

# Korea's Economic Growth

Youngsun Koh

September 2017

Korea's Leading Think Tank





# **C O N T E N T S**

**1. The Korean Miracle**

**2. Enabling Factors**

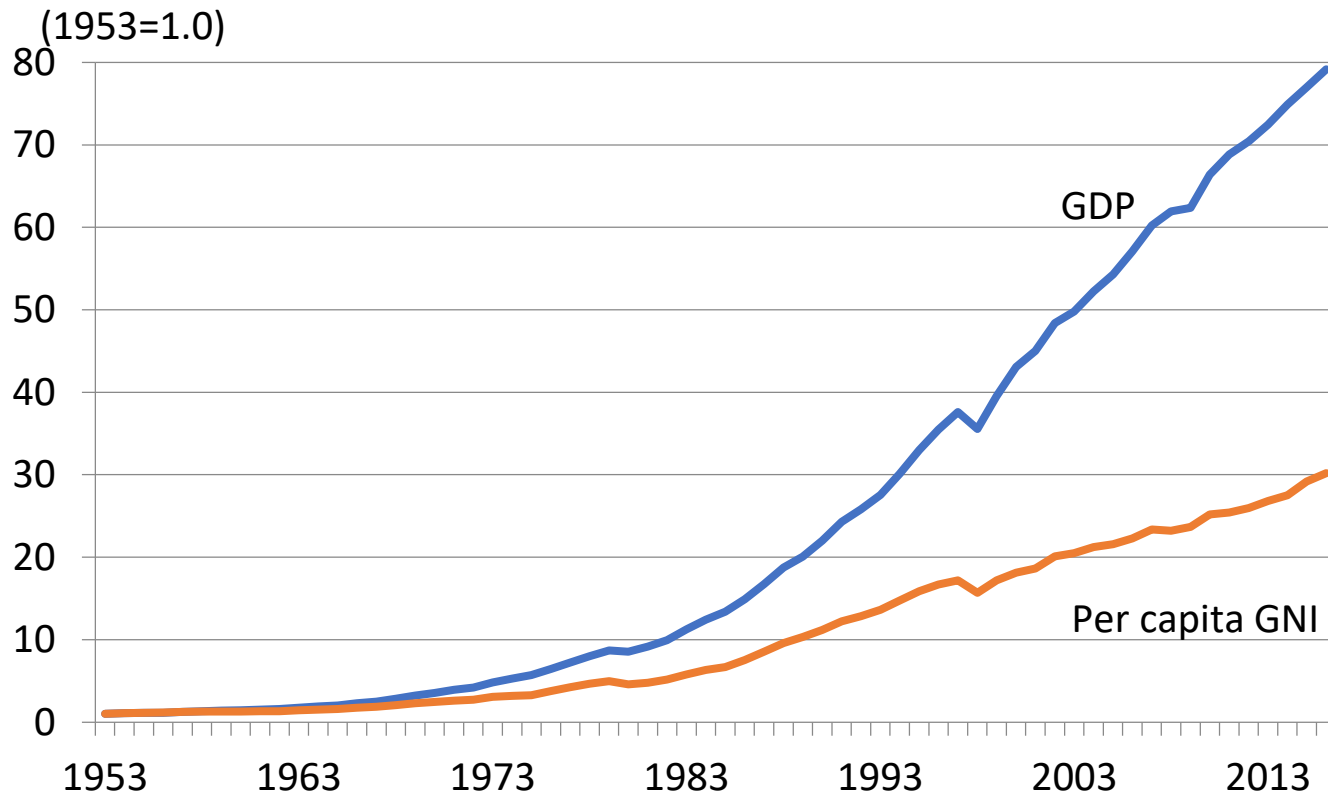
**3. The Other Side of the Miracle**



# **The Korean Miracle**

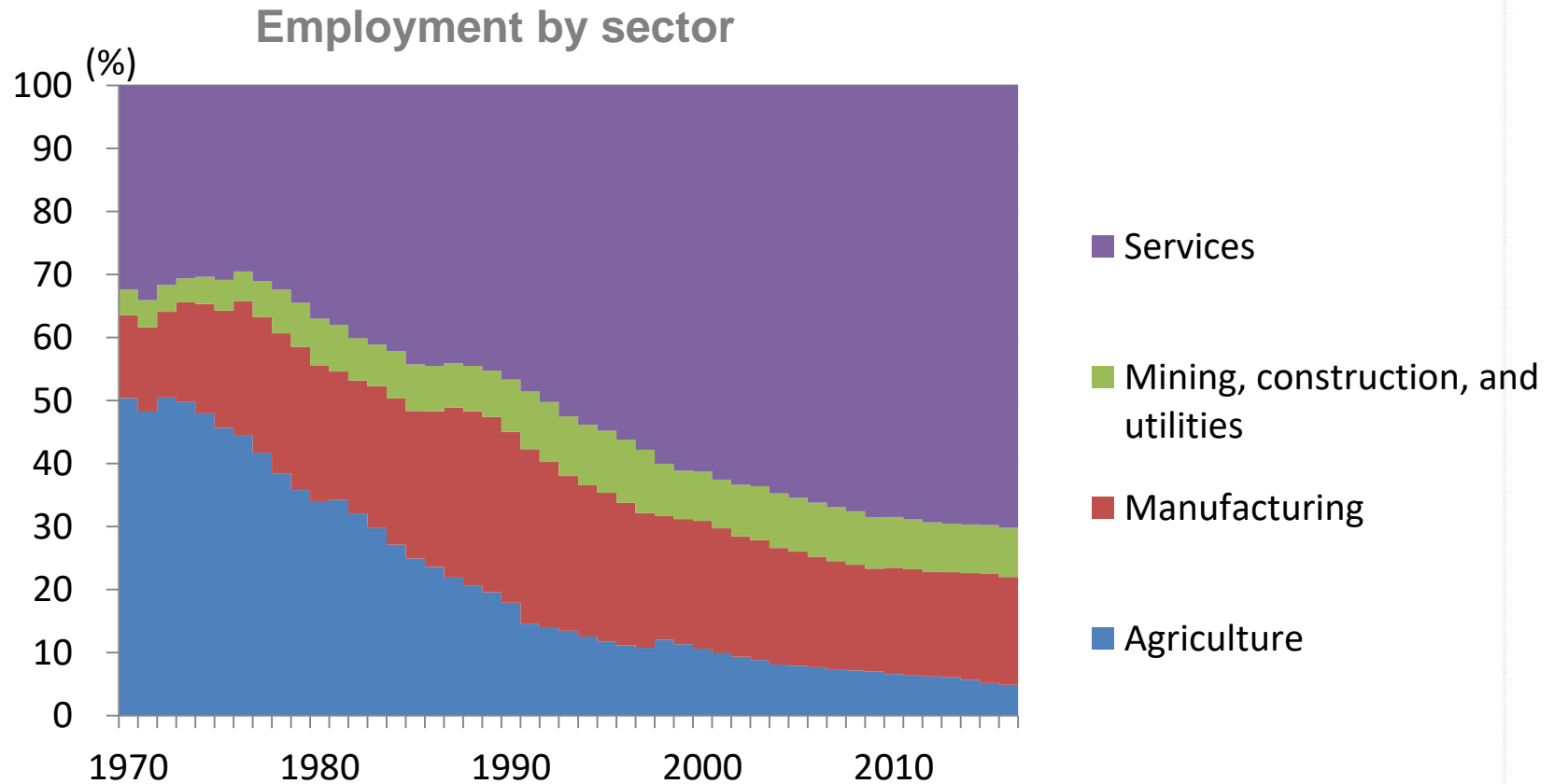
# Rapid economic growth

- *Size of the economy (GDP) has grown 80 times and per capita income (GNI) 30 times in 1953-2016 in real terms.*
- *(2016 GDP) USD 1,411 billion; (2016 per capita GNI) USD 27,561*



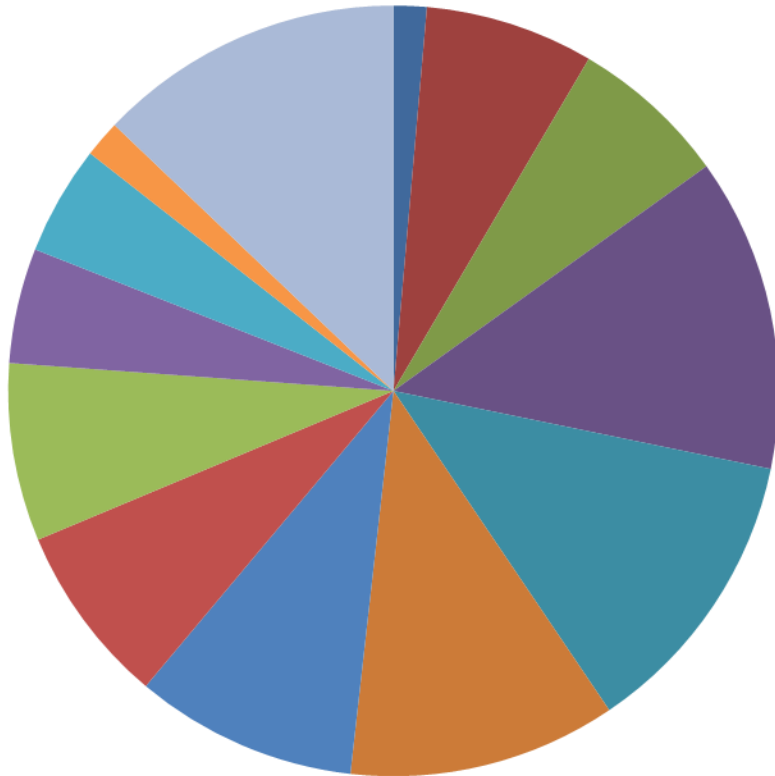
## ■ Industrialization

- *From a predominantly agrarian economy to an industrial one*



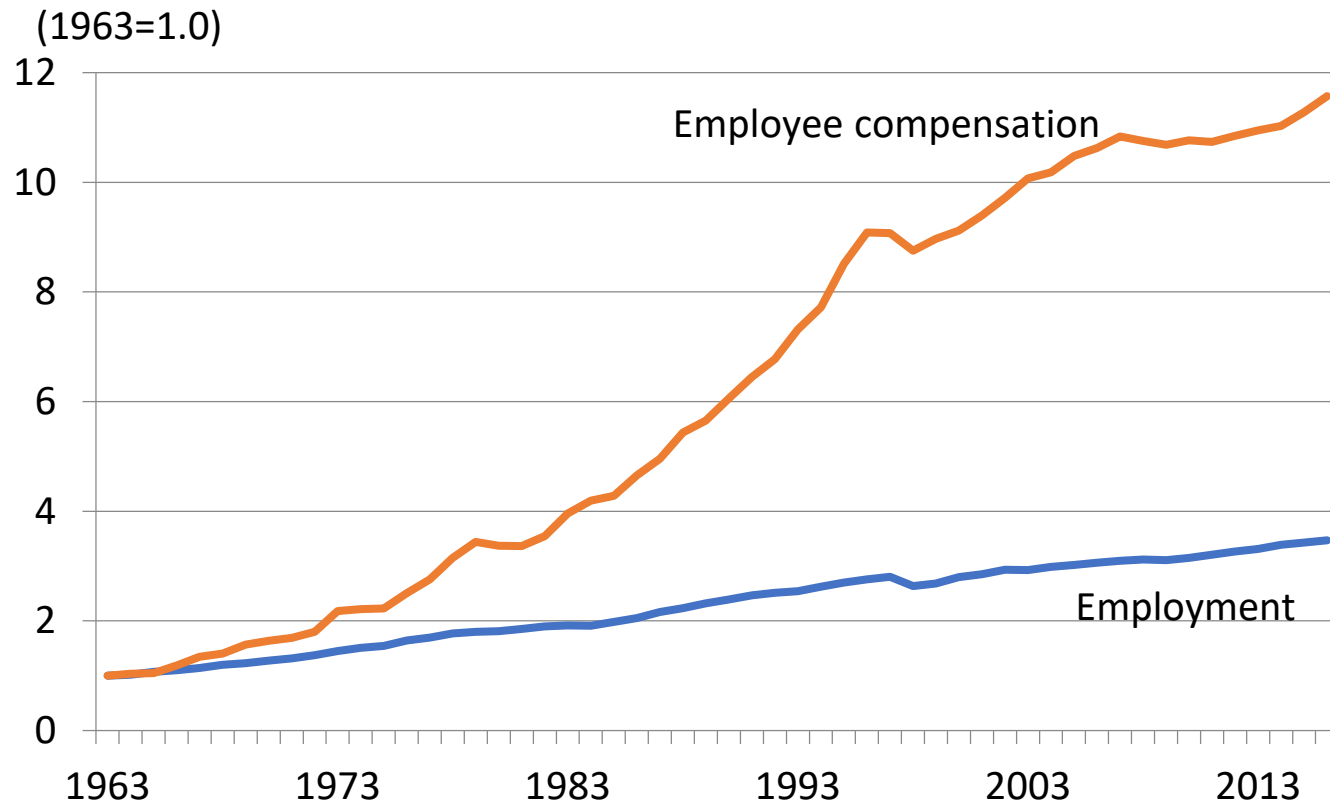
## ■ *Export diversification*

Export composition (2016)



- Food and other consumption goods (1%)
  - Basic materials and fuel (7%)
  - Light manufactures (7%)
  - Semi-conductors (13%)
  - Machinery and precision tools (12%)
  - Chemical products (11%)
  - Passenger cars (9%)
  - Iron and steel (8%)
  - ICT products (7%)
  - Ships (5%)
  - Car parts and components (5%)
  - Home appliances (2%)
  - Other heavy and chemical manufactures (13%)
- Heavy and chemical manufactures (85%)**

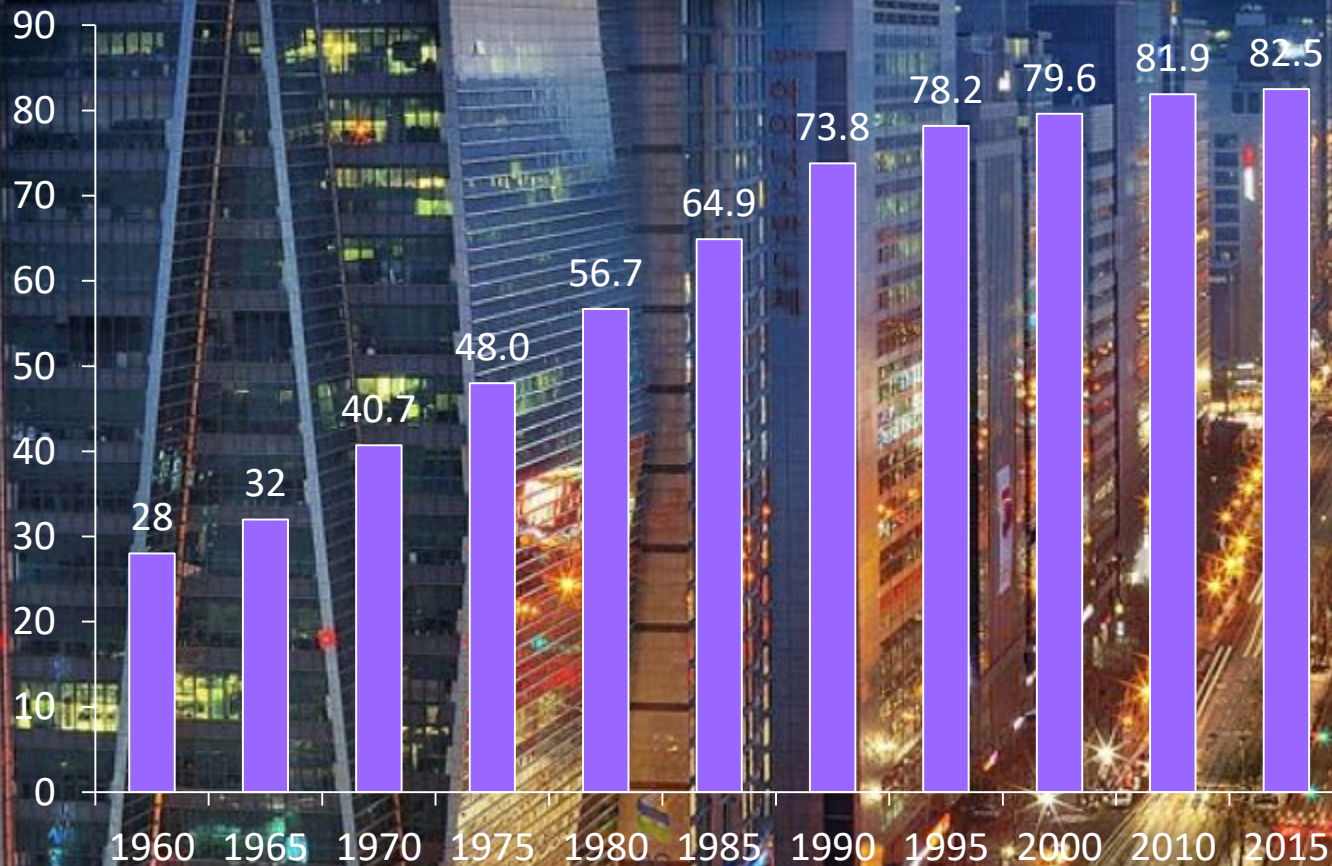
- *Total employment has grown 3.5 times in 1963-2016.*
- *Wages and salaries has increased 12 times.*



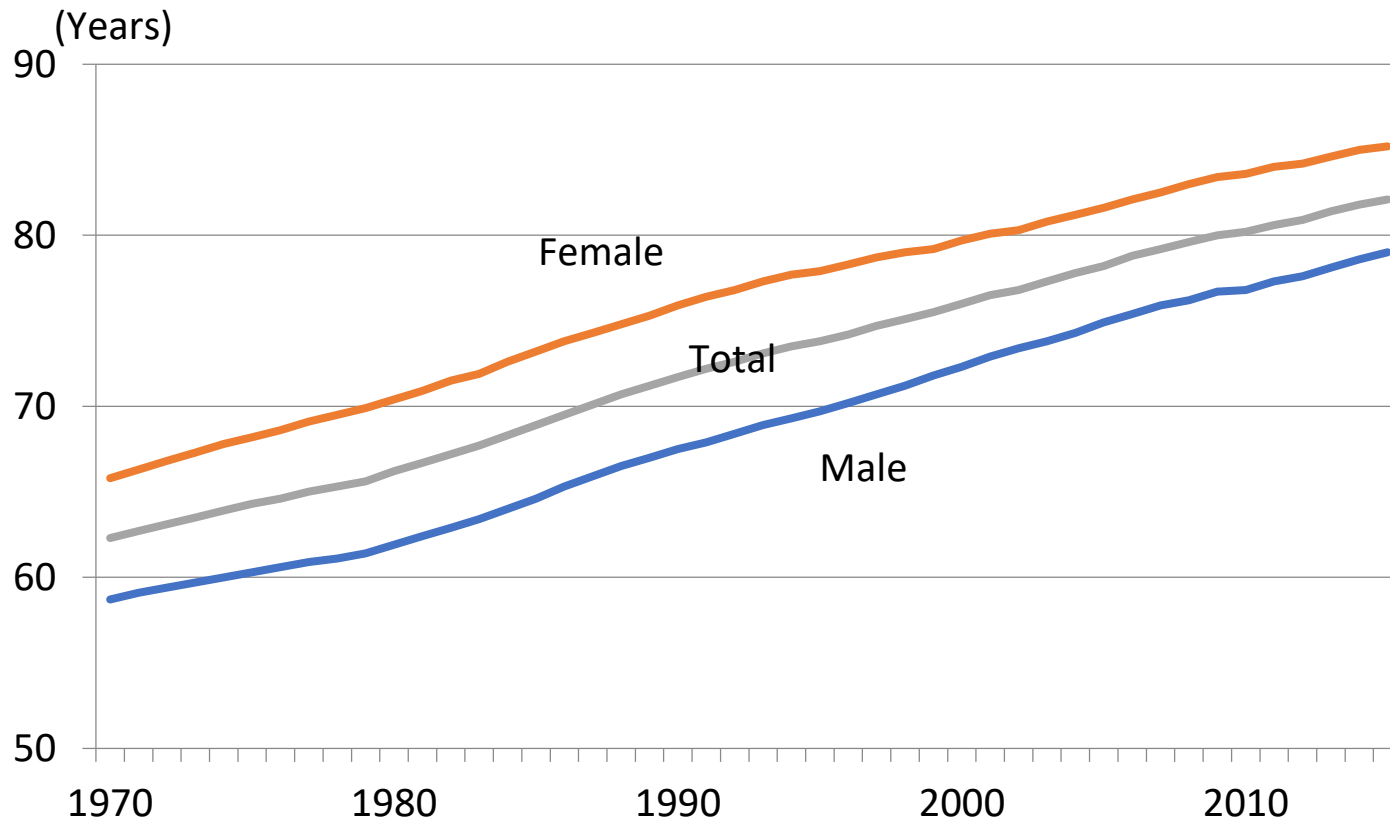
# Modernization

(% of total population)

Urban population

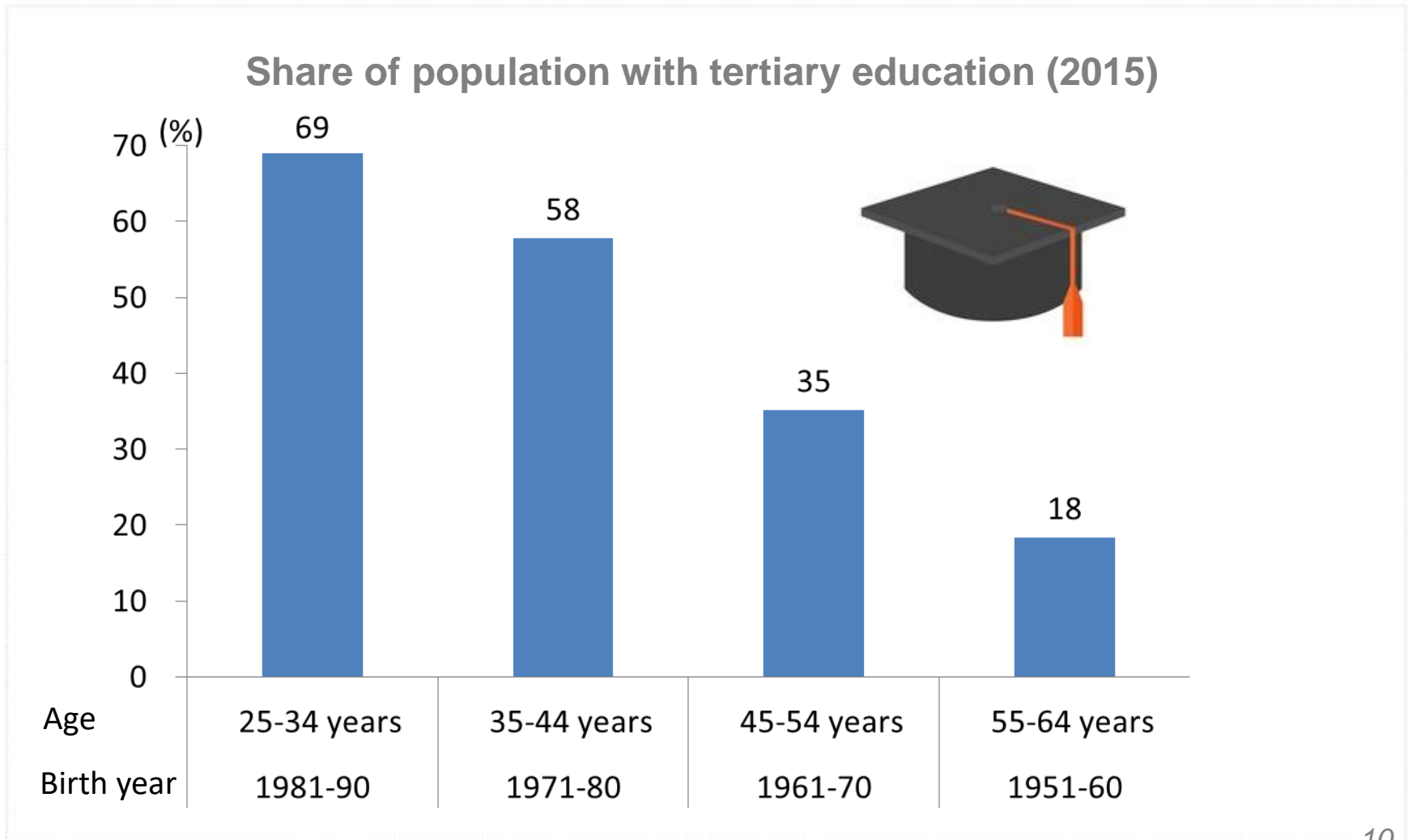


- *Life expectancy at birth: (1970) 62.3 → (2015) 82.1 years*
- *(Female) 65.8 → 85.2, (Male) 58.7 → 79.0 years*



## ■ Educational attainment

- *Almost 70% of those born in 1981-90 completed tertiary education while less than 20% of those born in 1951-60 did.*





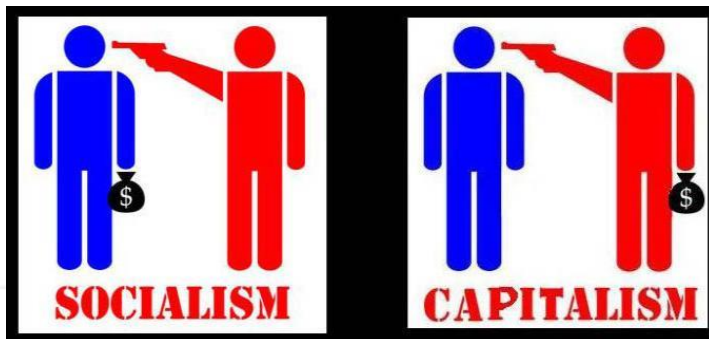
# Enabling Factors

# 1. Capitalism, from the beginning

## Capitalism vs socialism



**“Freedom in capitalist society always remains about the same as it was in the ancient Greek republics: freedom for the slave-owners.” - Vladimir Lenin**





**CAPITALISM**



**SOCIALISM**



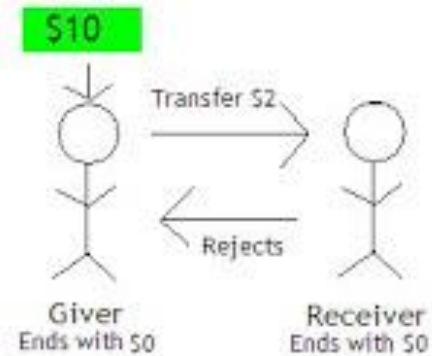
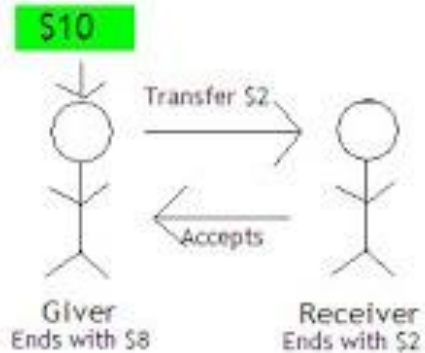
Capitalism works better than it sounds, while socialism sounds better than it works

Richard M Nixon

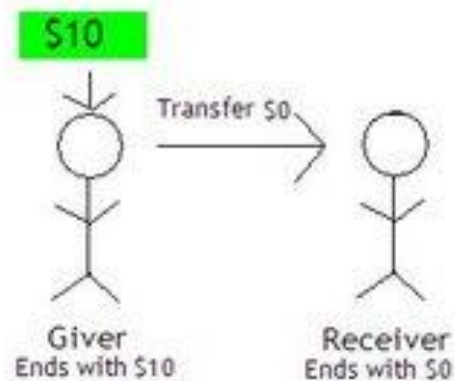
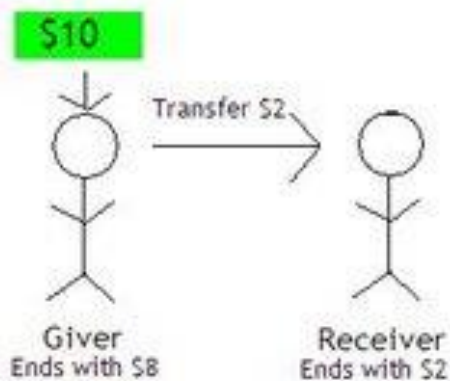
## ■ Why does socialism “sound” better?

- *Innate sense of fairness* (Pinker 2002)

### Ultimatum Game

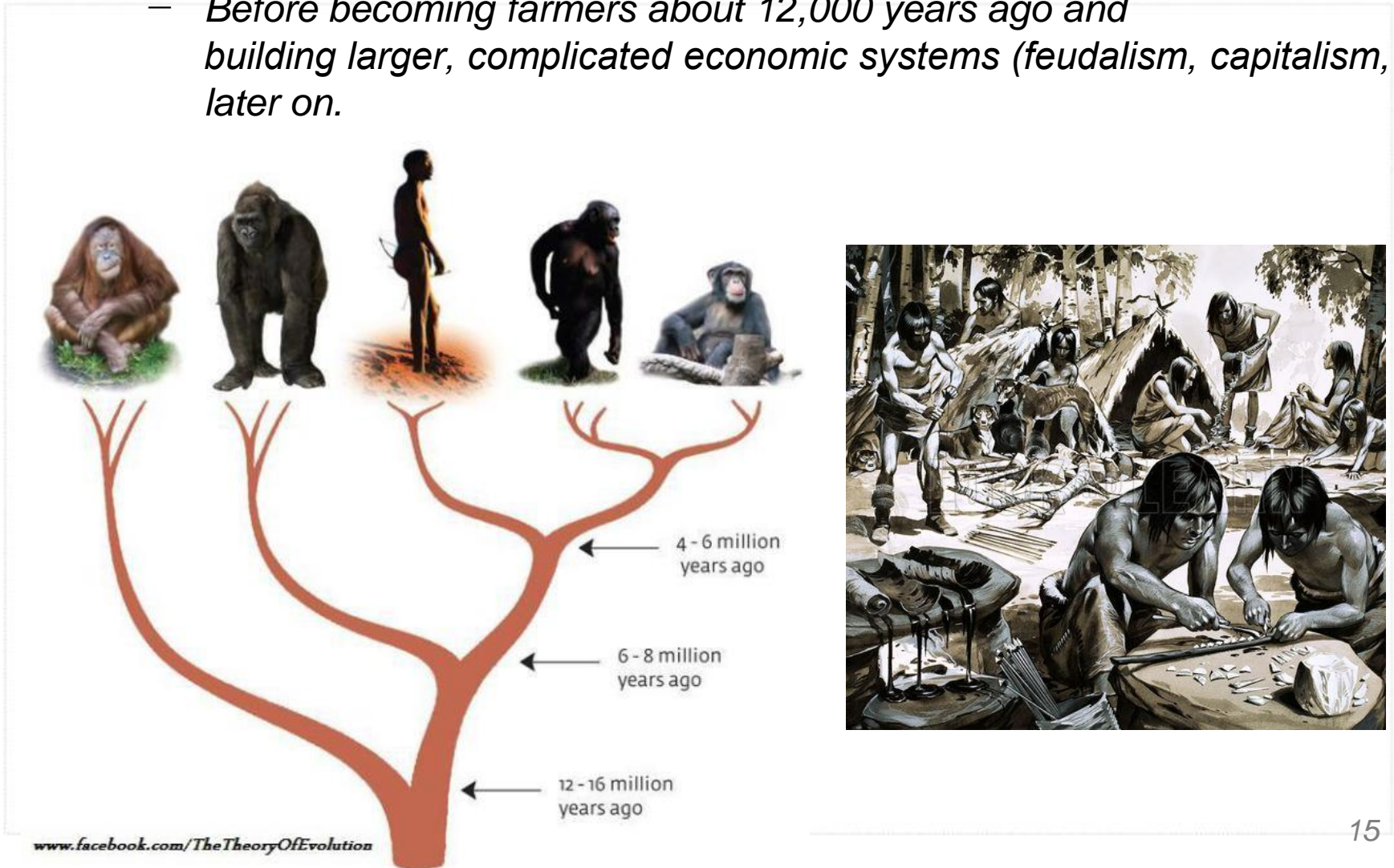


### Dictator Game



- *Several million years of evolution*

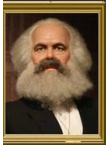
- *Living as hunter-gathers in small groups (primitive communism),*
- *Before becoming farmers about 12,000 years ago and building larger, complicated economic systems (feudalism, capitalism,...) later on.*



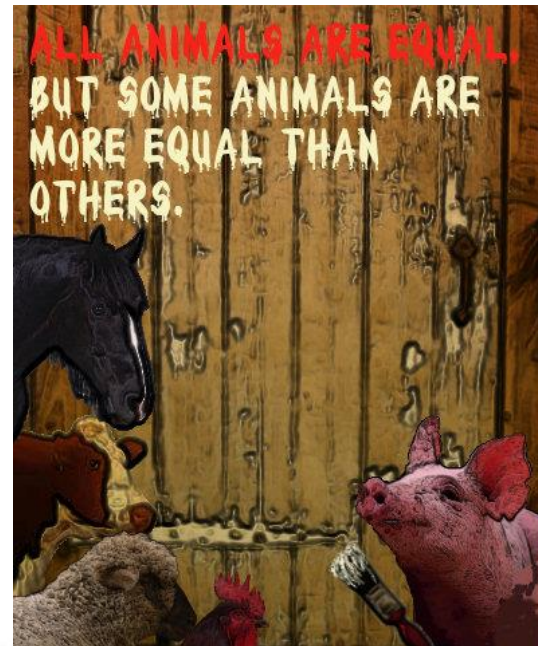
## ■ Why does capitalism “work” better?

- Human selfishness, again embedded in our evolutionary psychology (Double-Blind Dictator Game, Pinker 2002; “Selfish Gene”, Dawkins 1976)

FROM EACH,  
ACCORDING TO HIS  
ABILITY; TO EACH,  
ACCORDING TO HIS  
NEED.



**Karl Marx**  
Prussian-German philosopher  
(1818-1883)  
QuoteHD.com

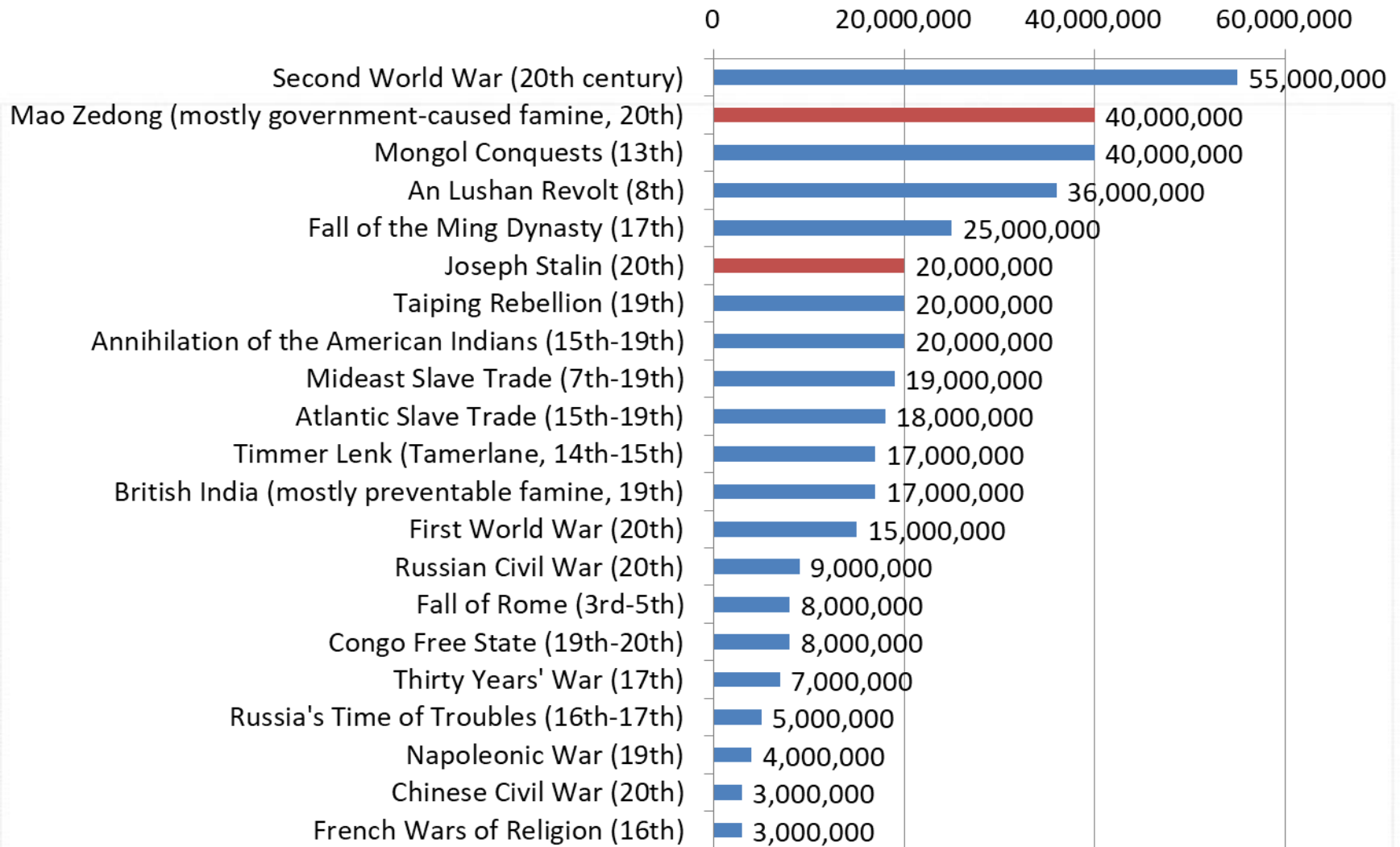


The problem with socialism is  
that you eventually run out of  
other people's money.

– Margaret Thatcher



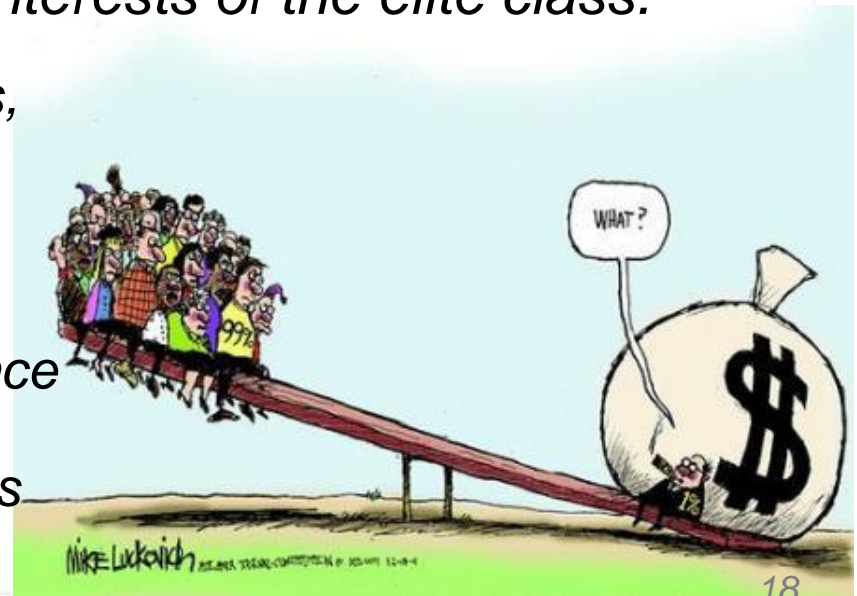
## The largest death tolls in history



Source: Pinker (2011).

## 2. Equal society and strong state

- *Belief in the equal opportunity for all creates strong incentives for productive economic activities.*
  - *Uneven distribution of opportunities, on the other hand, significantly reduces these incentives for both privileged and underprivileged.*
- *Concentration of economic power often produces a political system that mainly serves the interests of the elite class.*
  - *Elites, especially agrarian elites, may oppose modernization and industrialization (Moore 1966; Acemoglu and Robinson 2006).*
  - *The state may lack independence from the influence of elites and the capacity to enforce laws in the public interest.*



- *The Korean War (1950-53) and the Land Reform (1950-) are believed to have had an ‘equalizing effect’ in the Korean society, laying the basis for a broad-based economic growth.*
  - *Preceding these two events, the war effort during the last years of Japanese colonial rule might also have disproportionately affected the rich (Scheidel 2017).*
  - *No groups, including the much weakened agrarian elites, have registered visible resistance to the central government’s modernization campaign.*
- *Upon independence, Korea established a very effective machinery of government with a centralized system of administration, partly inherited from the colonial rulers.*
  - *Corruption was certainly prevalent in the early days, but the claims of ‘crony capitalism’ should be put into perspective as the government always had the upper hand against the business interests (“Embedded autonomy”, Evans 1995).*

■ Cf. *Oligarchs in Latin America* (Garcia 2017)

- Weak states and the omnipresence of oligarchs who infiltrate state and political institutions to protect their wealth
- Democratic deficit, whether as bureaucracies capable of enforcing the law, as taxation systems with redistributive goals, or as monopolisers of the use of force and control over the national territory
- Extreme inequality, which worsened with the implementation of neoliberal reforms in the 1980s and 1990s
- Questions of wealth redistribution such as policies of agrarian reform and progressive taxation often left out of political agenda due to the political pacts with oligarchs
- Populist leaders, who claim that they would curtail the influence of oligarchs, but who often undermine the principle of checks and balances and the rule of law, and increase social polarization

### 3. Spending for the future

- *Great importance was placed on education early on.*
  - *The government announced a six-year plan (1954-59) for full implementation of the compulsory primary education enrollment policy as mandated in the Constitution, supported by massive investment in schools and teachers.*
    - *Elementary school enrollments: (1954) 2.68 mil. → (1959) 3.56 mil.*
  - *A five-year plan (1954-58) to eradicate illiteracy was announced and a nation-wide effort was made to teach basic reading and math skills to the illiterate public.*
    - *Illiteracy rate: (1948) 78.2% → (1958) 4.1%*

An open-field classroom during the war



Illiteracy eradication movement



Too many students

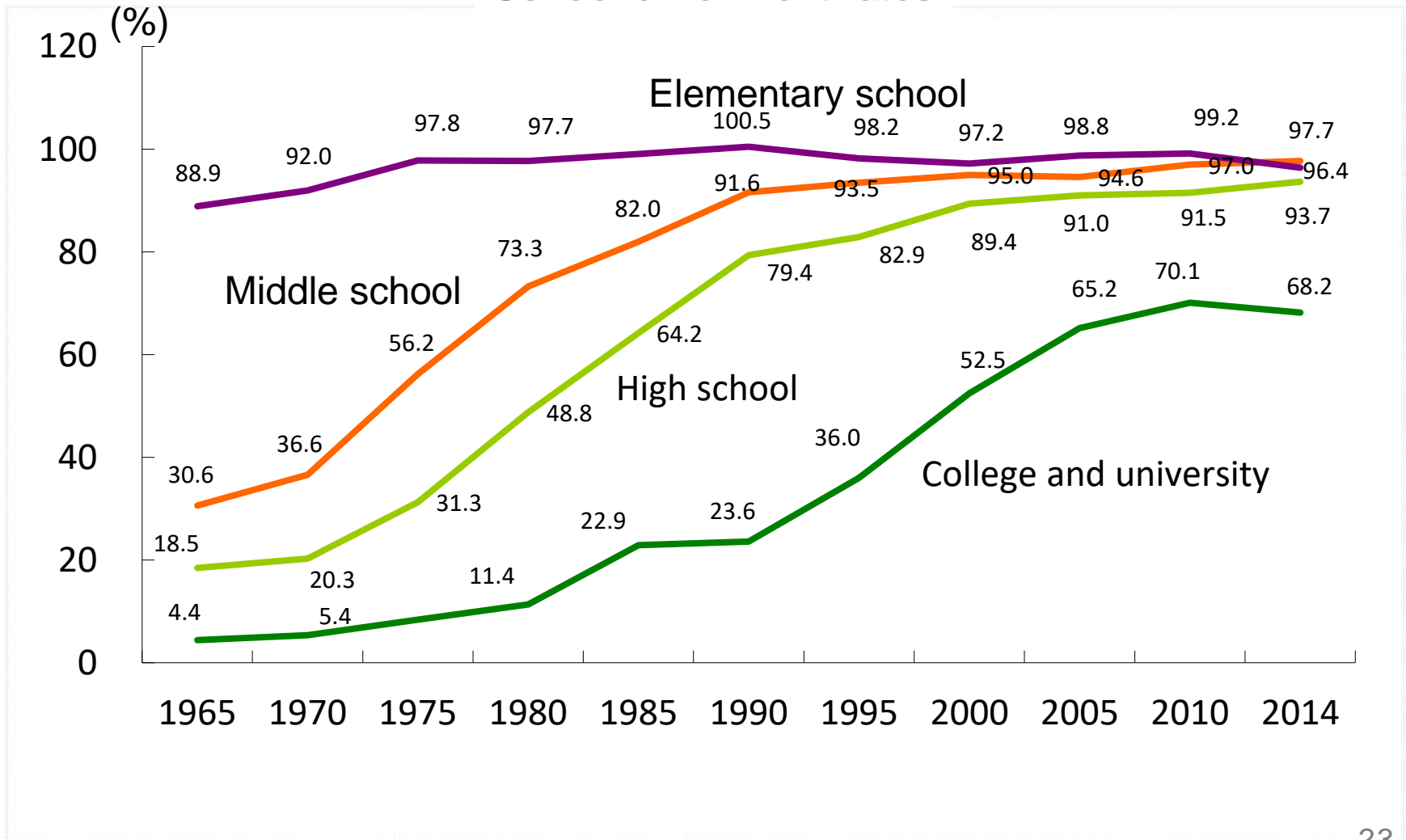


The only heating in the classroom



- Starting from the elementary education, emphasis moved on to the secondary and then to the tertiary education.

### School enrollment rates



- Public spending on education has taken up 4-5% of GDP and 15-20% of total spending.

- Another important area was economic affairs, which covers infrastructure investment.

- On the other hand, social protection was given a low priority, with public spending of only 1% of GDP in the 1970s.

### Functional classification of general government expenditure

(% of GDP)

	1970-79	1980-89	1990-99	2000-09	2010-15
General public services	2.8	3.1	3.4	5.1	5.0
Defense	4.5	4.3	2.7	2.4	2.7
Public order and safety	0.9	1.0	1.1	1.2	1.2
Economic affairs	5.2	4.2	5.2	7.0	5.7
Environmental protection	0.3	0.4	0.7	0.8	0.7
Housing and community amenities	1.2	1.1	1.2	1.1	1.0
Health	0.3	1.0	1.5	2.8	3.3
Recreation, culture and religion	0.2	0.3	0.4	0.6	0.6
Education	4.3	4.3	4.1	4.7	5.0
Social protection	1.0	1.9	2.8	3.8	5.1
Total	20.7	21.8	23.1	29.6	30.4

(% of total expenditure)

	1970-79	1980-89	1990-99	2000-09	2010-15
General public services	13.5	14.4	14.7	17.4	16.6
Defense	21.8	19.8	11.8	8.1	9.0
Public order and safety	4.2	4.8	4.9	4.0	3.9
Economic affairs	25.2	19.3	22.4	23.8	18.8
Environmental protection	1.4	2.0	2.9	2.8	2.3
Housing and community amenities	5.7	5.0	5.0	3.7	3.2
Health	1.5	4.7	6.6	9.4	11.0
Recreation, culture and religion	1.0	1.4	1.7	2.2	2.0
Education	20.7	19.9	17.7	15.8	16.4
Social protection	4.9	8.8	12.2	12.9	16.7
Total	100.0	100.0	100.0	100.0	100.0

■ *In many developing countries,*

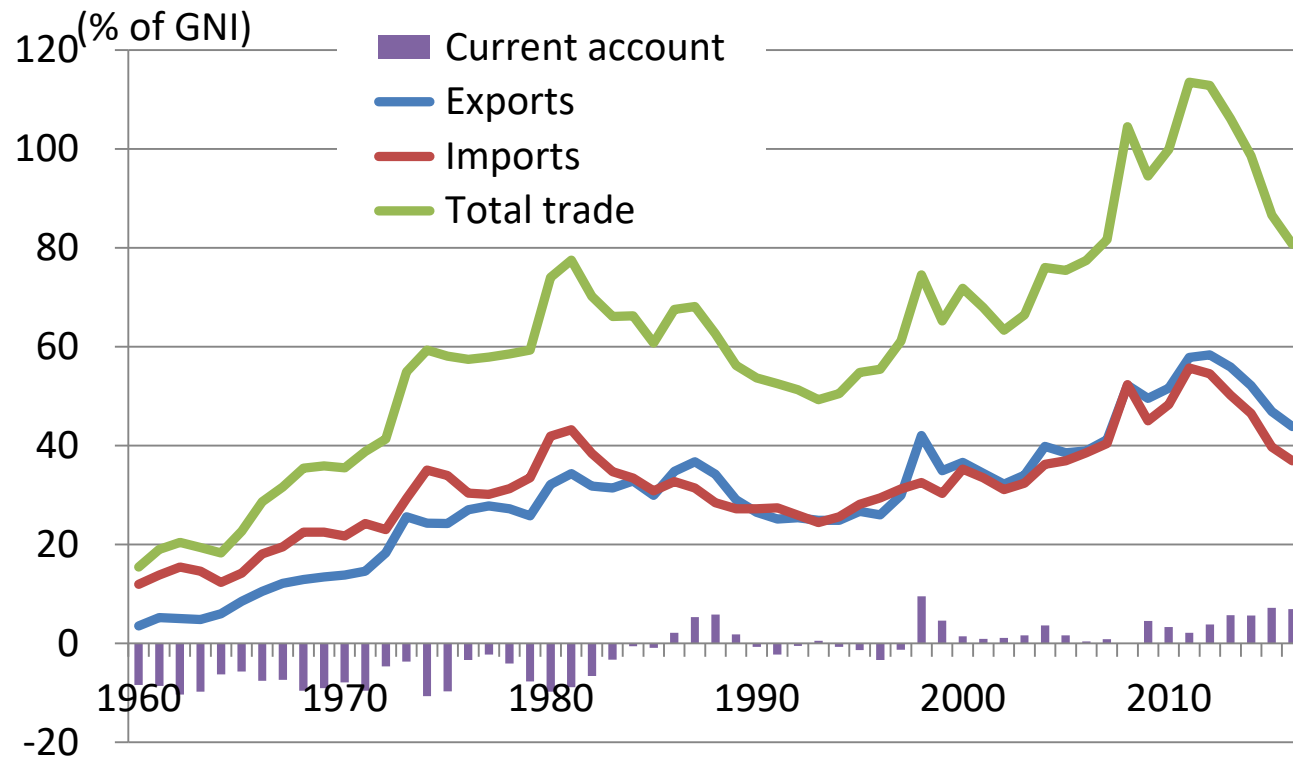
- *Sufficient attention is not being paid to education.*
  - *‘Elite education’ often receives a higher priority over ‘universal public education’, as demonstrated by, for example, the coexistence of widespread illiteracy and top-notch universities.*
- *Infrastructure investment (roads, railroads, electricity supply, etc.) is also weak.*
- *In general, public spending is geared to ‘current consumption’ rather than ‘future prosperity’.*
  - *A notorious example is the fuel and electricity subsidies in many developing countries that take up a large portion of public spending and crowd out investments in education, health, infrastructure,...*

## 4. Export orientation

- *Exports provide a country with an opportunity to*
  - *Discover and take advantage of its comparative advantage*  
*(Hausmann and Rodrik, 2003)*
  - *And improve productivity by*
    - *Realizing economies of scale*
    - *Importing capital goods and advanced technology*
    - *Getting exposed to global competition*



- *Industrialization began in Korea with the export-drive in the 1960s.*
- *Efforts were initially focused on light industries (textile, apparel, wigs,...) and then on heavy and chemical industries (iron and steel, chemical, machinery, ship-building, automobile, electronics...).*



■ *To promote exports, the Korean government*

- *Not only provided subsidies to exporters (which is no longer possible under WTO) but also;*
- *Abolished the multiple exchange rate system and maintained competitive exchange rates;*
- *Built industrial parks to house manufacturing firms at strategic locations across the country;*
- *Established transportation networks and provided electricity and other reliable sources of energy;*
- *Allocated a large share of budget to education, starting with the primary and moving up to the secondary and tertiary education;*
- *Held monthly export-promotion meetings with exporters (chaired by the president himself);*
- *Held annual ceremonies to award medals of honor to the best-performing exporters.*

President Park Chung-hee chairing the monthly export-promotion meeting (Mar. 18, 1968)



President Roh Moo-hyun awarding Towers of Export on the 43<sup>rd</sup> Day of Trade (Nov. 30, 2006)



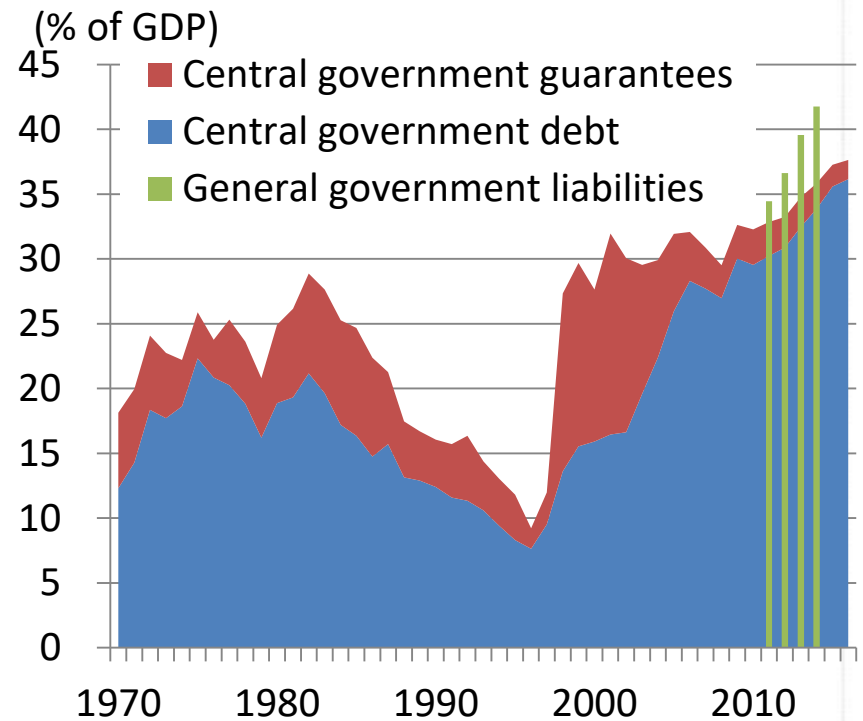
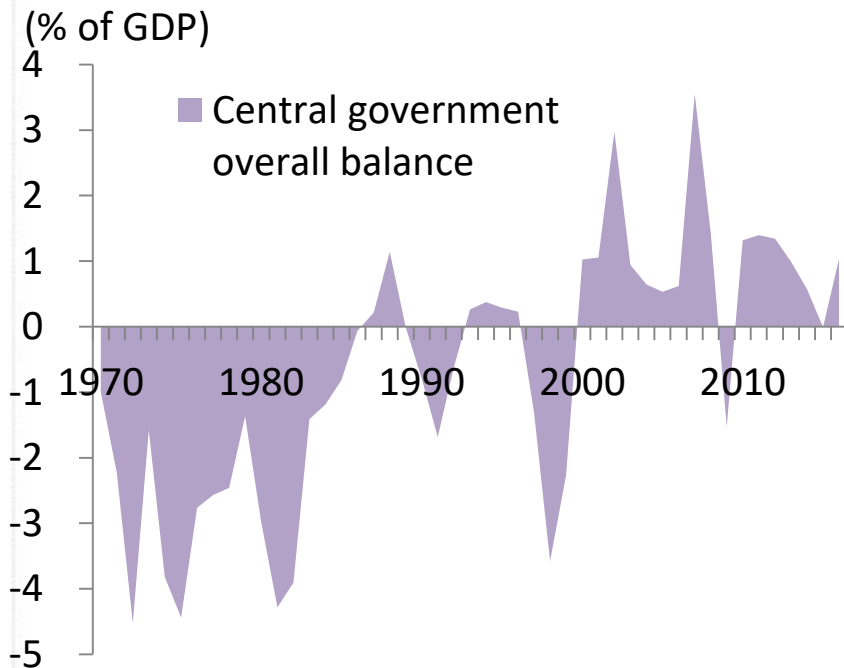
## ■ Cf. *Import Substitution Industrialization (ISI)*

- *Industrial development strategy to replace major consumer imports by promoting domestic industries*
  - *through protective tariffs, import quotas, exchange rate controls, subsidized loans, etc.*
- *Adopted by most of the larger Latin American countries between the late 1940s and the early 1960.*
- *Expected to wean them from dependence on larger economies.*
- *Led to wide-spread government interventions, markets isolated and limited in size, emergence of monopolies, reduced innovation, economic failure, and growing poverty.*
- *Eventually became discredited with the spread of East Asian success stories.*
- *Korea also protected its strategic industries and delayed full liberalization up until the 1990s, but the final goal was always to build a strong export-base, not a self-sufficient autarky.*

# 5. Public sector discipline

■ *Fiscal rectitude is one of Korea's important characteristics.*

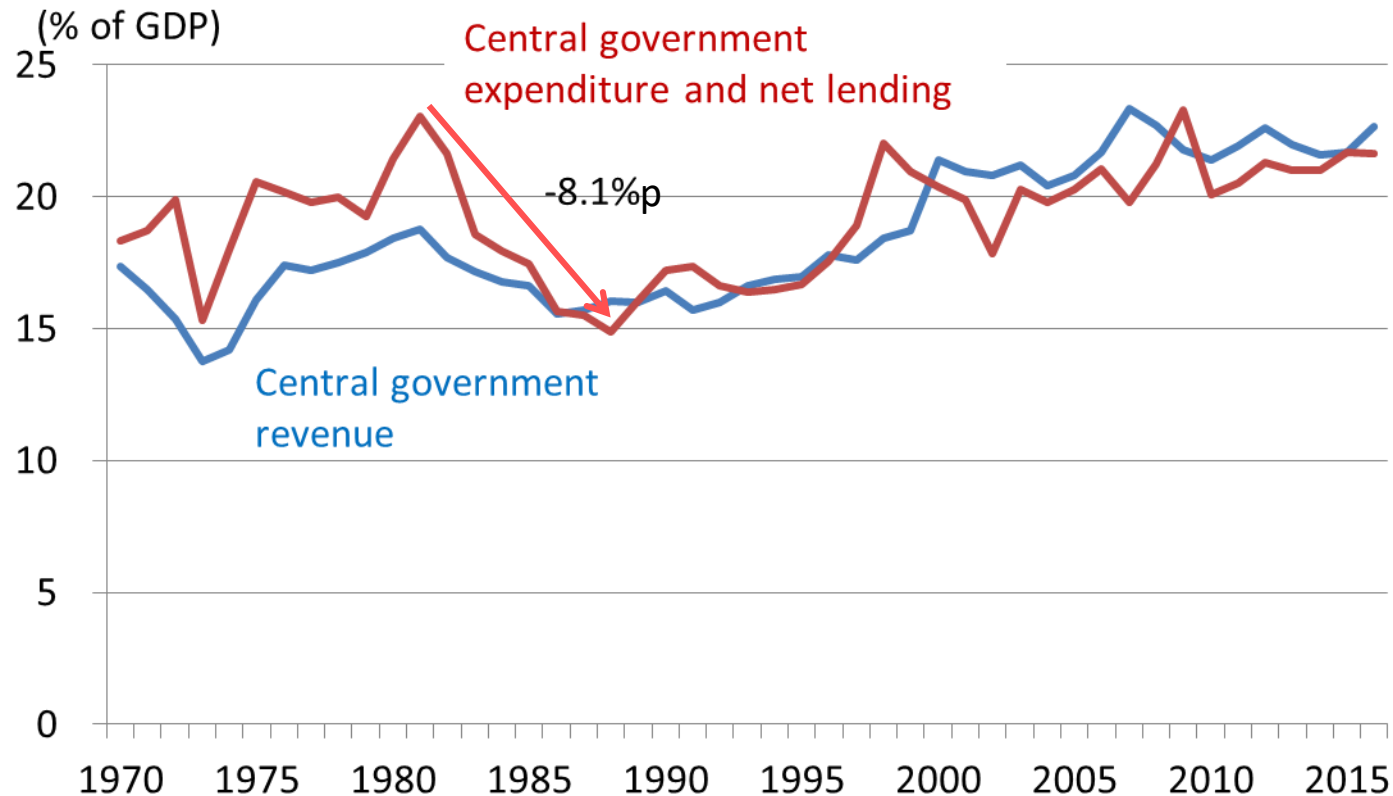
- *An aggressive fiscal tightening in the early 1980s to stabilize price inflation has put public finance on a sustainable path since then.*



■ *Fiscal tightening in the early 1980s relied on spending cuts.*

- *In 1983, the 'zero-base budgeting' was introduced to review all spending programs thoroughly and comprehensively.*

- *All areas of spending were subject to cuts, including the rice purchase program that subsidized farmers with above-market prices.*



- *On the monetary front,*
  - *Sterilization with Monetary Stabilization Bonds helped mop up the excess liquidity stemming from export promotion and industrial restructuring.*
- *The stabilization efforts temporarily decelerated output growth and increased unemployment,*
  - *But succeeded in subduing inflationary pressures.*
  - *In addition, they might have helped suppress import demands, improve current account balances, and avert balance-of-payment crises that inflicted many Latin American countries at the time.*
  - *The stabilization efforts also held back the growth of public sector, freeing resources for private sector growth.*
- *Many developing countries exhibit macroeconomic instability that finds its root in lax fiscal management.*



- *Another important aspect of the Korean public sector is the merit-based recruiting procedure.*
  - *All career civil servants are recruited through entrance exams that are open to all.*
  - *Many SOEs also have similar procedures of their own.*
- *In many developing countries,*
  - *Recruiting procedure is less transparent, leading to overstaffing in terms of size and understaffing in terms of aspiration and capacity.*
    - *In fact, public employment is often considered a part of social security system, providing tax-financed jobs for the youth.*
  - *This severely limits the government effectiveness in reaching its policy goals.*





# **The Other Side of the Miracle**

# 1. Divided nation

## ■ *Regional: East-West*

- *Development concentrated along the line connecting Seoul and Busan brought about resentment in other areas that felt left out, magnifying political tensions between Ho-nam and Young-nam.*

## ■ *Ideological: Left-Right*

- *Decades since the 1960s are equated by some to a period of modernization and rising welfare, while by others to a period of political repression and suppressed labor movement.*
- *The latter group demands a clean departure from the colonial past and a breakup of ties with America which they believe sanctioned and lengthened the past authoritarian rule.*

## ■ *Generational: Old-Young*

- *The older population is generally less educated and poorer than the young.*

■ *Q: Would democracy survive such divisiveness and prosper in Korea?*

- *Cannot be taken for granted.*
  - *Many reversals in recent history (Kurlantzick 2013)*
  - *Ancient democracy in Greece eventually fell to autocracy as did the Roman republic (Van Doren 1991)*



- *Divisiveness is deeply rooted in human psychology.*
  - *Political choice by the public is often made out of “group identity” with parties and candidates (Achen and Bartels 2016).*
  - *People are born with certain political predilections (Haidt 2012).*
- *Democracy needs some “undemocratic” institutions (Zakaria 2004).* 37



# DEMOCRACY FOR REALISTS

*Why Elections Do Not Produce  
Responsive Government*

CHRISTOPHER H. ACHEN  
& LARRY M. BARTELS

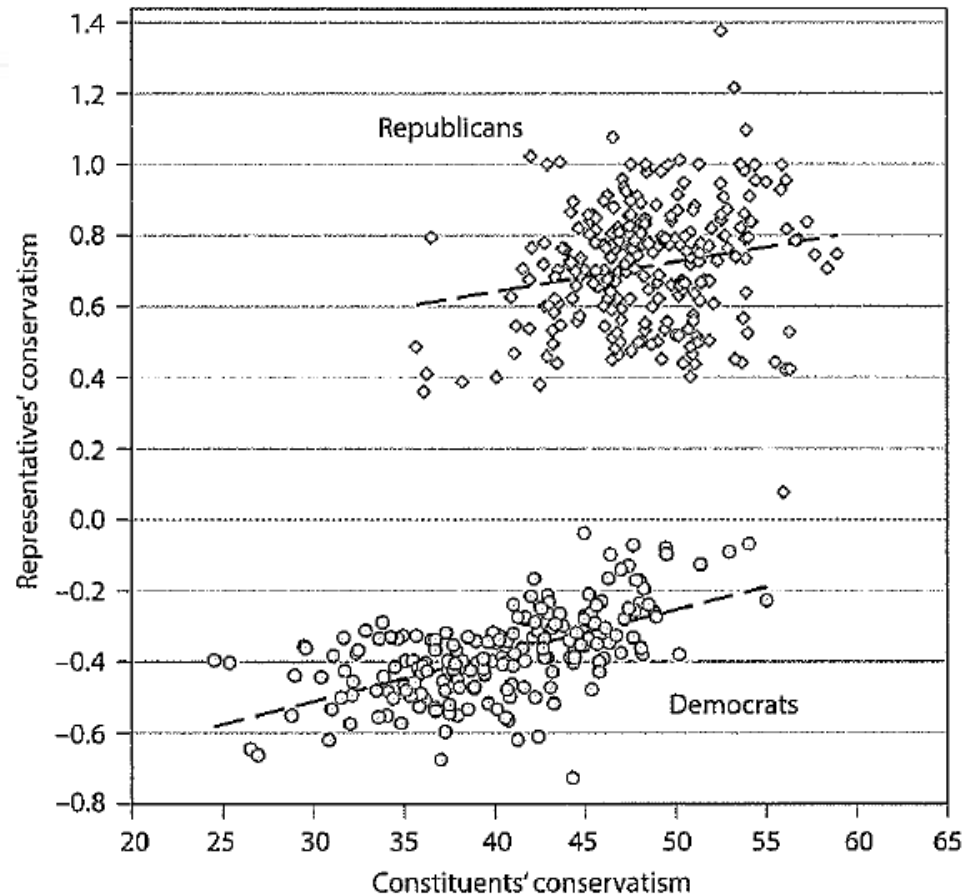
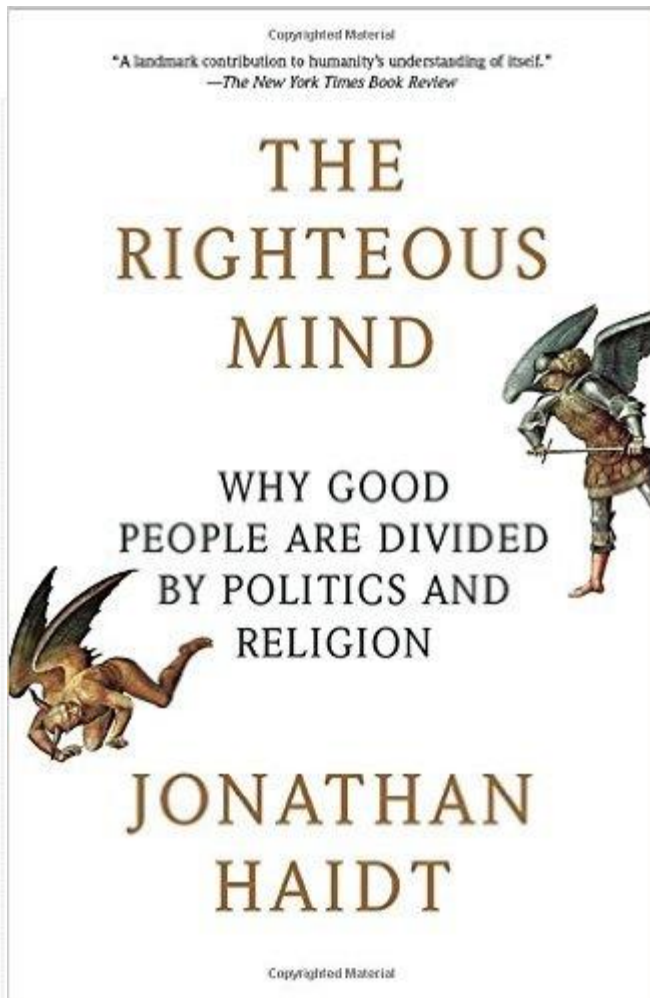


Figure 2.1. District Opinion and Representatives' Roll Call Votes, 2011-2013



Strongly  
endorse

Strongly  
reject

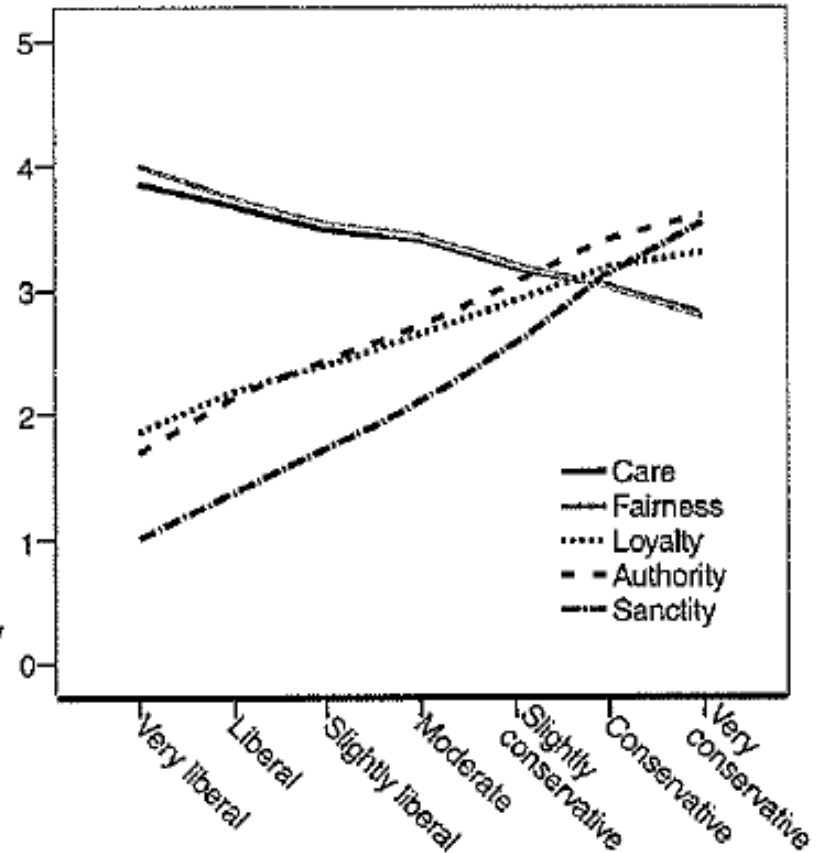


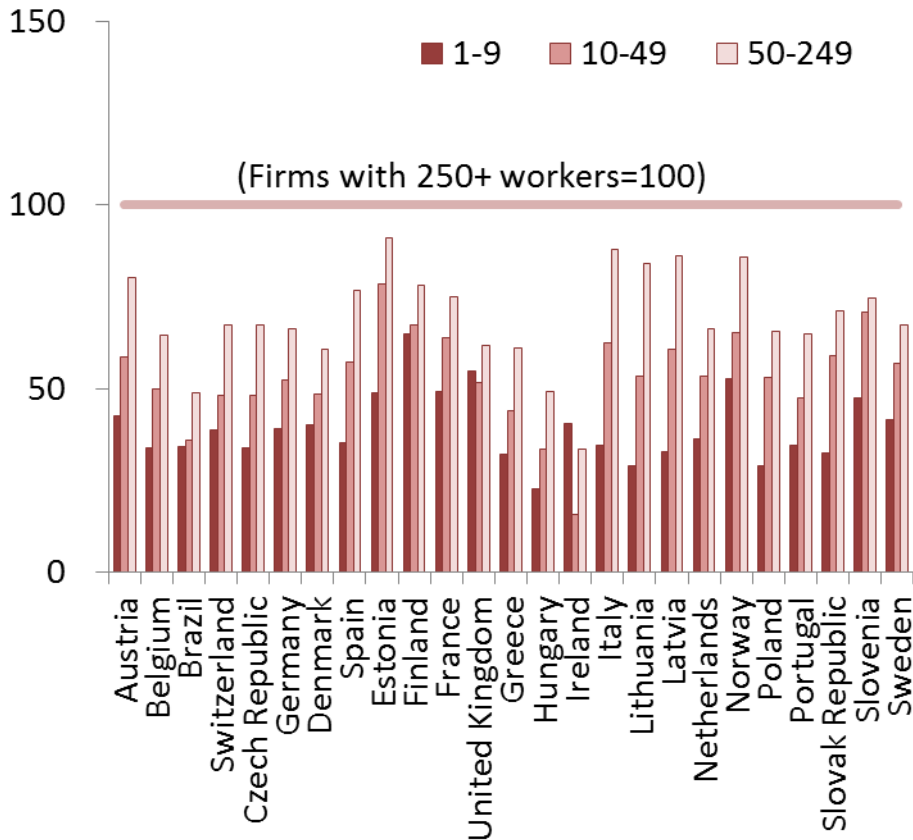
FIGURE 8.2. Scores on the MFQ, from 132,000 subjects, in 2011. Data from YourMorals.org.

## 2. Ambivalence towards the *chaebol*

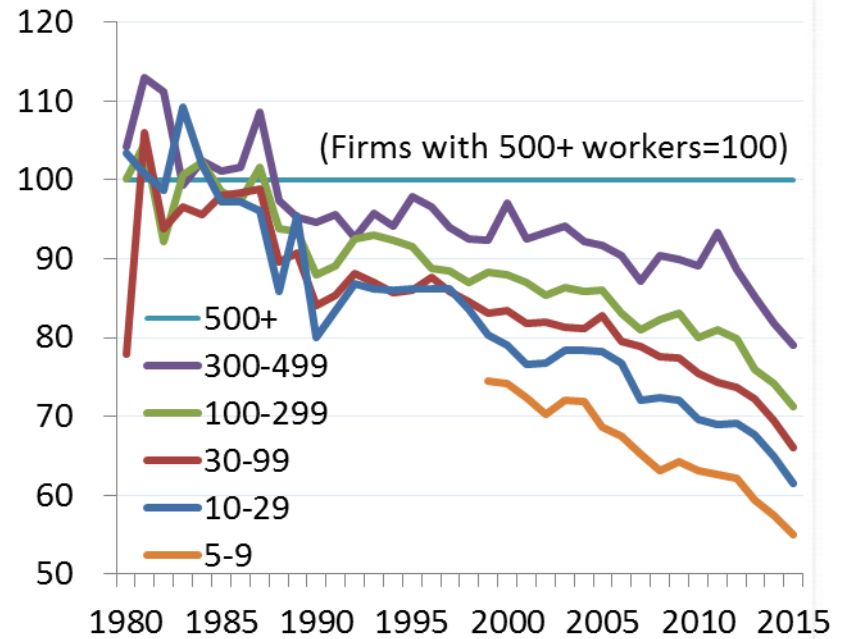
- *The chaebol are business conglomerates controlled by founding families through a web of interlocking shareholdings.*
  - *Their origins can be often traced back to the ‘pick-the-winner’ strategy adopted during state-led industrialization.*
- *Public animosity toward the chaebol is prevalent,*
  - *Which some claim have amassed unlawful wealth, exploit labor, and stunt the growth of SMEs.*
- *On the other hand, it cannot be denied that large firms, including the chaebol firms, pay better and provide better working conditions.*
  - *Most of the youth entering the labor market aspire to join large firms rather than SMEs.*

- *In general, large firms exhibit higher productivity than SMEs.*
- *Their wages and salaries far exceed those of SMEs.*

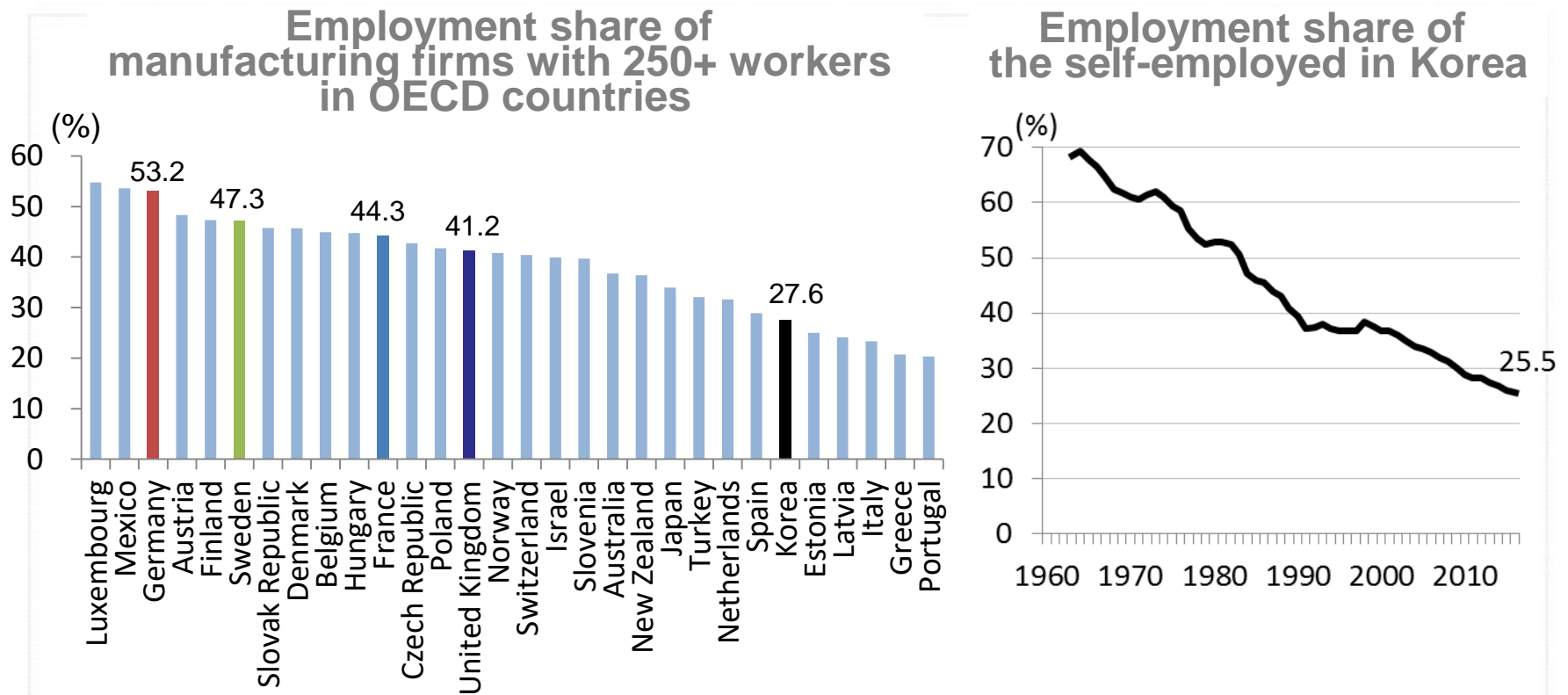
**Labor productivity by firm size in manufacturing in OECD countries**



**Wages and salaries by firm size in Korea**



- *The firm size in Korea is smaller than in other OECD countries.*
- *The self-employed still account for a quarter of total employment.*



- *Q: How can we improve the chaebol's internal governance and at the same time increase their role as a provider of decent jobs?*

### 3. Interventionism (a.k.a. dirigisme)

- *State-led economic growth has helped bringing about a general belief that government can and should solve all economic and social problems*
  - *Ex) Declining fertility and aging population*
- *Cycle of hopes and disappointments*
  - *Public demands for government actions*
    - *Hasty preparation of policy responses (對策)*
      - : *A jumble of tax, credit, procurement, and other measures*
      - : *Lacking an adequate analysis of root causes of the problem, assessments of previous efforts, and a specification of M&E (monitoring and evaluation) scheme*
    - *At the end of the day, no visible improvement in economic and social conditions*
    - *Repeated rounds of public demands and policy responses*
    - *Growing public disappointment and falling trust in government*

- *Such high hopes on government may not be unique to Korea, but the way they are handled may be.*
  - *Policy community: It is often difficult to find solid research outputs on the economic and social issues at hand.*
  - *Media: A lot of sensationalism and few cases of well-founded, impartial reporting*
  - *Government: Little attention to the final outcome of a policy (and more to the media coverage of their policy announcements)*
- *Q: How can we upgrade the policy formulation and evaluation practices?*
  - *Research institutions and academia*
  - *Media*
  - *Politicians and government*

## 4. Financial backwardness

- *“Bureaucratic control of the financial sector (官治金融)”*
  - *For a long time, the financial sector was considered an important policy tool for government,*
    - *Whether to promote industrialization (by supplying concessional credits to producers),*
    - *Or to stabilize inflation (by controlling credit expansion through banks).*
  - *It appeared natural for the government to intervene in the daily operation of financial institutions, including the nomination of CEOs.*
- *A full-scale attempt for liberalization came only after the currency crisis of 1997 (SaKong and Koh 2010).*
  - *Interest rates were liberalized, inflation targeting replaced monetary targeting, and macro-prudential regulation was introduced.*

- *Still the tradition of bureaucratic control remains in many aspects.*
  - *Intervening to augment credit supplies to SMEs*
  - *Sustaining ailing firms through concessional lending*
  - *As a result, Korea's financial sector remains underdeveloped despite many ambitious plans to transform it into a high value-added service industry (e.g. "North-East Asian financial hub")*
- *Q: How can we achieve a de-facto deregulation of the financial sector and increase the efficiency of resource allocation?*
  - *Are we ready to recognize and address the intrinsic contradiction between improving the competitiveness of financial sector and retaining bureaucratic control?*

## 5. Growing influence of vested interests

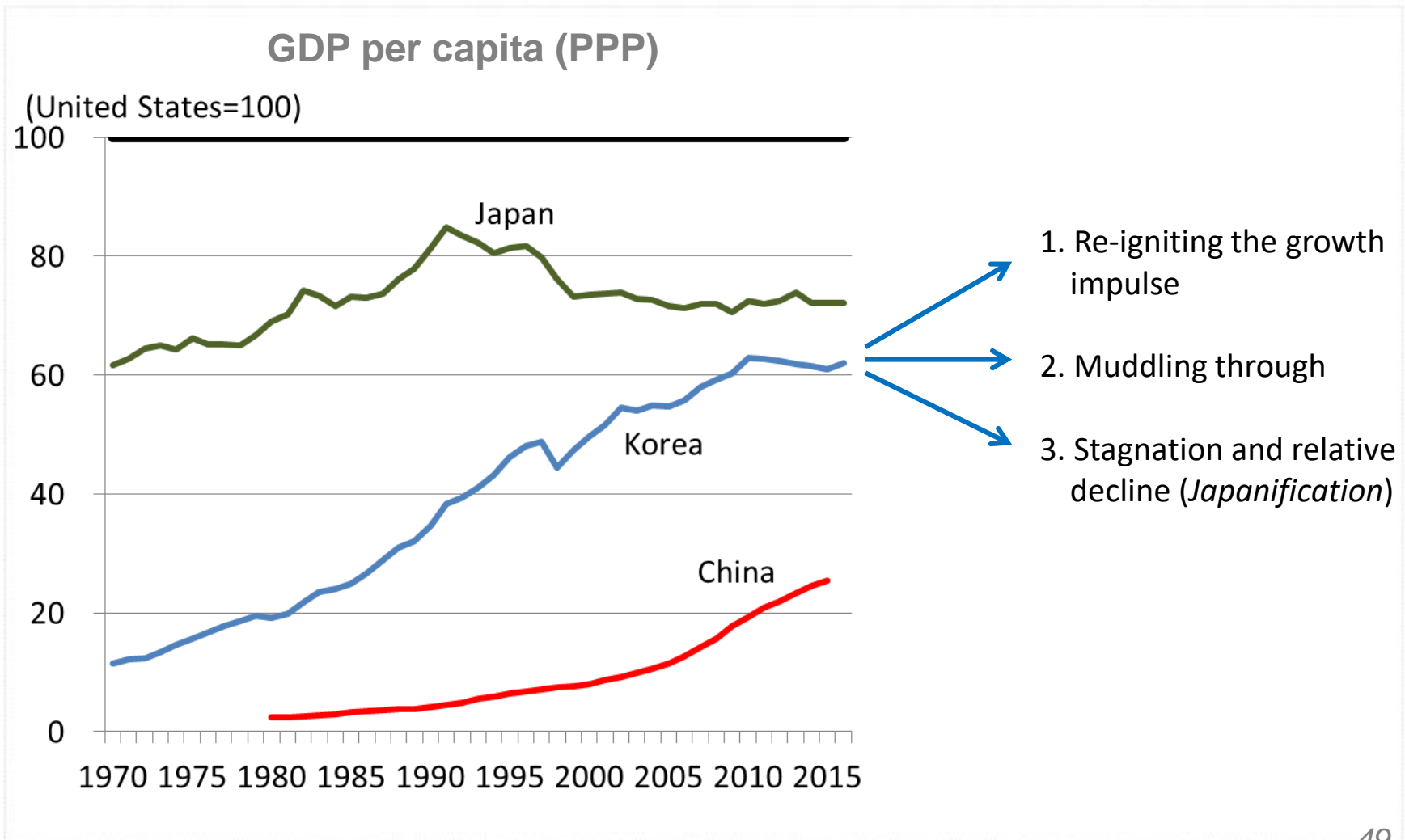
### ■ *Prosperity brings its own seeds of decay.*

- *While Korea was free from the growth-retarding influence of elite classes unlike in many developing countries,*
- *A long period of prosperity has produced, in my opinion, many pockets of vested interests in Korea,*
  - *Each claiming its share in public resource allocation, trying to protect its turf in the society, or opposing changes that would benefit the larger population.*
- *Growing influence of vested interests seems to be behind all problems of economic or social importance.*
  - *Employment, education, innovation, financial intermediation, corporate governance, agriculture, SMEs,...*

- *Historically, the fall of great powers has always been preceded by the emergence of influential groups that pursued their own interests at the expense of the country's (Acemoglu and Robinson 2012; Fukuyama 2011).*
- *Q: Would we need a 'great leveler' to destroy all vested interests and restart the nation-building process?*



# Which way for Korea?



# References

- Acemoglu, Daron and James Robinson, *Economic Origins of Dictatorship and Democracy*, Cambridge University Press, 2006.
- \_\_\_\_\_, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*, Crown Business Print, 2012.
- Achen, Christopher H. and Larry M. Bartels, *Democracy for Realists: Why Elections Do Not Produce Responsive Government*, Princeton University Press, 2016.
- Dawkins, Richard, *The Selfish Gene*, Oxford University Press, 1976.
- Evans, Peter, *Embedded Autonomy: States and Industrial Transformation*, Princeton University Press, 1995.
- Fukuyama, Francis, *The Origins of Political Order: From Prehuman Times to the French Revolution*, Farrar, Straus and Giroux, 2011.
- García, Ana Isabel López, “*Oligarchic Politics in Latin America*,” *Voxukraine Focus*, Jan. 23, 2017.
- Haidt, Jonathan, *The Righteous Mind: Why Good People Are Divided over Politics and Religion*, Pantheon Books, 2012.
- Hausmann, Ricardo and Dan Rodrik, “*Economic Development as Self-discovery*,” *Journal of Development Economics*, Vol.72, No.2, 2003, pp.603-633.
- Kurlantzick, Joshua, *Democracy in Retreat: The Revolt of the Middle Class and the Worldwide Decline of Representative Government*, Yale University Press, 2013.
- Moore, Barrington, *The Social Origins of Dictatorship and Democracy: Lord and Peasant in the Making of the Modern World*, Beacon Press, 1966.
- Pinker, Steven, *The Blank Slate: The Modern Denial of Human Nature*, Penguin Books, 2002.
- \_\_\_\_\_, *The Better Angels of Our Nature: Why Violence Has Declined*, Penguin Books, 2011.
- SaKong, Il and Youngsun Koh, *The Korean Economy: Six Decades of Growth and Development*, Korea Development Institute, 2010.
- Scheidel, Walter, *The Great Leveler: Violence and the History of Inequality from the Stone Age to the Twenty-First Century*, Princeton University Press, 2017.
- Van Doren, Charles, *A History of Knowledge: Past, Present, and Future*, The Random House Publishing Group, 1991.
- Zakaria, Fareed, *The Future of Freedom: Illiberal Democracy at Home and Abroad*, W. W. Norton & Company, 2004.



KDI KDI KDI KDI  
KDI KDI KDI KDI  
KDI KDI KDI KDI