), and Mexico (1960s), but their rates of growth have been much more accelerated than the earlier prototypes, thanks to the much more favorable international environments during the post-W. W. II era than in the 19th century. The technology and capital have been much more readily available,

and overseas market has been much more easily accessible today than in the 19th century.

From the 1960s, Korea and Taiwan absorbed capital and technology from advanced countries such as the United States and Japan, and exported manufacturing goods by processing imported materials to the United States and European countries. The geographical proximity to Japan gave Korea and Taiwan the advantage of overcoming bottlenecks on the supply side, and easy access to huge markets in the United States removed obstacles on the demand side. In other words, the accelerated growth of Korea and Taiwan is an outcome of the post-war international economic order, which has favored the expansion of the Pacific economic basin.

The process of Japanese economic development was not entirely same as that of Korea or Taiwan, in that Japan's rapid growth owed less to imported capital and technology than for either country. Nevertheless, the gap of technology between Japan and the U.S. during the 1950s and the 1960s was enormous, and Japan could enjoy the benefits of late-comers by introducing and imitating technology developed in the U.S. Thus, Japan's double-digit growth in 1955-70 can be explained in terms of a accelerated process similar to that of Korea and Taiwan.

The accelerated growth required an export market, because a narrow domestic market could not absorb the ever-increasing supply. In this light, the accelerated growth is an *extensive* or *outward-looking* pattern of growth in which the mass production system utilizing imported capital and technology can not but depend on the export market. A successful export-driven growth can easily achieve trade surpluses, as the Taiwanese experience showed. In comparison with Taiwan, the surplus in Korea was delayed for more than ten years. Another result of accelerated growth was that saving exceeded investment as the average propensity to consume decreased due to the rapid increase in income. Thus, an accelerated growth, when successful, tends to bring forth a disequilibrium characterized by international balance of payment surpluses and by saving rates in excess of investment rates.

IV. Accelerated Growth and Unbalanced Economic Structure

In the process of accelerated growth, the Korean economy exhibited many structural features which are different from the

Taiwanese and Japanese economies. The structural uniqueness stemmed mainly from the development-oriented government policy, although the natural and cultural conditions mentioned in the third section exerted an indirect influence on the growth pattern.

The ultimate aim of the first four Five-Year Development Plans was "the achievement of a self-sustained economy," and the major policy strategy can be summarized as follows:

- 1) All resources should be used to develop the national economy through industrialization. Industrialization should proceed from light industry in the early stage and then on to heavy industry.
- 2) Economic development will be achieved under the control and leadership of government. In each Five-Year Plan the government announces the major goals of economic policy, including the establishment of social overhead capital and the targets for private sector.
- 3) In principle, firms are privately owned and managed, but the government participates in the determination and operation of major investment projects. The government also helps build key industries, especially heavy industries.
- 4) To meet the amount of necessary investment, foreign capital will be induced. To repay foreign loan and increase income and employment, exports should be promoted.
- 5) The first priority of policies should be placed on growth, and equal distribution of wealth or income and balanced development across industries or regions are secondary goals. Some side-effects, like inflation, can be acceptable.

Although official documents of the Five-Year Plans do not describe the main strategy in so many words, it would appear that the actual goals of economic policies in the 1960s and 1970s closely followed the above five points.

A. Industrialization

From 1961, the Korean government launched many ambitious programs for economic development. The programs, most of which consisted of projects involving inflationary financing and waste of resources, ended in failure. However, the government was astute enough to recognize the need for more austere policies to check

inflation and economize foreign exchange, and it reintroduced the financial stabilization program which it had discarded against the advice of the foreign aid agencies. The government now adopted a few important liberalization policies with respect to exchange rate, bank loan rates and foreign capital inducement. These policies proved to be more or less appropriate at the time; investment and exports increased enormously.

In its Five-Year Plans, the government made much of "fostering agriculture" or "keeping the balance between agriculture and manufacture", but actual investment in agriculture fell short of planned levels. Prices of agricultural products were kept at a fairly low level until 1963, and the "price support policy" which was introduced in 1969 did not have much impact on agricultural development. Neither did the "Saemaul (new village) movement" which began in 1970 contribute, from long run point of view, to agricultural development.

Planning agencies in government did not actually regard agriculture as a key industry, since its potential for development was limited. The major emphasis of agricultural policy was placed on maintaining stable supply of food while the economic aspects of farming was more or less ignored. This resulted in increased agricultural production, which failed to improve poor economic conditions in rural regions.

The Korean government was concerned mainly with industrialization. To achieve this goal, government invested in social overhead capital to help private firms develop export and import substitution industries.

B. Government Leadership

The Korean government took the lead in launching development efforts, as did many other governments in early stages of industrialization because of the lack of risk-bearing entrepreneurs. The scope and intensity of government involvement can hardly be found in other countries.

The Korean government has had enormous centralized power. The pattern of centralization of power could be characterized by what Alexis de Tocqueville called "centralization in government" and "centralization in administration."⁷ The former refers to the extent

⁷Alexis de Tocqueville (1835, Chapter 5).

to which the central government assumes necessary power to govern a country, such as enacting a law and making a diplomatic policy, whereas the latter refers to the extent to which it intervenes in local affairs, such as disputes among regions and interest groups. The Korean government had both powers combined; it is certainly one of the most centralized government in the world.

To examine the role of the Korean government in the 1960s and the 1970s, one may divide the organization of central government into two parts. One is the power elite, which is composed of the president and his staff, such as the Task-Force for Developing Heavy Industry founded in 1976. The other consists of technocrats and bureaucrats who carried out orders from above. It was the power elite who established development strategy and made final decisions on important issues; whereas it was bureaucrats who devised and carried out specific measures to implement the decision made by the power elite.

From the 1960s, the power of central government grew steadily, not only because the power elite pressed for acceleration of economic growth with a view to legitimize the authoritarian rule, but also because the bureaucrats made extraordinarily zealous efforts to carry out, and in many cases, overfulfil the planned goals. The centralization of power in Korea was much stronger than that in Japan or in Taiwan, where the "centralization in administration" developed to a lesser extent.

In Korea, the central government intervened in ordinary business activities, including credit, finance, labor unions, foreign loans, business association, and even business management. It was vested with extra-legal powers to appoint the important personnel for public and private organizations, including most financial institutions.

The fact that the central government was unusually strong in Korea and that it exercised near-absolute power in carrying out development strategy reflects the impatience on the part of the people at the poverty and inefficiency to which they were accustomed. As Alexander Gerschenkron pointed out, the backwardness of a developing economy determines not only the speed of economic growth, but also the institution and ideology in that economy. Generally speaking, it seems that the more backward the initial conditions of the economy, the stronger the yearning of the people for development, and the greater the extent of the power they are willing to accord to the government.

As de Tocqueville admitted, a strong government might be condu-

cive to economic development in the early stage of industrialization. The strong Korean government did contribute to development, particularly at the initial stage of development, but, like all other strong governments in the world, it did its own share of irrational decision-making and waste of resources.

C. Support of Large Corporations

The Korean government tried to develop the economy by establishing large conglomerates called "Chaebol". In the 1960s, this did not lead to a serious problem, because primarily light industries were developed at that time, and the amount of government supported investment was relatively small. However the political and economic development since October 1972 proved decisively favorable to great leap-forward of Chaebols. The incumbent president instituted the so-called Yushin (or Revitalization) constitutional amendment, which accorded him with lifetime tenure of office. In order to legitimize the coup, and to placate the public for the "partial loss" of civil liberty, it was deemed necessary to accelerate still further the economic development. The means chosen to implement this aim were export drive and build-up of heavy/chemical industries.

Korea had already instituted nearly all measures available for stimulating exports, but the government took one more step; establishment of "general trading companies" in 1976, modeled after those of Japan. About ten large corporations were chosen, and they were given a variety of incentives to increase the volume of exports. The government had already launched an ambitious program of establishing heavy/chemical industries, and those enterprises which were called upon to take major parts in the designated investments were those designated as trading companies. To accelerate the rate of investment, the Korean government took the risk associated with large investments, by letting banks give credit to investing companies, guaranteeing foreign loans, and sometimes bailing out the bankrupt companies. Under this system, the owners of the private companies could get more returns at less risks, as they invested more. As is generally known, the major parts of the heavy/chemical projects ended up with failure, but ironically, the Chaebols emerged out of the overall lack of success, were vastly strengthened physically and financially.

The support of large corporations helped the Chaebol to grow in

a short period to be one of the largest business groups in the world. The status of large business groups can be measured by two indices. One is their market share in a specific market, and the other their share of production in a specific industry. It is quite certain that by either standard the economic power of Korea's Chaebol is much stronger than that of business groups in Japan or Taiwan,⁸ even though studies on monopolies and economic dominance of business groups are rare.

According to the World Bank, monopolies and oligopolies were more prevalent in Korea than in Japan or Taiwan, and this prevalence continued at least up to 1982.⁹ A good indication of the economic dominance of Korea's Chaebol is that Korea's fourth largest Chaebol is larger than the ten largest corporations of Taiwan together.¹⁰ According to *Fortune*, the nine largest business groups of Korea are among the world's 500 largest groups, and eight of them are among the ten largest groups in developing countries.

In the 1970s, large business groups in Korea occupied the dominant position not only in manufacturing and construction but also in the service industries such as trade, finance, real estate, transportation, hotel business, and sales. In the 1970s, the number of companies belonging to Korea's 30 largest business groups increased from 126 in 1970 to 429 in 1979.

Furthermore, as government took the investment risks for large business groups, these groups were able to expand their activities to *all* fields, because they had advantages in acquiring factors of production such as credit and skilled man-power, as well as monopolistic power in the market.

To counter the impact of the enormous expansion of large business groups, the Korean government tried to support small- and medium-scale companies.

As early as the early 1960s, the government showed its awareness of the importance of encouraging small business, as exemplified by the establishment of the Bank for Small and Medium Companies in 1961 and the support of export by small businesses in 1963. However, the policies in the 1960s failed to live up to the spirit of the declared purpose; the small business were encouraged mainly to support export drive, rather than to support small business as such.

⁸For example, see Lee (1985).

⁹World Bank (1987, p. 30).

¹⁰Scitovsky (1986, p. 154).

As heavy industries were developed in the 1970s, the government began to recognize the importance of the role of small and medium companies as suppliers of parts and intermediate goods for large companies. Since 1973, vertical alignment of the production structure has been emphasized. In 1975, the Law for the Vertical Alignment of Small and Medium Companies was enacted to encourage technical cooperation between small and large companies. In 1978, Law of Business Adjustment of Small Companies was enacted, prohibiting large companies from entering into business areas set aside for small companies. Throughout the 1970s, government tried to support small companies, both by extending credit to them and by limiting the entrance of large companies. But this policy line was in direct contradiction to the more fundamental policies of supporting heavy/chemical industries and of export drive, and as a consequence the small business policy received hardly anything more than lip services. Thus the small and medium enterprises in Korea have not been able to pull themselves out of the vastly disadvantageous positions. The cooperation between small and large companies has not developed as much as desirable, because small companies prefer producing final products for themselves, and large companies prefer having their own firms to produce parts and components, rather than depending on other companies.

Since the early 1980s, the lack of alignment has been perceived as one of major weaknesses in the Korean economy. To overcome this, the government enacted the Law for Government Purchase of Products of Small Companies in 1981 and the Law for Fostering Small and Medium Companies in 1982 to facilitate their modernization and cooperation. In 1986, the Law for Supporting Establishment of Small Business and the Law for Industrial Development were passed.

D. International Relations

The Korean economic growth owes much to imports of foreign capital and technology. In the 1960s, the share of foreign loans in total investment has been fairly large. During the First and the Second Five-Year Plan periods, the government made all-out efforts to induce foreign capital, and the actual amount of foreign loans surpassed the planned amount.

A favorite point made by commentators on the Korean economy is that the Korean trade policy has lived up to the principle of free

trade and that the success of the Korean economy lies in the development of its export industry according to comparative advantage. The second proposition of the argument seems nearer to the truth than the first, which is certainly wide of the mark. In as much as the Korean government was powerless in intervening with prices in international market, it certainly did observe the price mechanism, but it certainly did not refrain from intervening in domestic prices. It tried to lessen export costs by subsidies, and prohibit selectively the import of foreign goods. To protect domestic industries, it prohibited the imports of final products, and encouraged the imports of intermediate products and facilities for exports or for import-substitution. As the negative system was introduced in 1967, import liberalization was partly put into operation, but it basically aimed at the "liberalization" of imports of facilities for exports or for import-substitution. In 1970, the speed of liberalization was slowed down to protect the domestic market for heavy industrial products. It was not until the 1980s that liberalization began to be carried out for its own sake. In this light, the mercantilistic trade policy of the 1960s and the 1970s should be understood as one aspect of Korean's strategies for accelerated growth.

E. Inflation and Unequal Distribution

Unlike the Japanese and Taiwanese economies, the Korean economy experienced inflation in the 1960s and the 1970s. It was mainly a result of the pursuit of "growth-first policy" in Korea. The inflationary pressure due to "forced growth"¹¹ was regulated directly by the Korean government. The Korean government in the 1960s and 1970s had all available powers to check inflation. It had the power to impose ceiling on bank credit for each and every bank. It had near total control over wage rates. Furthermore, it had direct control over all prices, except for the most competitive prices. It had enough power to "overkill" inflation. The sole reason why it failed to contain inflationary pressure was because control of inflation ran counter to the primary goal of accelerated growth. The government encouraged exports, investments in heavy/chemical industries, and resorted to direct control over the inflationary pressure created by the growth policy. The result was that the process of inflation was marked by fits and starts — the government made spor-

¹¹Scitovsky coined this term. *ibid.*

adic efforts to contain what was uncontainable.

Many development economists believe that income in Korea was fairly equally distributed in comparison with other underdeveloped countries (except Taiwan). One study¹² reported that the degree of equality in Korea worsened up to 1982, but since then it has been improving.

Certainly, there have been powerful forces at work to check the worsening of income distribution; there are good reasons to believe that as far as the flow of income is concerned, the Korean distribution is better than in most other developing countries. One reason is that the real wage rates in Korea have been increasing almost as fast as the increase in productivity of labor and the second reason is that in spite of the rapid increase in real wage rates, increase in employment has been absorbing the potential labor force fairly rapidly. These two trends are believed to have checked the worsening of inequality in income distribution. However, there have been prevalent forces working for income inequality; such as very regressive tax system, moribund inheritance tax, support of unprofitable enterprises, weak enforcement of Fair Trading Act, weak trade unions, and the extremely rapid growth of conglomerates. All in all, the policies aimed at reducing income inequality are only conspicuous by their absence, and one has to be wildly imaginative to believe that there have been a self-correcting mechanism at work to reduce income inequality in Korea.

Furthermore, one has to take into consideration the distribution of stock of wealth. In Korea, inequality becomes very conspicuous. We have seen in the preceding paragraphs that there emerged in Korea groups of large conglomerates largely controlled and owned by the "owners" and their families, and the distribution of personal wealth in Korea, if it can be accurately measured, would be far from being equalized. One has to take into consideration the great increase in the price of land in recent years. The ownership of land in Korea is extremely concentrated, reflecting the extraordinarily strong predilection of the Koreans for land. The "capital gain" realized by the land owners from the price increase has been enormous.

V. Concluding Remarks

Can Korea continue the late-comer's accelerated growth? Korea is

¹²For example, see Choo (1979, 1982).

still a late-comer and there is still an enormous technological backlog that the country as a late-comer can make use of. For this reason, one may expect that Korea's growth will continue to be accelerated for, say, the remainder of this century.

The accelerated growth is essentially an extensive growth, in the course of which the sources of intensive growth will have to be laid. Otherwise, the growth will have to slow down as the sources of accelerated growth peter out. It would appear that the sources of accelerated growth in Korea — such as the low wage rates, great technological backlog, the strong authoritarian government — are fast petering out, while the sources of intensive growth have yet to take root. Wages have gone up, and productivity is sagging. The labor as a whole is visibly relaxing their work, and the business firms are visibly less intent on investing.

The manufacturing industries of the country is dependent heavily on imported technology; home-grown technology is still scarce. The country does export electronics goods, automobiles, and other technology intensive goods, but many of these export items rest upon imported parts and components.

The kind of technology which the country needs for achieving intensive growth will have to be different from the technology imported in the past. So far, the imported technology consisted mostly of those which are needed for mass-producing standardized goods, but technological development in the future should ramify itself to many diverse areas, in order to cater for the increasingly diversifying demand for differentiated goods. These technologies will have to be home supplied as much as they are imported and innovations should be encouraged in all fields.

The ways in which technological development takes place are not independent of the structure of industries, and the style of management of the firms. In Korea, the small and medium-sized firms are extremely weak, and unless they are strengthened, the intensive growth of the economy will be difficult to achieve. Furthermore, the ownership of the firms should become diversified and the style of management should be made in such a way as to stimulate innovations in all echelons of the firms.

The development of domestic and international situation for the last several years pose serious challenges to the Korean economy. Domestically the country has to achieve democratic order and internationally the country has to adjust itself to the shifting comparative advantage. The Korean economy has to "restructure" itself ex-

tensively to cultivate new sources of intensive growth. As long as the business, the government and the people in general neglect the restructuring, the dynamism of growth will be lost.

Economists not only in Korea but around the world are now waiting to see whether the Korean economy will succeed in shifting from the path of late-comer's accelerated growth to the more normal track of balanced development.

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