ECONOMIC DEVELOPMENT IN THE REPUBLIC OF KOREA
A Policy Perspective

Edited by
Lee-Jay Cho and Yoon Hyung Kim

East-West Center
ECONOMIC DEVELOPMENT
IN THE
REPUBLIC OF KOREA
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Lee-jay Cho
Yoon Hyung Kim

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Preface

During the 18 years of President Park Chung Hee’s leadership, from 1961 to 1979, the Republic of Korea underwent dramatic economic development, maintained relative domestic political stability, and achieved major economic and political advances in the international arena. A salient feature of this period of rapid growth was the close and extensive cooperation between government and business in pursuit of national development objectives. This cooperation is reminiscent of Japan, where policy reflects a fairly good consensus of opinion among the principal elements of the Japanese industrial community. In Korea the government and its development policymakers took much more assertive leadership and set policies, with the business community cooperating in their implementation.

By any economic criteria, the South Korean economy registered outstanding material performance in the 1960s and 1970s. The gross national product (GNP) increased in real terms more than thirteenfold when measured at 1980 constant prices (from 3.00 trillion won in 1961 to 39.25 trillion won in 1979). Comparing South Korea with North Korea, the South did not overtake the North in per capita GNP until the late 1960s. In 1987, however, the South exceeded the North by more than sixfold in GNP and more than threefold in per capita GNP. From one of the poorest developing countries in 1961, South Korea was transformed into a semi-industrial, middle-income nation by the final year of the Park era, and during that period per capita income rose from a mere US $82 to US $1,644.

The rapid development was led by export-oriented industrial expansion and was achieved in spite of poor natural resource endowments. Korean exports, which remained stagnant at a low level in the 1950s, increased rapidly at an average annual rate of 39.1 percent when measured in constant 1980 dollars (from US $40.9 million in 1961 to $15.1 billion in 1979), with manufactured goods accounting for the majority of total exports. As the rapid expansion of exports stimulated the domestic economy, real GNP grew by an average annual rate of 9 percent during 1961-79, compared with only about 4 percent in the immediate postwar period 1954–61. The manufacturing sector, in particular, expanded at an average annual rate of 17.5 percent during 1961-79, thereby increasing its share of GNP from 13.5 percent to 26.9 percent. Over the same period, the share of agriculture,

1. Throughout this volume, “Korea” refers to the undivided peninsula up to 1945 and to South Korea—the Republic of Korea—after World War II. Likewise, “Koreans” refers to the entire Korean populace up to 1945 and thereafter specifically to South Koreans. References to modern North Korea should be clear from the context of the discussion. This terminology has been adopted for simplicity of style and does not imply any cultural or political judgment.
forestry, and fishing declined from 38.7 percent to 20.5 percent (BOK, *Economic Statistics Yearbook*, 1986).

What caused this transformation? The rapid economic growth that characterizes the Park era can be attributed to many factors, including investment and rapid capital growth, expansion of industrial productive capacity, and the development of human resources and labor productivity. Other contributing factors were the favorable worldwide economic conditions prevailing during the 1960s, Korea's political stability, the commitment of the country's leaders to economic development (as illustrated by the launching of the First Five-Year Economic Development Plan), the outward-looking strategy of industrialization, the vitality and entrepreneurship of the emerging corporate leaders, the grassroots support and participation in rural transformation, and the close government-business interplay in Korean economic development. It can also be argued that the cultural values shared in common among the Koreans, Chinese, and Japanese contributed to the quality of the labor force, principally through education.

Manufacturing output expanded dramatically during the 1960s and 1970s, thereby leading the rapid growth of an economy that had been shattered by the Korean War (1950-53). As Korea shifted from the import-substitution strategy of the postwar 1953-61 period to an export-led industrialization strategy during 1962-79, exports (principally manufactured goods) rose sharply. Along with the dramatic increase in the proportion of the manufacturing sector in GNP, the share of this sector in total employment nearly tripled during the high-growth period under President Park. In particular, the output share of heavy and chemical industries nearly doubled (to almost 55 percent) by 1979.

The Park era is also characterized by a dramatic increase in capital formation. The average proportion of GNP devoted annually to gross domestic capital formation increased sharply (from about 15 percent in 1962-64 to about 32 percent in 1977-79). During 1953-63 Korea financed up to two-thirds of total investment requirements from foreign sources, most of which was economic aid from the United States. When the major fiscal and financial reforms were set in motion in the mid-1960s, however, the government successfully mobilized domestic resources. The gross domestic savings rate, which was about 3-5 percent until the early 1960s, rapidly increased to 28 percent on average during 1977-79. Moreover, the sectoral savings pattern underwent drastic changes. Government saving was negative up to 1963 but rapidly increased in the late 1960s and 1970s. Household saving also remained negative during 1961-63 but increased remarkably to 12.6 percent of GNP in 1977-79. More than 80 percent of GNP was expended on private consumption until the early 1960s, but Korea successfully reduced its average propensity to consume to 62 percent in 1977-79. Throughout the entire 1953-89 period, however, it was the business sector that made the greatest contribution to the rapid increase in gross domestic saving. As a
result of the sharp increase in domestic saving over the past three decades, Korea's national economic capacity has expanded to such an extent that the country is now able to finance more than its entire gross domestic capital formation.

The labor force required for expansion of manufacturing production during the high-speed growth period was provided by the existing unemployed urban population and the abundant human resources in the rural sector already available in the early 1960s. Rapid industrialization was thus not restrained by shortages of labor and skills. From the early 1960s, concurrent with the industrialization drive, the government embarked on a bold family planning program and successfully reduced the population growth rate. The sharp growth in per capita GNP in real terms led to a commensurate substantial increase in per capita private consumption, greatly improving the living standard of the Korean people as a whole.

Prior to the 1960s, about two-thirds of the Korean labor force resided in rural areas. Even though total population grew at about 2 percent on average per year between 1963 and 1979, the "baby boom" after the Korean War resulted in an increase on average of 3.4 percent per year in the total labor force. Rapid industrialization, led by the expansion of labor-intensive manufacturing for export, nonetheless absorbed the existing unemployed population as well as the newly participating labor force. The growth rate of urban employment far outstripped that of the rural areas, reducing the urban unemployment rate by about two-thirds (from 16.0 percent in 1963 to 5.6 percent in 1979). This rapid increase in urban employment substantially alleviated unemployment throughout the economy. In the meantime, the proportion of urban employment in the total employed population rose sharply (from 35.6 percent in 1963 to 58.5 percent in 1979). The rising demand for labor in the industrial and urban sectors led to heavy migration from rural areas. But, although rural employment was declining, value added in agriculture in real terms was growing at a fairly respectable rate. Labor productivity in the manufacturing sector also rose at a healthy rate, and real wages increased even more rapidly.

High-speed growth could not have materialized without Korea's abundant human resources and continuous investment in education. Over the two decades from 1960 to 1980, the average number of years that the employed population spent in school nearly doubled (from 4.2 years to 8 years). The improvements in education not only enabled urban employment to increase quickly without significant shortages of skilled workers until early in the 1980s, but also contributed to increased labor productivity and wage levels.

Rapid growth and structural change in such a brief span of time was not achieved without sacrifices. The tempo of inflation accelerated at an annual rate of about 19 percent throughout the period 1962-79. This inflation can be attributed mainly to the approximately 29 percent average
annual growth rate of the money supply, caused by the accumulation of fiscal deficits, expansion of preferential policy loans, grain-price subsidies, and the low level of the domestic savings rate at the outset of industrialization. Inflation was regarded by the Korean government as the inevitable price for high-speed economic growth. Although an economic stabilization program was initiated in the last year of the Park administration, inflationary pressure was not brought under control until the mid-1980s, by which time Korea was faced with yet another crunch in the form of mounting foreign debt.

This book examines the major economic policies of the 1960s and 1970s. The measures examined in this work, which were formulated and implemented during the administration of President Park, played a critical role in transforming the structure of the Korean economy and in moving it to a higher growth path. The conceptual framework underlying the appraisals in this book is also based on the broader premise that Korea's economic performance during the 1960s and 1970s was an outcome of the interactions among environment (defined to include resources, technology, and international markets), the economic system, government policy, and the public. The success stories and hard lessons of recent Korean experiences will serve, moreover, as a valuable set of materials for future socioeconomic development planning and implementation by both Korea and other developing countries.

This research project was planned and coordinated by the East-West Center on a cost-sharing and cooperative basis with the Korean Traders Association, the Korea Development Institute, and the Korea Institute of Industrial Economics and Technology. Comprehensive and detailed case studies of 18 major economic policy measures constitute the core of the book. Additional chapters have been designed to place these policies in the broader perspective of cultural values, the development of human resources, and modern political change in Korea. The final chapter summarizes the political, economic, and social development of Korea during the 1980s.

The case studies have a common structure, thereby providing a basis for tracing patterns of economic policy, interactions, the Korean model of economic development, and the lessons for the future. Each examines the main features of a particular policy measure, its theoretical appropriateness and effects, and the interaction of government, business, and the public in its formulation and implementation.

Prominent Korean scholars were invited by the East-West Center to write specific modules in their respective areas of expertise. Active participation by Korean institutions was an important feature of the project. Subsequent amendments resulted from information and criticism obtained at consultative meetings. At those meetings, former senior economic policymakers from Korea, prominent Korean business leaders, and U.S. scholars engaged
in intensive discussions to clarify the historical background of each policy study and to provide supplementary unpublished data and information. This book attempts to describe economic policymaking during the Park years as accurately as possible through the contributions of Korean scholars and policymakers who were involved directly and indirectly in the economic modernization of Korea during the last three decades.

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PART I

POLITICAL AND ECONOMIC BACKGROUND
Remarkable changes were forced on the Korean people during a relatively brief time span, not only after World War II but also earlier in this century. For a better understanding of Korea's present-day social and economic institutions, it will be useful to examine first some of the broad historical patterns of the country's transition from kingdom to colony and finally to republic.

Korea has always been surrounded by harsh political reality and forced to tackle the challenges thrust upon it by its powerful neighbors, particularly China and Manchuria. In response, nevertheless, Koreans absorbed and benefited from the invaders' culture and know-how. Despite many foreign intrusions during its long history, including Japanese incursions on the mainland in the sixteenth century, Korea was able to maintain its political independence until the turn of the twentieth century. The ancient Korean monarchy survived until 1910 partly because the kingdom remained a tributary under the protection of the Chinese imperial system. By the end of the nineteenth century, however, the great Chinese empire was crumbling under misrule and was no longer capable of meeting its traditional obligation to ensure the defense of its tributaries. Korea became a bone of contention among its three large neighbors and was soon overwhelmed by the emerging power of Japan.

The Meiji revolution in Japan swept away the Tokugawa bakufu (military regime) in 1868, launching a new stage of development by bringing in Western technology and ideas. The resultant modernization touched upon almost every aspect of Japanese society—from clothing to the constitution and from the legal system to the education system. For some time after the Meiji revolution, the Japanese followed the policy of tatsuaron ("getting away from Asia"), which meant the avoidance of "continental Asian" influences in general. Viewing China and Korea as technologically backward, Japan turned to the West for its technology and scientific ideas. By no means, however, did Japan abandon the values with which it had been imbued for centuries. On the contrary, its blending of East Asian values together with Western technology and science greatly expedited modernization and economic development in Japan. Thus, by the turn of the twentieth century, within one generation after the Meiji revolution, Japan became the only modern power in Asia that was able to challenge the Western powers.
In contrast to the outward-looking Japanese attitude, Korea continued to turn inward, maintaining its overly Sinified political system and upholding its traditional tributary relationship with Beijing. Continuing to view China as the center of the world, while not realizing that the world was passing it by, Korea was dubbed the "Hermit Kingdom" (Griffis 1897).

Korea's long history of seclusion ended partly as a result of Japanese gunboat diplomacy, which forcibly opened the country to trade under the 1876 Korean-Japanese treaty of commerce. During the following several decades, Japanese immigrants began to arrive in Korea to develop businesses. Starting with their monopoly on foreign trade, they gradually established complete control over the Korean economy. The Korean branch of the Japanese Dai Ichi Bank was opened in 1878 and assumed the role of central banking in 1905, linking the currencies of the two countries. In October 1909, the central bank of Korea was established. Thus, for the first time, a modern financial system was introduced to all of Korea, together with a modern currency system. (For further discussion, see Palais 1975; Griffis 1897; and K. Z. Cho 1977.)

ANNEXATION BY JAPAN

Korea was unable to meet the external challenges confronting it at the end of the century—whether military aggression or international politics—and could not defend its sovereignty. Rival imperial ambitions brought Japan into two wars for control of Korea—with China in 1894–95 and with Russia in 1904–05. Subsequently, the Japanese virtually ruled Korea through the advisory system (kumon kaiji) and supervisors (tokanfu). In 1910 the Korean peninsula became part of the Japanese empire through annexation.

Prior to the Meiji revolution, the Japanese had always regarded China as the origin of superior culture and Korea as the transmitter of that culture to the archipelago. The Japanese, therefore, had looked upon China and Korea with profound respect. While the Meiji revolution was making great advances, however, China and Korea were unable to break away from their political and technological backwardness. In spite of the tradition of cultural superiority and heritage from continental Asia, Japan began to regard the Chinese and Koreans as second-class nationalities, giving rise to the Japanese sense of national as well as racial superiority. Thus, the Korean peninsula was not regarded after annexation as equivalent to the provinces within Japan, but rather as a colony governed by the Sotokufu (Office of the Governor-General)—an institution imposed by the Japanese government and officially headed by a high-ranking general in the Japanese army. Traditional Korean administration was swept away.

Basically, the Japanese aim was to structure Korean economic expansion to meet the overall needs of the Japanese economy. In the beginning, the Japanese tried to develop the Korean economy as a major source of food for Japan and as a market for Japanese manufactured products. Thus from
annexation through the 1920s, the Japanese made a major effort to raise agricultural productivity, especially in the production of rice, by transferring Japanese technology to increase productivity per unit of land in Korea. As the Japanese developed the industrial sector in Korea, ownership in this sector became almost wholly Japanese, and most of this sector’s leadership consisted of Japanese immigrants. The Japanese share of total paid-in capital in the industrial sector increased from 32 percent in 1911, to 80 percent in 1917, and to 90 percent in 1921 (Suh 1978:10).

After annexation, Japan developed plans not only to make Korea permanent Japanese territory, but also to use the peninsula as a base for further territorial expansion. The vast northeastern part of China (Manchuria) offered an enticing abundance of the natural resources that Japan lacked. Its coal reserves were almost comparable to those of the United States; it also had other important mineral resources, petroleum, and forests. In 1932 Japan established a puppet state in Manchuria that was administered, for all political and economic purposes, by the Japanese imperial government. Japan could be best provisioned with the products of this resource-rich territory by way of the Korean peninsula, and this link soon became known as “the lifeline of the great Japanese empire.”

The availability in Korea of mineral resources, hydroelectric power potential, and cheap labor were advantages for developing the industries needed to provision both Japan and Japan’s forces in Manchuria. The quality of the Korean labor force was almost comparable to that of Japan, with the advantages that some of the work force spoke Japanese and had received a Japanese-style education. After 1932, when the Japanese-controlled government was established in Manchuria, the geographical position of Korea gave it increased strategic importance for further development of these industries in Korea, which in turn enabled further Japanese expansion in East Asia. Thus, from the early 1930s to 1941, the initial emphasis on rice production was replaced by promotion of large-scale industries. This shift was primarily to meet the growing need of the arms build-up as Japanese military power expanded: beginning with the creation of the new state in Manchuria and followed by the occupation of major coastal cities in China in 1937, the extension of Japanese power into Vietnam in 1940, and finally the Japanese attacks throughout Southeast Asia at the end of 1941.

During the period of Japanese colonial rule in Korea the agricultural sector continued to grow at a low but fairly steady rate, but the manufacturing sector was growing several times faster, especially during the late 1930s. Indicators of economic growth, such as annual growth rates in the production of commodities (Table 1.1), demonstrate that fairly rapid development did take place in Korea. The overall growth rate of the economy during this period was about 3 percent, whereas the population was increasing at a net rate of only around 1 percent, showing that Korea experienced substantial economic growth under Japanese colonial rule.
Table 1.1. Annual growth rates of commodity products by industrial origin: 1910-39 (%)

<table>
<thead>
<tr>
<th>Period</th>
<th>Agricultural sector</th>
<th>Manufacturing sector</th>
<th>Overall growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1910-15 to 1916-21</td>
<td>3.2</td>
<td>7.0</td>
<td>3.4</td>
</tr>
<tr>
<td>1916-21 to 1922-27</td>
<td>1.3</td>
<td>8.9</td>
<td>1.9</td>
</tr>
<tr>
<td>1922-27 to 1928-33</td>
<td>2.7</td>
<td>8.2</td>
<td>3.2</td>
</tr>
<tr>
<td>1928-33 to 1934-39</td>
<td>1.0</td>
<td>15.0</td>
<td>3.4</td>
</tr>
<tr>
<td>1910-15 to 1934-39</td>
<td>2.0</td>
<td>9.7</td>
<td>3.0</td>
</tr>
</tbody>
</table>

Source: Suh (1978).

The rapid growth of the Korean industrial sector was an outcome of Japanese capital investment. It was imposed on the Koreans from outside and was unconnected to the traditional sectors of the Korean economy. The linkage effect, in which both traditional and modern sectors grow simultaneously while complementing and benefiting each other, did not take place in Korea. Some sectors of the Korean economy thus remained relatively backward, whereas others were as advanced as their counterparts in Japan.

The Japanese favored capital-intensive development in certain military industries, and introduced the latest technology. This resulted in further imbalance and sharper wage differentials between the agricultural and manufacturing sectors. The productivity gap also became wider, as agricultural workers became progressively less productive when compared with those in manufacturing. The productivities were nearly equal in 1920, when the real product per worker in agriculture was 91 percent of that in manufacturing; by 1940 the ratio had fallen to a mere 24 percent. This unbalanced dualistic growth in the Korean economy sufficed, from the Japanese viewpoint, so long as the growth met the needs of the Japanese economy.

**ECONOMIC LEGACY OF COLONIAL RULE**

In terms of technical and economic development, the 36 years of Japanese occupation were not entirely disadvantageous to Korea. In carrying out its imperialistic expansion, Japan provided the Korean peninsula with substantial infrastructure, including:

- the railway traversing the peninsula from Pusan to Seoul to Shinyiju, providing a strategic link across the peninsula with major towns in Manchuria
- major investments in branch railway lines, roads linking the major cities of the peninsula, and major harbor facilities at Pusan and Inch’ŏn to facilitate the trade in commodities between Korea and Japan
- a modern communications system, including telephone and telegraph networks
the European-style Japanese educational system in which, however, the medium of education was strictly the Japanese language
• Keijo Imperial University, which later became Seoul National University
• medical studies and the modern medical profession
• factories for textiles and other manufactures
• the modernization of the mining industry
• the modernization of agriculture
• the centralized administrative structure

While under Japanese rule, Koreans did gain some social and economic benefits, even if confined to only some segments of society. Many of these were conducive to later economic growth—in particular, the lasting benefits of technical education, acquisition of new skills and technical know-how, experience in working with entrepreneurs and in large-scale industries, and changing habits of consumption. Despite the colonial policy of extracting from Korea both natural and human resources, manufactured goods, and agricultural products to help meet the needs of Japan, despite the relative backwardness of the traditional sector (as opposed to the large-scale, Japanese-led industrial sector), despite the fact that Koreans could not play a leadership role in either the agricultural or the manufacturing sector, they were nonetheless brought into a development scheme for higher agricultural and industrial productivity. High-yielding varieties of rice were introduced, not for the benefit of Koreans but as a secure source of supply for Japan. To accelerate this plan, the Japanese built agricultural training centers and agricultural high schools throughout the peninsula. The independent-minded Koreans were resentful of such programs, despite their long-term benefits, because these modernizations were forced on them by a foreign power.

When the Japanese left Korea in 1945, they could not take with them the physical plant, and they also left behind the people who had helped them to manage their plants. Their assistants, who had never played an executive role before, had acquired enough skills and knowledge from technology transfer to assume control immediately and did not have to start building these sectors all over again.

Given the conditions prevailing at the time, the economic development of Korea was remarkable. The Japanese, of course, never expected to lose control of Korea; if they had hedged their policies around the possibility of being dislodged, they would never have invested so heavily to provide the peninsula with so much infrastructure. But because the Japanese-controlled Korean economy was designed and structured primarily to benefit the Japanese, the material benefits to the Koreans were less than what might appear superficially to be the case in view of such rapid growth.

There was a transmigration of several million Japanese from Japan to the
Korean peninsula. Large numbers of Koreans also migrated to Japan, where they supplied cheap labor for the construction of roads, munition works, and the textile industry, and to Manchuria for frontier development, particularly agriculture and mining. The Koreans were compelled to migrate at first. Later, because of Japanese agricultural and land policies in Korea, many farmers and other Koreans felt that they could make a better living in Japan or Manchuria, and they therefore migrated voluntarily.

Japanese nationals were always given priority in the new settlements, in educational institutions, in occupations, and of course in the government hierarchy. Koreans were denied a leadership role in their own government because Japan (unlike some colonial powers, such as Great Britain) did not bring the colonized people into their own local civil service.

During World War II enormous sacrifices were forced upon Koreans through military conscription and the compulsory mobilization for paramilitary service in Japan and throughout the war zones of the Pacific and Southeast Asia.

In the years immediately following the war, after almost four decades of Japanese rule, anti-Japanese sentiment led Koreans to eliminate virtually everything readily identifiable as Japanese in origin. In retrospect, this seems an unfortunate process. By phasing out or eliminating what was perceived to be Japanese, the Koreans did away with certain positive Japanese accomplishments, but ended up by retaining some negative qualities that were to hamper subsequent development. At one extreme, even some useful public equipment was destroyed because it was Japanese-made.

Koreans could straightforwardly reject the tangible manifestations of Japanese influence, but found it less easy to cast off institutions and habits developed during the Japanese occupation. The highly centralized Korean bureaucracy was modeled after the tightly controlled Japanese colonial apparatus, although not perceived as such. Even after the Japanese bureaucracy had departed, therefore, some of its more undesirable structural elements were retained, for the sake of convenience. One example is the military police (the much-feared kampeitai of the war years) with its secretive monitoring and control. Whereas in Japan the postwar American military administration helped to eliminate the vestiges of the old military machine, the postwar Korean bureaucracy was actually drawn from the remnants of the Japanese military organization.

Japanese influence was brought strongly to bear on the Korean character most widely through the Japanese system of universal primary education. The shu-shin (self-refinement) system of education was a Japanese adaptation of Confucian ethics; it was taught in all Korean elementary schools, principally for the purpose of assimilating Koreans as Japanese imperial subjects. With modifications suited to Korean national identity and national values, the substance could have been useful to the modern Korean education system. Unfortunately, because it had been instituted by the im-
perial Japanese government, Koreans insisted on its elimination. Yet by 1945 the Japanese-style school system had already had its effect on Korean education, not least because it was Korea's initial experience with genuinely universal education.

The South Koreans were still able to employ the Japanese legacy of skills and technology. Although Korean managers had never been trained to perform by themselves without Japanese supervision, those with a three-quarters grasp of their enterprises' operations were quickly able to close the remaining gap in their knowledge. South Korea's greatest resource was its people. It initially had the larger share of the divided country's population. It also gained about two million emigrants from the North during the Korean War, many of whom had achieved high levels of education and economic status, further increasing the quality of human resources. The post-war return of Koreans from Japan and Manchuria likewise brought valuable skills to Korea.

Because Korea had long been part of the Japanese economic system, Koreans were able to acquire postwar technological innovations from Japan, to take advantage of Japanese methods of conducting business, trade, and manufacturing, and to understand Japanese ways of thinking that could be profitably utilized by Koreans. These types of interchanges were not possible for most of the other countries, such as Indonesia and the Philippines, that had been under the Japanese imperial system only briefly. Added to this was the massive direct contact with U.S. technology and interchange that would later contribute to Korean economic development. Although Koreans had no say in or control over the economic, educational, and other policies imposed on them for 36 years, the experience gained under the Japanese and the economic infrastructure forced on Korea contributed in numerous ways to subsequent Korean economic growth.

**NATIONAL LIBERATION AND ALLIED OCCUPATION, 1945–48**

The modern history of independent Korea begins in 1945, when the peninsula was emancipated from Japanese colonial rule. Through an unfortunate sequence of events at the end of the war, the peninsula became divided. The American leaders' and policymakers' lack of understanding of East Asian history, politics, and cultures brought about this arbitrary division, which was not intended to be permanent. The Russians had long held territorial ambitions in East Asia, and the situation at the war's end provided the Soviet Union with the opportunity to advance in the wake of the crumbling Japanese empire. The American delegation to the Yalta Conference in February 1945 was unable to resist Soviet pressure for the division of the Korean peninsula and agreed in principle to joint occupation. The 38th parallel was subsequently proposed by the Pentagon and accepted by the Soviet command as the limit of military operations by their respective
occupation forces. American troops occupied the southern part of Korea up to the 38th parallel, and Soviet troops occupied the remainder of the peninsula. Thus the Soviet Union, for its negligible involvement in the Far Eastern Theater during the final ten days of the war, was able to form a strategic alliance with leaders in the North, thereby gaining greater access to the Pacific Basin through the northern half of the Korean peninsula.

The years from 1945 to 1948 were a period of political instability and economic turmoil, which precluded any orderly movement toward development. With the withdrawal of nearly 70,000 Japanese administrators, who had governed Korea for 36 years, the political and economic apparatus of the nation was virtually paralyzed. The political division diverted most of the energies of Korean leaders to the political questions affecting the divided country.

The lack of seriousness with which American leaders regarded the commitment of the United States to establish a free and independent Korea resulted in the overall failure to install an effective Korean government. One reason was that the United States Army Military Government in Korea (created in January 1946) received instructions from Washington through General MacArthur's staff in Tokyo, who were concerned primarily with the occupation of Japan and took little interest in Korean affairs. Whereas Japan benefited in the long run from some of the changes instituted by the occupation forces, the U.S. military government in Seoul was unprepared, erratic, and almost totally ignorant of Korean culture and the economic situation. The artificial division of the country had a devastating impact on the Korean economy, because the industrial base was in the North and the South was predominantly agricultural. To alleviate mutual difficulties in Korea and Japan, the U.S. staff in Seoul and Tokyo could have allowed some economic cooperation between the two countries, including barter trade (Meade 1951). But little thought was given to the economic welfare of the Korean nation and its populace, although the U.S. military government made a significant contribution by initiating discussion of land reform. The politically and economically chaotic period of occupation by U.S. troops lasted for three years. (For a detailed discussion of the U.S. military government in Korea, see Meade 1951.)

The elements for launching postwar economic development were all still in place at the end of World War II: the benefits of the physical plant, Korean experience in participating in the modern sectors of the economy, the education system, and technology gained from Japan. Also, fairly rapid urbanization had taken place during the later colonial period, and by around 1940 about 20 percent of the population was urban. Thus Korea had a relatively large urban workforce, much of which had received at least a primary Japanese-style education. Given the necessary capital input from abroad, Koreans could have embarked on their postwar development almost im-
mediately after the Japanese departure—if they had had the benefit of political stability and a peaceful international climate.

Unfortunately, as indicated earlier, the peninsula was divided in 1945 by arbitrary, external, political decisions. Because the country's natural resources and large-scale industrial plants were mostly in the North, whereas the South was primarily agricultural, the complementarity between North and South was lost. Even worse, much of the physical plant, in both the North and South, was destroyed during the Korean War.

FIRST REPUBLIC AND THE KOREAN WAR, 1948–60

Syngman Rhee, a prominent Korean independence leader, energetically pressed the United States to establish a unified and independent country by all possible diplomatic means. However, North Korean leaders refused to allow the proposed general election under the supervision of the United Nations Commission for Korea. When all efforts failed to achieve a unified government through a general election, no alternative remained except the formation of a government in the South alone. In May 1948 a general election was held in South Korea, under United Nations supervision, and Syngman Rhee was elected president. The Republic of Korea was proclaimed in the South on 15 August 1948; the Soviet command was instrumental in forming the Democratic People's Republic in the North. The nation was effectively divided under two politically incompatible and mutually hostile regimes. The Rhee government eliminated the remnants of Communist activity in South Korea and helped diminish considerably whatever sympathy there was for Communist institutions and practices.

The charismatic first president successfully defended South Korea, with direct involvement by United Nations forces, against the North Korean invasion that began on 25 June 1950. The bloody Korean War lasted three years, destroyed a quarter of the wealth of South Korea, and inflicted the loss of over a million lives. As a condition for agreeing to accept the Korean Armistice signed on 27 July 1953, Syngman Rhee concluded a mutual defense treaty with the United States. This treaty, which has subsequently served as the cornerstone of security relations between the two countries, stipulates that an armed attack on either country would cause each to “act to meet the common danger in accordance with its constitutional process.” To ensure the survival of the Republic of Korea against North Korean aggression, the Rhee government also systematically expanded the Korean armed forces into the largest formal organization in Korean society, thereby laying the foundations for South Korea as a viable independent nation-state. (For further details on the Rhee period, see Oliver 1954, 1978.)

Syngman Rhee helped lay the political foundations of an independent, modern country and some of the groundwork for later rapid economic development. Although the idea of land reform came from the United States, the program was pursued by the Korean government, partly out of politi-
cal necessity in view of the land reform taking place in the North. President Rhee sought land reform as a right that was justly due to the peasantry and fought for it against political reactionaries. The program also coincided with the president's intention to cripple his political opposition, which was based on the landlord (yangban) class.

Land reform was implemented in two stages. Initially land that was formerly under Japanese ownership or control was distributed to farmers. Under Rhee's leadership, the government broke up large Korean-owned estates and set a limit of three hectares per owner. Land reform probably lowered crop production during a brief initial period, because the government could not immediately replace the inputs (notably seed, fertilizers, and credit) formerly supplied by the landowning class. In the longer term the reform succeeded in raising productivity, and politically it placated the rural population.

The reform helped to bring about a more equitable distribution of assets and income in at least two ways. First, poor farmers received a share of the assets formerly exploited by the Japanese and the landlord class. Second, the landowners were partly compensated in the form of government bonds. The rapid decline in the value of these bonds because of inflation contributed to the redistribution of income.

Syngman Rhee maintained democratic ideals and allowed some of the basic elements of democratic institutions to operate. Reflecting on the past four decades of Korean history, the Rhee period was perhaps the most liberal in terms of freedom of expression, freedom of the press, and direct elections of both parliamentary representatives and the president. This period also witnessed experiments with local autonomy.

The president's political subordinates and other bureaucrats, who made and implemented many administrative decisions without the president's knowledge, were responsible for the corruption that spread during the last years of the Rhee government. Contrary to accusations made at that time, none of the corruption can be attributed to the president himself. Syngman Rhee was personally not ostentatious, nor did he accumulate wealth. In the end, he lost his grip on the country by refusing to obey the dictates of public opinion which yearned for a more democratic process. He had simply become too old (he was age 85 in 1960) and too conservative in his outlook to assess the changing political and social realities of the republic. He established some bad precedents, which have left a blot upon Korean constitutional history, notably by forcing an amendment to the constitution in 1952 (to ensure his own re-election) and again in 1957 (to enhance his personal authoritarianism). His March 1960 landslide victory for a fourth term in office was marred by accusations of election-rigging and violence toward the opposition. As a result of mounting political discontent, corruption in government, despair over lack of opportunities for the younger generation, and the economic hardships endured since the Korean War,
Rhee's increasingly personal authoritarian government was overturned by a student uprising in April 1960.

**SECOND REPUBLIC, 1960–61**

Out of the ensuing chaotic period emerged a revised constitution, fresh elections, and a new government formed in August 1960 by Prime Minister Chang Myon, thereby shifting from an authoritarian regime toward a more democratic one. The "democracy" of 1960–61, however, encouraged and widened splits, aggravated the power free-for-all, and projected an image of weakness and hesitation where chaotic conditions demanded strength and resolution (Henderson 1968).

Although the military remained politically neutral until 1961, largely because of Syngman Rhee's strong political leadership and skills, the Chang government was too weak to maintain civilian supremacy over the military. In view of the fact that the military had emerged as the strongest organization in Korean society since the Korean War, the possibility of military intervention in government was quite high. In retrospect, it seems regrettable that the Chang regime was overturned within nine months of assuming office. Given adequate time, the parliamentary system might have survived, strengthening the foundations for the democratic process in Korea.

Thus far, efforts toward postwar reconstruction in Korea, which began after the ceasefire in 1953, had left the economy stagnant and at the subsistence level. The Rhee government had embarked on reconstructing infrastructure and industrial facilities and stabilizing prices, with American aid as the major financial resource. Recovery from the Korean War was slow, and during the period 1953–61 the economy was kept alive largely by massive economic and military assistance from the United States. Between 1953 and 1961 the average annual growth rate of GNP in real terms was merely 3.9 percent. However, because the population was growing at an average annual rate of 2.9 percent, per capita GNP in real terms increased by no more than 1 percent on average each year.

The subsequent growth process was doubtless made easier by the massive influx of foreign exchange during this critical period of development, which held the country together and prevented massive starvation and economic dislocation. During the entire period 1945–83, aid or assistance from all sources to Korea is estimated at over US $26 billion (AID, U.S., 1985). Much of this was in the form of grants or concessions. About one-third of the total was military assistance, much of which was given during and just after the Korean War. By expediting postwar reconstruction and the recovery of the economy, these forms of assistance helped to lay the foundations for subsequent development during the 1960s. As discussed in the following chapter, economic modernization was one of the most urgent challenges facing the government that came to power in 1961.
2 Major Economic Policies of the Park Administration

by Lee-Jay Cho and Yoon Hyung Kim

MILITARY GOVERNMENT, 1961–63

The coup d'état of May 1961, headed by General Park Chung Hee, dramatically increased the influence of the military in Korean society and marked the beginning of political involvement by the military, which continued for the next 27 years. The justifications given for the military takeover were the pervasive corruption in government, inefficient bureaucracy, social disorder, degenerated national spirit, lagging economic development, and prevailing poverty. Under the encompassing ideology of "modernizing the fatherland," the new military regime set out to implement political reform, bring back social discipline and order, and re-educate or "reform" individuals by placing greater emphasis on traditional cultural values and by generating a national spirit of independence.¹

When the new military government began to formulate policies for economic development, capital was scarce. The domestic savings rate was extremely low. Foreign aid was rapidly declining, both in quantity and variety. Business enjoyed little public confidence, and entrepreneurial talent was deficient. Under these circumstances, the government asserted its leadership by setting the stage for formulating policies for national development. During the period 1961–63, the military government established the institutional framework for industrial development.

The Economic Planning Board (EPB), established in July 1961, was headed by a senior minister for economic planning, who was given the title of deputy prime minister. The EPB has subsequently developed into a powerful bureaucratic organization responsible for development planning and policymaking. In this capacity, it coordinates the functions of the Ministries of Finance, Commerce and Trade, Transportation, Agriculture, Health and Social Affairs, and Science and Technology.

¹ To demonstrate that these goals were not just rhetoric, the new regime rounded up gangsters and syndicate leaders and paraded them in the streets. To exemplify the seriousness of their actions, a gangster leader was executed. Housewives caught in secret dance halls were paraded in the streets as examples of persons violating the Confucian norms of family harmony. Several scores of generals in the armed forces were arrested and jailed for corruption. A few of the largest capitalists were "pointed at" for dishonest accumulation of wealth.
Government Control Over the National Economy (1961–62)

The First Five-Year Economic Development Plan (1962–66) was formulated by the EPB. To implement it, the government embarked on investment planning. The major issue was how to finance major industrial investment projects. Under the conditions prevailing in the early 1960s—the extremely low domestic savings rate, the absence of a well-functioning financial and capital market, and the decline of foreign aid—the military government had to develop a means for providing long-term capital to industry. Thus, the supply of capital for the needs of industrialization led to the government's control of access to domestic credit and foreign borrowing (see Chapter 3). This measure was aimed not only at increasing government influence in the allocation of financial resources but also at expanding the availability of loanable funds, particularly from foreign sources. In fact, the system of foreign-loan repayment guarantees (which required EPB approvals to loan seekers) contributed substantially to increasing the inflow of foreign capital.

Recognizing its role as the predominant source of capital for industry in the early 1960s, the government resorted to the practice of “overloaning” by the central bank (Bank of Korea), which helped to forge close links between commercial banks and industry. Through the device of formally short-term but in reality long-term current-account credits (the so-called “rollover” of commercial bank loans), commercial banks could play the role of industrial investment banks designed to finance the long-term investment needs of the economy. Korean enterprises willing to conform to the government's development priorities were entitled to borrow from a commercial bank amounts well in excess of the individual companies' net worth. The commercial banks, in turn, overborrowed from the central bank. The Bank of Korea was the ultimate guarantor of the financing system and the minister of finance served as chairman of the Monetary Board. Thus, the government gained detailed control over the policies and lending decisions of commercial banks. This so-called “indirect” financing reduced the financial risks associated with the high-debt levels of Korean enterprises because the central bank had a major role in deciding the fate of a defaulting company. By thus reducing the risks for foreign lenders, the government opened the door to massive foreign borrowing. During the early industrialization period, therefore, the Korean government not only selected strategic industries to be nurtured and provided with industrial financing, but also assumed the major risk for large-scale investment ventures undertaken by private enterprises.

In the meantime, the printing of money as an expedient to mobilize domestic resources for growth and employment resulted in rapid expansion of the money supply and contributed to inflation. To cope with inflation, the government resorted to an incomes policy (see Chapter 4). The first policy measure enacted by the military regime in 1961 was the imposi-
tion of a complete price freeze. Although the price freeze was lifted after two months, the government continued to rely on a system of selective price controls to alleviate the burden of the high rate of inflation on low-income families and to restrain price inflation. Some of the long-term consequences of government intervention in both the factor market (through interest and wage controls) and the commodity market (through price controls) resulted in distortions of resource allocation. The failure of the first two policy measures thus necessitated the 1964–65 exchange-rate reform, export-promotion policy, and import-liberalization measures (see Chapter 5), which were formulated after President Park achieved a popular mandate through his victory in the October 1963 general election. With aggregate demand policies directed to promoting growth and employment, the government continued to rely extensively on price-control measures to stabilize the price level.

Population Policy

Prior to the military takeover of the government, no discussion of population control was possible. The traditional Confucian value of the large extended family was shared by Korea's leaders. In particular, Syngman Rhee's government was not receptive to policy dialogue concerned with population control, despite the fact that the Korean population was growing far more rapidly than at any previous time.

Debate on the implications of Korean population growth and the wisdom of establishing a nationwide program to encourage low fertility became possible only upon the overthrow of the Rhee regime in 1960. President Park Chung Hee as a nationalist and Confucianist was initially reluctant to introduce family planning to Korea, but arguments by Korea's technocrats that rapid population growth would impede Korea's development were convincing. A decrease in the birthrate was adopted as one of the goals of Korea's First Five-Year Economic Development Plan (see Chapter 12). Funds were provided through the Ministry of Health and Social Affairs to establish government-sponsored family planning in Korea.

The Korean family planning program accomplished its primary objective. Korean women are bearing only two children each on average compared with six children each in 1960. Given this fertility level, Korea's population should stop growing in the twenty-first century and stabilize at about 60 million—approximately 18 million more than in 1987. Among the positive structural results, the success in the rapid reduction in fertility and the consequent reduction in childbearing responsibilities have contributed to increased labor-force participation by Korean women. Also, the increase in labor-force quality resulting from the higher education attainment of children from small families has contributed to the rise in labor productivity. Moreover, a significant proportion of the increase in the domes-
tic savings rate, which is essential for continued capital accumulation, can also be attributed to the decline in the number of young dependents. 2

THIRD REPUBLIC, 1963-72

In accordance with the military regime's commitment to transfer the powers of government to a civilian administration through a national election, there was a constitutionally legitimate and peaceful transition to the Third Republic in late 1963. Under the new constitution, General Park Chung Hee was elected president through popular election in October 1963, and a civilian government was formed.

President Park came from a very poor farming village and acquired a strong sense of social justice and egalitarianism, having suffered from poverty and having been influenced as a young adult by socialist ideas (Time Magazine, May 1961). He also demonstrated a strong predilection toward authoritarianism for the sake of efficiency and order. His early attraction to socialism, combined with the need for rapid economic development and the lessons learned from the Japanese for mobilizing the populace to expedite rapid development, enabled him to combine many positive elements of capitalism, socialism, and military discipline. Park possessed many of the qualities of the traditional (Confucian) authoritarian leader whose actions were "for the good of the masses" (in the sense used by the Confucian scholar, Mencius), and was very effective in this role.

The president had a strong commitment to eradicating the prevailing extreme poverty in the rural areas, which he himself had suffered during his childhood and youth. Having lived as a poor farmer himself, he understood the situation of Korean farmers. His New Community (Saemaul) Movement was started for the purpose of transferring the benefits of development to the backward rural villages (see Chapter 16). The movement mobilized local labor for local improvements, providing poor villages with basic infrastructure—paved roads, bridges, better housing, schools, and training facilities. Some aspects of the Saemaul training program resem-

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2. No consistent and general theory of demographic transition has yet been developed, but the rapid transition process in Korea has clearly helped to promote and expedite economic growth (L. J. Cho 1984; Cho and Togashi 1985). The demographic transition in Europe began in the eighteenth century and was completed in the twentieth. As high birth rates and death rates were reversed, and birth rates continued to be low, the age structures became similar in most European countries. Japan was the first Asian country to pass through this transition, completing it in the 1960s. Korea was already in the midst of transition in the 1970s, whereas the transition has barely begun in most of the Southeast Asian countries. As economies such as Korea's and Taiwan's pass through the newly industrialized stage, and export their own capital and technology, similar benefits may be shifted to the lower-wage Southeast Asian economies. For economic planning in the latter region, Korea's recent experiences may thus provide valuable insights.
bled the Chinese May 7 Cadre Schools, with their training centers to re-educate leaders for national revival, and recalled the Chinese slogan “With self-reliance you survive.” The program also reflected the “group solution” to a problem frequently found in Chinese, Japanese, and Korean traditional culture and history. By providing incentives with training, technology, and construction materials, the Saemaul movement was fairly successful in motivating farmers to participate in projects for the common good, and it fostered a sense of national spirit.

Another factor contributing to President Park’s popularity was his handling of business leaders. The leaders of the conglomerates were told in essence that their property was not their own but really belonged to the nation. Under the president’s influence, they curbed their lavish spending and extravagant life-styles and were also encouraged to invest not merely in ways that were best for their own corporate profits but in ways that the government regarded as best for long-term national economic development goals.

President Park acquired a great following among the masses—especially among the poor rural people, whom he understood very well. As far as they were concerned, his leadership during the first 15 years of his presidency was a success, partly because it provided Koreans with a sense of national pride and renewed their sense of national identity through development.

To President Park, economic development was “an integral part of a nationalistic vision of a more independent Korea to come—more independent of U.S. aid and influence and as an economically stronger and independent entity, more able to deal with North Korea” (C. H. Park 1963:19–20). Under the slogan of “Eradicating Poverty through Rapid Economic Growth,” the military regime gave first priority to the promotion of economic growth. This strongly appealed to the country in the early 1960s and became a nationally supported goal of the Third Republic. One objective of the Park regime was to catch up first with Taiwan, a rapidly industrializing country, and to follow closely Japan, an economic superpower. Having passed through the prewar Japanese-style education system, Park had learned a great deal about the role of the Meiji revolution in modernizing the Japanese economy. He also realized that only through economic growth could a country earn international respect. He thought that democratic institutions could not prosper without a strong economy, and his philosophy was, therefore, “economic development first, democracy later.”

3. The May 7 Cadre Schools got their name from a letter by Mao Zedong, dated 7 May 1966, addressed to Marshall Lin Piao stating that all Chinese should do physical labor combined with an educational program (“physical work and study program”) to raise their political consciousness. During the later part of the Chinese Cultural Revolution, all cadres were sent to re-education farms organized in the spirit outlined in the letter.
Economic Liberalization and Reforms (1964–67)

One of the principal reasons for the tightening of economic control in the early 1960s was that Korea was still a major recipient of U.S. aid. The United States, through its Office of Economic Coordinator, wielded considerable influence over Korean economic policy, to the extent that assistance funds were linked with development policies. The 1961 coup was not welcomed by the United States which, therefore, tried to pressure the new government to loosen its political grip by various means, such as withholding the delivery of goods until certain conditions were met. The incomplete flow of assistance in commodities and raw materials created difficulties for the Korean government, and measures were taken through government control of credit and foreign borrowing to limit imports and stabilize the markets. These measures exacerbated the situation, requiring additional policy measures as correctives.

Imports of raw materials and industrial machinery increased dramatically, however, because the government was trying to stimulate industrial activities by pumping money into large-scale projects. By the end of 1963 Korea’s foreign exchange holdings had shrunk to no more than $90 million. The prospects of a severe foreign exchange deficit for 1964 were even more serious. The fragility of postwar Korea’s economic health and its consequent poor credit standing in international financial markets, combined with the political turmoil resulting from rapid changes of government, made it extremely difficult for Korea to attract foreign capital. Faced with a severe foreign exchange crunch, the construction of some large-scale industrial plants was interrupted. Worse yet, because of the shortages of imported raw materials, some of the existing plants faced a slowdown in operation. Under these circumstances, and in view of the rapid reduction of foreign aid, the government decided to promote exports to earn foreign exchange. From this point in time, the importance of “export promotion” was equated with that of “national defense” and was frequently referred to as the means for national survival.

Korea had little experience in dealing with large-scale manufactured exports. In the past they had dealt only with exports of raw materials such as tungsten and some agricultural products. The government had to rethink its organizational structure to deal with the new task of expanding trade. A convenient model for Korea was provided by Japan’s Ministry of Commerce and Industry (subsequently transformed into the Ministry of International Trade and Industry, or MITI). In 1965 Korea’s Ministry of Commerce and Industry, patterned after its Japanese counterpart, was reorganized to create an export component in each of its industrial bureaus, supplementing the existing Bureau of Foreign Trade. The main function of each export component was to set annual export targets by commodity, as well as by region and country of destination, and to monitor the export performance
of the firms that were under the purview of each bureau. The immediate task was to enable factories to operate by making raw materials available. Then the government curtailed domestic sales of exportable commodities as a means of promoting their export.

One of the major issues the government was confronted with was how to deal with the possible losses that firms would incur by exporting commodities that thus far had not been tested or accepted in world markets. To be competitive these commodities would have to be marketed below prevailing world prices. The government recognized the need for substantial financial support and subsidies for the exporting companies to expand exports. To achieve this objective, the government launched its 1964–65 exchange-rate reform, export-promotion measures, and import-liberalization program. In 1964–65, as discussed in Chapter 5, the won was devalued and the system of multiple exchange rates was replaced by a unitary, floating exchange rate designed to maintain a realistic effective exchange rate. The exchange reform was combined with export-promotion measures (in the form of tax concessions, preferential credits, and export subsidies), and with the import-liberalization program that was designed and implemented during 1964–67.

The ideas for these comprehensive export-promotion policies were generated at the Monthly Export Promotion Meeting, which was initiated in 1965. The meeting served as a forum for business and government and was chaired by President Park and attended by trade-related ministers, business association leaders, heads of major financial institutions, and representatives of major export firms. Institutional arrangements, legal and procedural issues, and other policy matters for promoting exports were discussed, and fairly concrete policy recommendations and determinations were made on the spot. This forum contributed greatly to the elimination of innumerable bottlenecks that had impeded the promotion of exports.

Subsequently exports expanded rapidly. In June 1964, the government had set its export target for the end of that year at US $120 million. On 30 November 1964 Korea's exports passed the $100-million mark for the first time within a single year, and the last day of November has been commemorated annually ever since as Export Day. This remarkable achievement provided both government and business with such self-confidence that the old Korean saying equivalent to "He who tries will succeed" was frequently heard in business circles. The expansion of exports resulted in corresponding increases in production, and therefore the government framed export promotion and industrialization into a coherent strategy of export-led industrialization. Measures were also taken to liberalize imports, with the aim of reducing various domestic distortions resulting mainly from quantitative restrictions on imports. The implementation of the import-liberalization program, however, was not completely satisfactory, as discussed in Chapter 5.
Along with these policy measures, the Park government initiated the interest-rate reform in 1965 (see Chapter 6). Sustained rapid economic growth required a continuous rapid increase in investment. Yet limits had already been reached for financing the required capital investment by means of domestic saving and the mobilization of financial resources through commercial banks. The government's industrial financing policy resulted in excessive monetary expansion and inflation. During 1961–65 a high inflation rate prevailed, despite the government's efforts at direct price controls, and the highest bank deposit rate became negative in real terms for a number of years. The time and savings deposits of the financial institutions did not increase in real terms between 1962 and 1965, despite the nationwide savings campaign launched by both the government and financial institutions. An overriding issue for rapid industrialization then was how to mobilize private savings through financial intermediaries. The principal aims of the interest-rate reform of 1965, which sharply raised interest rates on both time deposits and loans of banking institutions, were to attract private savings through financial intermediaries for ultimate increases in aggregate domestic saving and investment, as well as to improve the effectiveness of interest-rate policy for resource allocation and monetary control.

On 30 September 1965 the Monetary Board raised the ceiling on savings deposits from 15 to 30 percent per annum; the ceiling on ordinary bank loans was raised from 16 to 26 percent per annum (see Chapter 6). At the same time, the central bank introduced a new system of subsidizing the deposit-money banks to compensate them for losses incurred as a result of the negative margins between the deposit and loan rates. Patterned after the Taiwan success story of 1957–58, the 1965 interest-rate reform in Korea was mainly designed to increase the attractiveness of financial saving rather than to improve the financial soundness of the banking institutions. At that time, there was an incalculable amount of currency floating in the unofficial "curb market." The government tried to encourage the transfer of these funds to the regulated banking institutions by trying to inculcate the general public with an appreciation of dependable, stable, institutionalized interest on their money. The high-interest-rate strategy, which was maintained for almost seven years until August 1972, did affect the savings behavior of the general public and succeeded in achieving an increase in saving.

During 1966–67 major tax reform measures were undertaken to increase tax revenues and aggregate domestic savings. The reform measures entailed the reorganization and upgrading of tax administration in 1966 and the subsequent enactment of a comprehensive revision of tax law in 1967 (see Chapter 10). The establishment of the Office of National Tax Administration in 1966 was a turning point in Korea's development financing. The revamping and restructuring of tax administration contributed significantly to the efficiency of tax collection and more than doubled revenue within a year.
Major Economic Policies of the Park Administration 23

by eliminating corruption, tax evasion, and arbitrary tax assessment procedures. At the same time, there was no apparent public resistance to the measures.

Agricultural Policy and the Saemaul Movement (1969-71)

It is apparent that the government put utmost emphasis on policy measures for promoting export-oriented industrialization by mobilizing available capital resources. Yet President Park, as mentioned earlier, had experienced the misery of the poor farmer's life, and his lifelong desire was to promote rural development and to improve the quality of village life. However, in the first few years of his government, the president's freedom of policy action was constrained by the scarcity of capital resources.

Immediately after the military takeover, the government advocated agricultural reform. This involved rearranging and eliminating some exploitive elements of the moneylending system that were then operating to the detriment of agricultural communities. The system was especially oppressive for poor farmers, who had to borrow money during the growing season and repay at exorbitant interest rates after disposing of their crops.

The government also tried to rearrange some landholdings to consolidate small plots of arable land, as a means of increasing productivity. Another project attempted to improve the exploitation of underground water resources. Most important of all, shortly after assuming leadership, President Park initiated the National Reconstruction Movement, which was aimed especially at the rural sector and focused on arousing a spirit of revival for modernizing the villages. This movement can perhaps be regarded as the precursor of the Saemaul (new community) movement discussed below. Although some progress was made in the rural sector, it was inevitably overshadowed by the rapid growth of the industrial sector up to 1969, because of the scarcity of resources available to agriculture.

Moreover, up until 1969 the government had maintained low grain prices to hold urban wages at a relatively low level. This may have been one of the major factors responsible for slow growth in the agricultural sector, which eventually led to food shortages and a growing disparity between urban and farm household income. By the end of the 1960s, as a result of sustained industrial growth, the government felt that sufficient (although still limited) capital resources were available for modernizing the agricultural sector. The government launched a two-pronged reform to stimulate food-grain production, raise farm incomes, and promote rural development: adoption of the two-tier price system for rice and barley in 1969, and the launching of the Saemaul movement in 1970 (discussed in Chapters 15 and 16, respectively).

Under the two-tier price system that took effect with the 1969 harvest, the government procured grain from farmers at a price higher than what
urban consumers had to pay when it was resold to them. This system provided price incentives for an increase in farm production and at the same time held down urban consumers' food costs. The implementation of such a two-tier price system conflicted in several ways with the objectives of financial and monetary stability. Nevertheless, it significantly contributed to the increase in farm income and grain production, in that the measure encouraged the expanded cultivation of high-yielding varieties as well as the improvement of farming techniques.

The Saemaul movement launched in 1970 was a bold stroke in the government's policy toward rural development. This movement not only embodied President Park's ideals about modernizing the rural sector but also represented his strong personal mission to upgrade the village life of the poor. It was conceptualized and designed to revitalize and rebuild rural communities by inculcating the "will to work" among villagers and by organizing rural human resources so that they could be channeled into productive activities. In some ways, it recalls the "will to economize" depicted by Nobel laureate Sir Arthur Lewis as a prerequisite of Western economic development.

The movement involved close cooperation among government agencies at all levels in the effort to introduce more rational thinking in the management of farm production and village life, to inculcate a national revival spirit, and to promote diligence, self-help, and mutual cooperation. Numerous small-scale investment projects were undertaken with government support and assistance for the improvement of rural infrastructure (such as building farm access roads, bridges, washing facilities, toilets, and wells), as well as improving farm income. The basic principle of the Saemaul movement was that the government provided the necessary construction materials (such as cement and steel) free of charge; other goods (such as fertilizers and roofing materials) were provided at subsidized rates. The villagers in turn supplied the organized human resources for the construction projects. Work was performed collectively on village projects (such as bridges) but individually on others (such as house improvements). The movement thereby mobilized rural residents, insofar as the villagers' own resources would permit, for the common goal of improving rural infrastructure.

This movement contributed remarkably to the improvement of the rural infrastructure and environment, and consequently to better average farm income. By the mid-1970s rural household income had increased so dramatically that it had caught up with and, in one year, even surpassed urban household income. The Saemaul movement was instrumental in developing and modernizing rural communities. These poor villages had been a symbol of poverty in the Korean peninsula for many centuries. The movement helped to extract poor farmers from a situation of low morale and frequent despair and to inspire them with a development-oriented men-
tality and make them good citizens. After it had been in existence for about ten years, however, the movement came under some criticism, mainly for its authoritarian approach, which discouraged voluntary participation by the rural people and even led to some misallocation of resources.

**Promotion of Science and Technology**

About the time the plans for the Saemaul movement were being implemented, the government launched a major effort to upgrade science, technology, and professional skills. In 1968 the government founded the Korean Institute for Science and Technology (KIST). KIST's objective was not only to import advanced science and technology but also to introduce and disseminate advanced industrial technology. It was designed as an institute for research and applied science (operating in part under contracts from big industries) to provide innovations in manufactured commodities, especially in the field of electronics. KIST sought to bring leading Korean scientists and technicians residing abroad back to Korea, and to do so offered these expatriates international-level salaries. As a result, many high-level Korean scientists returned and joined Korea's scientific research efforts. These scientists and technicians also worked on industrial applications, thereby contributing to the quality of Korean manufacturing.

The government also founded the Institute of Advanced Science and Technology as a teaching institution—it was combined with KIST in the early 1980s to form the Korea Advanced Institute of Science and Technology (KAIST).

The government placed great emphasis on promoting and upgrading skills in the fields of craftsmanship and services (such as mechanical skills, metal work, tailoring, and carpentry), which were important to industrial development. The emphasis placed on the acquisition of scientific and technical skills resulted in the founding of the Professional Skills and Craftsmanship Training Center, which has had long-term beneficial effects on the economy. Pilot projects were started in Seoul by the president and, once in successful operation, were spread to other provinces of the country. A national testing center was also established for certifying craftsmanship and services skills.

Along the same lines but on the economic front, the government established the Korea Development Institute (KDI) in 1972, to attract leading economists and social scientists to study and provide recommendations on long-range development issues and macroeconomic directions. KDI recruited most of its staff among Koreans abroad, offering salaries on an international scale. Such innovative measures to bring in talent, advanced technology, and scientific knowledge—not only to promote industrial growth but also to upgrade the country's level of science and technology—contributed to the rapid industrialization that followed in the 1970s.
External Affairs and National Security

A fairly bold step taken during the Third Republic, which provided a boost to economic development, was the normalization of diplomatic relations with Japan in 1965. Syngman Rhee, having devoted most of his life to the movement of liberation and national independence from the Japanese empire, had a tremendous hatred toward Japan. During his presidency, the government tried to eradicate everything manifestly Japanese by banning, for example, Japanese songs, Japanese movies, and the use of the Japanese language. This policy was implemented even though the Korean leaders themselves had been trained by and had served in the Japanese bureaucracy and military. In 1965, when the treaty with Japan was concluded, strong anti-Japanese sentiments were still widespread and were manifested principally through student demonstrations.

In seeking to establish closer ties between the two countries, President Park had political and economic objectives. The geographical proximity of Korea and Japan, and their common bond in the alliance of free nations against the common threat of communism, made it inconvenient and somewhat absurd not to have diplomatic relations. Furthermore, Korea could benefit from Japanese investment and technology by fostering economic cooperation through diplomatic relations. Under the reparations terms of the treaty, Japan transferred US $300 million to Korea as a grant-in-aid and arranged for a long-term development loan of US $200 million at 3.5 percent interest. These funds were used to develop the Pohang Steel Company and for irrigation, farm mechanization, and other works designed to increase productivity in the agricultural and fisheries sectors. The payment of reparations not only facilitated technology transfer from Japan but also provided Korea with considerable foreign exchange, which was useful for the development of the country. In this regard, it is important to note also that between 1962 and 1981 roughly $42 billion in foreign lending and grants was received by Korea—one-third from public and two-thirds from commercial sources—further facilitating economic growth during this period (AID, U.S., 1985). The move to normalize diplomatic relations thus contributed directly to international economic cooperation as well as to subsequent growth at home.

The drive to meet the foreign exchange requirements of the expanding economy likewise benefited from Korea's participation in the protracted Vietnam War, from 1965 until the withdrawal of American troops from South Vietnam in 1973. The war had important ramifications for the Korean economy. It provided both the military and business sector with invaluable technical skills and experience. Korean business firms were offered lucrative opportunities to market their manufactured goods, the Korean service sector identified numerous openings to provide services to both American and Korean troops stationed in Vietnam, and Korean construction companies
took advantage of highly profitable construction projects in Vietnam. Moreover, two divisions of the Korean armed forces were stationed in Vietnam, and their military pay and allowances were provided in U.S. dollars under international arrangements. The influx of foreign exchange earnings from these war-related activities was especially valuable to the Korean economy, which was just taking off during this period.

A few unfavorable international events had serious consequences for political and economic development in Korea. In 1968 scores of North Korean armed infiltrators reached Seoul in an attempt to assassinate President Park. Other guerilla groups struck at villages in the mountainous areas of South Korea. These actions, combined with the international events that followed, changed the political and military situation, and the country took a definite turn toward tighter military security. Then, with the 1969 Guam Doctrine, the United States emphasized that its Asian allies would henceforth have to bear the primary responsibility for their own conventional defense. Subsequently, in 1971 the Nixon administration removed one of the two U.S. divisions from Korea. In July 1971 the United States unveiled its basic shift in policy toward the People's Republic of China. As Mason argues, "Widespread doubt existed in Korea as to the willingness of the U.S. to support its allies in East Asia and this emphasized the necessity of rallying around a strong leader" (Mason et al. 1980:53). Under these circumstances, it was clear that Koreans would have to make greater efforts to achieve self-reliance and self-defense.

The earlier part of the Third Republic witnessed a more democratic process with great emphasis on economic development. In the later period, the international political and military security situation was changing, and there was greater concern about national security issues, thereby causing a movement towards greater regimentation and national mobilization. Political development was perceived to have stalled, therefore, students and intellectuals in urban centers began to express a sense of uneasiness and dissatisfaction.

FOURTH REPUBLIC, 1972–80

The Fourth Republic can be viewed as an "emergency regime" in the sense that the existing regime was structurally transformed to make way for arbitrary rule by the executive authority for as long as it claimed that a period of crisis prevailed (Das Gupta 1978). The national security crisis brought on by the turmoil of superpower politics and the perceived threat of a North Korean invasion provided the justification for amending the constitution to enable President Park to issue emergency decrees, dissolve the national assembly, and perpetuate his tenure indefinitely. The proposed constitution was submitted to popular referendum, and was supported by the majority of the voters.
Once President Park had successfully met his major challenges of launching economic development and modernization and reviving the national spirit, he felt a great need to maintain the momentum of change and thereby consolidate the achievements of the previous decade. Having nurtured this process from the start, the president felt that no one other than himself could accomplish this task. Because his grand scheme for the nation was working well at the time, it is understandable that he did not want to leave office in the midst of a process that had not yet reached the successful conclusion that he envisaged. However, the constitutional limitation on his tenure was a stumbling block. The constitution was amended in 1969 to allow him to be elected for a third term. Finally, under the 1972 constitution, all limitations on Park's future re-election were removed.

The 1972 constitution was given the title Yushin (Revitalizing), a term that was used to label the Meiji revolution (called in Japanese the Meiji Yishin). President Park had begun the work of laying the foundations of a nation-state that could survive on its own, internationally as well as against the threat of North Korea, without being totally dependent on the United States and other allies. He also wanted to complete the task of modernizing Korea in the way that Japan had modernized during the Meiji era (1868-1912). Through the initiation of state capitalism, Japan had developed enterprises as well as entrepreneurs by mobilizing warriors (the samurai class). The state initiated the development of textile mills, mining activities, shipbuilding, and other enterprises, and later transferred ownership at low prices to private hands, thus giving rise to the family-owned conglomerates of the twentieth century. The Japanese modernized education, taking Western technology and combining it with Japanese thought derived from Confucianism and Legalism.4 They also achieved social order and harmony by encouraging development of individual discipline through adherence to the values of Confucian ethics, loyalty to the state, filial piety toward parents and family, and loyalty to the organization (government or private) to which they belonged. It took more than 40 years in the Meiji period to accomplish this, thus laying the foundations for Japan's subsequent development.

Clearly, numerous parallels emerge when these changes of the late nineteenth century in Japan are compared to those that began in Korea just

4. Legalism, which was synthesized by Han-fei-tzu (d. 233 B.C.), advocated the enforcement of law with liberal rewards and heavy punishment, the manipulation of statecraft, and the exercise of power by the ruler. The Legalist school shared certain concepts with other schools—such as the equality of all men—but rejected the Taoist natural standard of the Way, the Confucian moral standard of jen, and the religious standard of heaven advocated by Mo-tzu. The philosophy of the Legalist school was put into strict practice during the Ch'in dynasty (221-206 B.C.), but soon thereafter Confucianism began to gain ground and within less than a century became the state doctrine (W. T. Chan 1979:417). Nonetheless, Legalism's influence remained and its precepts served as the basis for the establishment of the Chinese bureaucracy.
a little more than a century later under the Yushin Constitution. To the mind of President Park, a mere eight or ten years in office were not sufficient to build the modern state that he envisaged, nor sufficient even for some of the most basic achievements of the Meiji revolution. He set himself the task of replicating in Korea what was done during the Meiji reforms in Japan. In essence, the objectives in modernizing the two countries were basically similar: economic development, a strong defense, and a cohesive society based on the Confucian ethics of harmony and loyalty. President Park made explicit efforts to inculcate in the Korean populace the Confucian value of chung hyo (loyalty to state, filial piety, and harmony). In this respect, the Japanese and Korean techniques for achieving national goals also appear similar, notably in terms of education and mobilization of the population. The Yushin measures, for example, included institutionalization of student military training, and establishment of hometown militias and a civil defense corps. Great emphasis was placed on social cohesion and national integration.

From 1972 onward, the Park regime became more authoritarian, moving toward increasing limitation of civil liberties and participation in the political process. The government created a weak national assembly and sought to counterbalance it with a strong bureaucracy. President Park did attempt, however, to decrease military influence in political and economic affairs.

**Emergency Decree and Policy Measures for Industry (1972-74)**

As Korea entered the 1970s, a few signs in the world economy boded ill for Korea's export-led industrialization. Economic recession in major industrialized countries, the increase of protectionism in world trade, and international monetary disturbances in the early 1970s generated uncertainty in the Korean business community about the short-term prospects for sustaining Korea's export growth. When the growth of exports slowed in 1971, the economy started to cool off and slid into economic recession in 1971 and 1972. In the process, it was realized that the capital structure of many Korean firms was neither stable nor healthy. By the early 1970s many companies had grown into large-scale enterprises in terms of sales, assets, and employment. These companies, however, started their businesses with little equity; although they grew very large, they subsequently became heavily dependent on loans from domestic commercial banks and on foreign loans. For their working capital they had to resort to the unorganized curb market. When the economic slowdown arrived and the 1971 devaluation of the Korean won reduced their current earnings, at the same time increasing the won-costs of servicing their foreign debts, these large enterprises faced severe short-term cash-flow problems and the possibility of defaulting on their foreign loans. Such short-term, high-cost financing forced some
of the companies into bankruptcy or to come under bank control. In this situation economic growth stagnated.

To stave off massive bankruptcies and to stimulate the economy, the Presidential Emergency Decree for Economic Stability and Growth was announced on 3 August 1972. This measure, discussed in detail in Chapter 7, was taken essentially to relieve the financial strain on business firms, to improve corporate financial structures, and to curb inflationary pressures. Under this decree, loans from unorganized money markets (which charged extremely high interest rates) were forcibly converted into “new debt claims” with lower interest rates and rescheduled payments. A credit-guarantee fund was established for small and medium-size businesses. Bank interest rates were reduced for both borrowers and depositors. Many in the business community were cognizant of the extremely serious implications of massive bankruptcies and also of rampant usury. Business leaders were convinced that their enterprises could not survive under such a climate and that the short-term curb market profiteers rather than the institutionalized banks were running the show. The president finally came to share their view and announced this drastic measure to eliminate the tyranny of usury. It is arguable that, had business not been saved from bankruptcy, those who contributed in major ways to rapid economic expansion in the decade that followed would not have been able to make such a contribution. Some argue, however, that the emergency decree, while giving immediate and substantial assistance to debt-ridden firms, provided only temporary relief but no long-term financial solutions to industry.\(^5\)

The emergency decree of 1972 went side by side with a policy measure to open private companies to public shareholding, with emphasis on the gradual separation of ownership and management. In 1972 the government enacted the Law on Opening of Closed Corporations to induce large family-owned enterprises to sell a portion of their equity to the public. President Park did not have a liking for large capitalists, which is understandable, considering his own background. He personally examined the results of this measure by requiring a monthly report on the progress of opening up the family-held companies. The large corporations found various means to avoid opening up from the beginning; therefore, on 29 May 1974 the presi-

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5. An interesting commentary by Professor Shinichi Ichimura of Kyoto University on Chapter 7 of this book is noted here:

[An assessment of the 1972 emergency decree] requires a view on history rather than an economist’s analytical mind. The late President Park may have been a historic figure who played the role that Korea needed just at that time. He reminds me, as a Japanese scholar, of Oda Nobunaga who achieved an end to the Medieval Age and started a period of rationalization and secularization [in Japan] and was assassinated by his subordinate. Leave the evaluation of President Park to an outstanding Korea historian some decade later (Ichimura 1985).
dent issued a special directive to force recalcitrant companies to comply (Chapter 18). By 1979 publicly held shares were supposed to be 49 percent of total shares in 355 of the largest 500 companies in Korea. The ultimate design for reducing family holdings to only 10 percent of shares was already in the planning stages, but it was never actually implemented. Moreover, during the same period, the total value added of the top 20 conglomerates, as a percentage of gross domestic product, increased significantly, from 7 percent in 1973 to 14 percent in 1978.

The government under President Park made a consistent effort up to 1979 to regulate the excess concentration of economic power in the hands of a small number of large corporations. Since 1979, however, not much progress has been made in opening up the family-held companies. Looking at the situation in the late 1980s, some would argue that efforts along these lines have met with limited success. However, if the policy intentions of the Park government had been implemented continuously over a longer span of time and had not been interrupted by the president's death in 1979, it is conceivable that public shareholding in the larger corporations might have increased to a greater extent than it has.

Another policy measure sought to promote heavy and chemical industries as envisaged in the Heavy and Chemical Industries Promotion Plan announced by the government in 1973 (Chapter 17). It was an ambitious scheme to foster the growth of heavy engineering and petrochemical-process industries, including iron and steel, nonferrous metals, shipbuilding, industrial machinery, electronics, and petrochemicals. This plan was seemingly motivated by two arguments. First, the development of defense-related industries was considered a necessity, in view of the signals from the United States regarding the eventual withdrawal of U.S. ground forces from Korea. Second, the increase of heavy industrial goods in the commodity composition of Korean exports was necessary to increase the value added in its exports (such goods represent higher value added) and also to cope with increasing protectionism against labor-intensive light manufactures in world markets (particularly in view of rapidly rising wage levels in Korea). The government provided a variety of incentives to the enterprises investing in the designated heavy and chemical industries, which ranged from preferential loans and tax concessions to protection through restrictions on commodity production. The government's big push succeeded in developing a nucleus of heavy and chemical industries in Korea. But the concentration of scarce capital in this sector had an adverse effect on the economic stability and export competitiveness of other sectors of the economy (agriculture, light manufacturing, and nontradable goods). The financial insolvency of many of the latter firms in the early 1980s may be attributable to the lopsided allocation of financial resources in favor of the heavy and chemical industries.
The rapidly changing international political scene in the early 1970s—in particular the visits of the American president and other top leaders to China (viewed in Korea and elsewhere as the "Nixon Shock") and the opening of the dialogue between Japan and China—made it extremely difficult for Korean leaders to assess the implications and future consequences of such changes for Korea's national security. The sense of insecurity and instability resulting from not knowing what was going to happen must have strongly motivated President Park and his economic policymakers to place stronger emphasis on heavy and chemical industries, which would enable Korea to become more self-reliant in national defense. A question arose as to whether the United States would be trustworthy and reliable in time of desperate need for military hardware and other direct support for the defense of Korea. Unbalanced investment in the heavy and chemical industries caused distortions in the country's industrial structure, in income distribution, and in other dimensions of the economy. Nevertheless, the concern for national security, especially vis-à-vis the increasing belligerence of North Korea, was the overriding issue facing the Korean leadership. The threat from North Korea was exemplified by a 1976 incident when North Korean soldiers ruthlessly hacked to death two American officers who were attempting to trim the branches of a tree in the demilitarized zone. Joint U.S. and Korean military plans for possible counteraction were subsequently formulated and approved by the presidents of both countries. Another work crew was sent to continue the trimming. South Korean and U.S. air and ground forces were on alert and prepared, if they too were attacked, to strike across the demilitarized zone to recapture territory up to the 38th parallel that had been lost during the Korean War. This time, the North Koreans took no action, but under such tense circumstances verging on war, national security overrode all other concerns as the focus of South Korean policymaking.

As the government implemented the policy measures to expand heavy and chemical industries, their will was further intensified by President Carter's platform for the complete withdrawal of all U.S. troops from Korea by 1982. The Korean government thus set 1980 as the target date for fulfilling the basic requirements of self-reliance in the defense industry.

Having relieved business firms of severe financial restraints through the 1972 emergency decree, the subsequent massive investment in heavy and chemical industries spurred industrial growth through the 1970s. Such rapid industrial expansion entailed significant changes in industrial structure and market organization. There was also noticeable change in the distribution of industrial and economic power, and a sizable number of large-scale corporations (perceived as associated with family fortunes) emerged. The emergence of the jaebul (family-connected corporations) was beginning to change the public's perception of the benefits of the development-first strategy, in
that rapid economic growth was perceived to have resulted in distortions in the distribution of income and wealth. In this context, the freezing of the curb market was regarded by many as financial relief to help large businesses at the expense of the middle-income people who had invested in the curb markets.

Policy Response to the Oil Crisis (1974)

The Middle East war of October 1973 and the ensuing oil crisis caused a sudden panic in Korean economic circles. The Arab oil embargo led to a quadrupling of the world oil price in 1973-74, followed by recession in the Japanese and U.S. economies. Korea depended on imported oil for about 55 percent of its total energy requirements, and the situation was serious. The Presidential Emergency Decree for National Economic Security was announced in January 1974 (Chapter 8). The essence of the decree was: (1) to secure the welfare of the majority of the population by minimizing the impact of oil price increases on low-income groups, (2) to discourage luxury expenditures and promote frugality among high-income groups and corporations, and (3) to minimize the deterioration in the balance of payments. The decree's energy-specific measures aimed to promote energy conservation and reduce dependence on imported oil, and were later consolidated into an integrated policy that became the centerpiece of Korea's energy policy.

On the macroeconomic side, the government attempted to sustain a high rate of economic growth by borrowing from abroad. In a sense, the policy response to the oil crisis was a success in the short run, in that the country was able to maintain a relatively high rate of growth during 1974-75. The real rate of GNP growth in 1974 was 7.7 percent, which compares favorably with those of the major industrialized countries as well as with some of Korea's major trade competitors such as Singapore and Taiwan. Nevertheless, this policy measure may have contributed in subsequent years to increasing Korea's foreign debt-service burden and to inflationary pressure. The negative impact of the policy measure on the balance of payments was so serious that net foreign exchange reserves declined nearly to half a month's imports at the end of 1974. The deteriorating balance-of-payments situation was a portent that continued economic growth might not be possible.

Promotion of General Trading Companies and Construction Exports (1975)

Changes in the international economic environment immediately following the 1973-74 oil shock dampened the prospects for continuous expansion of Korea's commodity exports. At the same time, the prospects for exporting construction services to the oil-rich Middle East countries ap-
peared promising. Against this background, the government undertook two specific policy measures in 1975 to promote the creation of general trading companies and exports of construction services.

The measure to designate specific companies to function as "general trading companies" (GTCs) was taken in early 1975 by presidential decree (see Chapter 19). Prior to formulating the policy measure, numerous consultations among some of the major Japanese conglomerates and Korean policymakers resulted in recommendations containing principally the ideas of Ryuzo Sejima of the Japanese conglomerate Itochu. The top ten companies were designated as GTCs. The principal objectives of the establishment of the GTCs were to strengthen Korea's export marketing activities by using the extensive network of the GTCs' overseas branches to perform the role of "windows" or export agents for small and medium-size firms producing export commodities and to reduce excessive competition among Korean firms. The small and medium-size industries' share of export commodities constituted about 50 percent of the GTCs export trade a few years after the initial designation of the GTCs.

Patterned after the Japanese model of general trading companies (shogogaisha), Korea's GTCs contributed substantially to revived export expansion. But unlike their Japanese counterparts, the Korean GTCs were much more competitive among themselves (to the extent of cutthroat competition) rather than complementary (as is the case of the Japanese GTCs) in delimiting functional markets. The Korean GTCs did increase exports but were perceived as having used their financial resources, obtained through preferential bank loans, for real-estate speculation and the acquisition of existing medium-size firms and small export firms. For example, the large conglomerates experienced a dramatic increase in earnings from overseas construction contracts. Many of the construction companies were using those funds to buy real estate, either for speculation or for later domestic development projects. Because these construction companies were generally associated with the GTCs, it looked as though the conglomerates were buying up real estate, whereas it may be that only the construction companies were involved in the real estate dealings. In any case, the positive impact of the GTCs for the long term was the recruitment of a new generation of young, competent, well-trained managers both in the home offices and abroad, whose subsequent experience and training have contributed to the quality of corporate entrepreneurship.

The Overseas Construction Promotion Act was promulgated in December 1975 to provide a legal basis for government support to and supervision of the export of construction services, and to promote the international

6. Ryuzo Sejima, who graduated from the Japanese military academy at around the same time as Park Chung Hee, is still an active business leader and remains influential in political circles in Japan.
sion of the export of construction services, and to promote the international competitiveness of the Korean construction industry (see Chapter 20). The Park government saw salvation for the heavy industrialization strategy in the export of construction services to the Middle East. The act required that a company obtain a license from the Ministry of Construction to engage in the overseas construction business. Construction companies licensed by the ministry were provided with performance bonding by Korean banks and were insured against exchange fluctuations and other risks of foreign trade. They also received tax benefits on income derived from foreign construction.

The implementation of this policy measure was not entirely a success. The more profitable activities of the contractors—building harbor facilities and industrial plants, for example—were very successful in earning foreign exchange. A few major companies encountered serious losses, however, notably in the construction of housing, mainly because of a lack of understanding of the culture and behavior of Islamic people. The Middle Eastern countries complained at first about Korean government control over and interference in free competition among competing companies. Despite government efforts to manage construction export services to the Middle East, some destructive competition took place to the detriment of the overall industry, and some Middle East governments later complained about “dumping” of construction services because some companies were grasping for any opportunity to obtain contracts regardless of their capabilities to fulfill them.

Korea’s balance of payments improved substantially during 1976–77, thanks to the boom in Middle East construction activities, but the overexpansion of construction service exports was threatening to disrupt the stability of the economy. The surplus balance was an entirely new phenomenon for Korea’s economic policymakers. The influx of foreign exchange earnings from the Middle East contributed to the dramatic increase in the money supply and fanned inflation. Because of the lack of both experience and insight with respect to the surplus balance, the distortion in the finance sector was not properly handled and the negative impact lingered, exacerbating later difficulties. In the early 1980s, after the boom had ended, the financial insolvency of many construction firms became evident. In retrospect the government should have taken more decisive action in streamlining and curtailing the overseas construction service industry when the demand for these services began to decline.


While Korea was emerging as a newly industrializing country and eliminating absolute poverty, concern about social welfare received increasing at-
tention. As a result of the heavy emphasis on economic growth, efforts toward social development and welfare were lagging in the mid-1970s. The Park government was able to launch only a limited social welfare program, which included the enactment of the Medical Insurance Law at the end of 1976 (see Chapter 13).

Since the law's implementation in July 1977, the health insurance program has played an important role in making medical services more accessible to the working population. Although the number of persons covered by the program has increased steadily, many problems remain to be solved in order to achieve an adequate level of service for the population at large. The medical insurance system has not received the level of investment needed to fulfill its function.

During the 1960s, 1970s, and 1980s, the spatial structure of human settlements in Korea was drastically transformed. As discussed in Chapter 14, rapid industrialization was accompanied by massive rural-to-urban migration. As a result, the proportion of the total population residing in urban areas increased from 28 percent in 1962 to almost 60 percent in 1980. The principal problems in Korean urban growth have been the persistent primacy of the capital city and regional imbalance. This is partly a result of the government's development strategy, which stressed economies of scale and agglomeration.

Although the Korean government began taking some policy initiatives in the late 1960s to grapple with these problems, the 1977 Population Redistribution Plan was the most ambitious government effort to guide the pattern of urbanization. The 1977 measure was prompted by the increasing belligerence of North Korea, in that the economic and industrial predominance of the capital city made South Korea precariously vulnerable to easy attack or sabotage from the North. The plan was comprehensive in the sense that it employed almost every conceivable means and strategy to achieve the planning objectives.

The Korean population redistribution policy achieved limited success initially. The predominance of the capital city in economic, financial, educational, and other aspects still seems to be increasing. The ineffectiveness of the plan can be attributed to its lack of integration with economic development policies, the control-oriented nature of its policy measures, and the lack of a firm political commitment for population dispersal. The redistribution policy should have been formulated in the early 1970s, when the country was at the take-off point in industrial development. An effective and comprehensive policy could then have had a greater impact. Nevertheless, the Korean experience in population redistribution provides a valuable lesson for other countries that are considering the formulation or implementation of a national urban policy.
Value-Added Tax (1977)

The Fourth Five-Year Economic and Social Development Plan emphasized the promotion of heavy and chemical industries to strengthen national defense, and social development projects to enhance the people's welfare. The government was painfully aware of the need for increased revenues as well as other sources of capital.

Up until 1977 Korea maintained a complicated structure of domestic indirect taxes. Then in July 1977 the value-added tax (VAT) was formally introduced (see Chapter 11). The principal objectives of VAT were, on the one hand, to simplify the existing tax structure and, on the other, to increase revenues. Some economic policymakers at that time were greatly attracted to the VAT system already operating in some of the countries of the European Economic Community. When the basic idea was first brought forth for discussion, an Irish tax expert who was a strong advocate of the merits of the system was consulted. Subsequently, a study team was formed to review and evaluate the VAT system operating in European countries; the study results were formulated into recommendations for adopting the system in Korea. The principal proponent of this system was an economist who had recently returned to Korea from an American university. The VAT as implemented in advanced industrial countries was theoretically neat and persuasive both from the tax administration viewpoint and in the context of rational behavior. However, the noneconomic aspects of human behavior based on traditional values, customs, and habits were lacking in this "pure" frame of thinking. If the majority of the populace are not educated or persuaded to cooperate willingly in the implementation of a tax reform, the costs of enforcement may ultimately outweigh its advantages and merits.

There has been heated argument as to whether VAT caused price increases, thereby contributing to inflation. It has been argued that the policymakers, by intentionally placing emphasis on the heavy and chemical industries, were prepared to live with a certain level of inflation in any case to meet the target of national security self-reliance by 1980. In addition to revenues generated under the VAT system, the dramatic increase in Middle East construction earnings was also fanning inflation. It has also been argued that the rate of price increases in the first half of 1977 was greater than in the second half (that is, after the introduction of VAT). However, a proper evaluation of the impact of the new tax system would have to be carried out over a much longer time frame. The Korean experience has demonstrated that the VAT system, although simple in principle and neat theoretically, created voluminous paperwork and procedures that were, at that time, not consonant with the habits and behavior of the populace, thereby causing irritation, annoyance, and complaints which were, in the end, manifested in political consequences. The public's perception of the
tax was that it would benefit big business but would hurt smaller businesses. The implementation of VAT contributed to the decrease in popular support for the government during the general election of 1978 and was the beginning of serious political trouble for the regime. The VAT reform can thus be regarded as a political-economic foible. In the Korean cultural setting one has to conclude that VAT was some years ahead of its time.

Comprehensive Economic Stabilization Program (1979)

During the 1961-79 period, the Park government accepted inflation as an inevitable price for sustained economic growth. The policy response to the first oil shock in 1974, the massive injection of capital into the heavy industrialization projects in 1976-78, and the sudden increase in money supply resulting from the influx of foreign exchange earnings from the Middle East added to the inflationary pressure in the latter half of the 1970s. As inflation accelerated, however, it became clear that sustained economic growth would be difficult unless inflation was curbed. The weakening of export competitiveness, inflationary distortions in resource allocation, and the growing frustration of workers who were increasingly aware of the widening disparity in the distribution of wealth and income pointed to chronic inflation as a principal factor undermining economic health.

The government announced the Integrated Economic Stabilization Program in April 1979 (see Chapter 9). The essence of this policy package was to control aggregate demand through restrictive fiscal and monetary management and investment adjustment in the heavy and chemical industries. Subsequently, with the change of government in 1980 as a result of President Park's assassination, the new team of policymakers modified the policy package more into controlling costs and prices—for example, by reducing interest rates and freezing wages. However, before the program produced any signs of price stability, the economy was hit by the second oil price increase and the worldwide economic recession. The assassination of President Park and ensuing political turmoil caused a drastic setback in economic activity. The numerous policy measures taken during 1980-86 to stimulate the economy were, in most cases, cautious and sensitive so as not to jeopardize price stability. Nonetheless, the stabilization effort initiated by the 1979 measures was not abandoned—not even during the difficult period of the oil shock and recession. It has been continued and, as a result, there has been a fairly sharp deceleration in inflation since 1981.

ASSASSINATION OF PRESIDENT PARK AND TRANSITION TO THE FIFTH REPUBLIC

A serious political disturbance began in September 1979 when the head of the major opposition party was dismissed from the National Assembly
and his followers resigned in protest. This disturbance was severely repressed. Then, in October 1979, President Park Chung Hee was assassinated by the head of the Korean CIA, abruptly ending his 18-year term of state control.

The assassination of President Park was followed by serious civil disturbances and economic disruptions during the final year of the Fourth Republic. President Park's prime minister, Choi Kyu Hah, was sworn in as interim president, and a new cabinet was formed. During the next six months, the government was basically trying to cope with the chaotic disruptions in the wake of the assassination, including political activism among the opposition early in 1980 and student rioting in the universities. The business community became demoralized, and the military grew increasingly uneasy. Although the government did what it could to stabilize the economy from the political shocks, the Korean economy for the first time in two decades experienced negative growth (-3.7 percent in GNP in 1980).

President Choi, who rose to the presidency as a docile bureaucrat, was never groomed for a role that demanded forceful and effective political leadership. During the critical transitional period in late 1979 and early 1980, President Choi demonstrated no leadership ability or courage in managing the political vacuum created by the assassination. In December 1979 a power struggle within the military culminated in an internal leadership takeover by a group of officers around General Chun Doo Hwan. This group then began playing an increasing political role. In May 1980, when the government was confronted by the Kwangju civil uprising for "democratization," the military took control of the country, extended martial law, and restored order in Kwangju (although at the cost of about 190 lives). General Chun formally retired from the army to head the government and promised a general election under a new constitution within a year.

This chapter has attempted to paint only a broad backdrop to introduce the main features of the Park administration's policy measures in historical perspective. The following chapters will review 18 major policy initiatives that were developed to further the government's rapid economic development strategy from 1961 to 1979. Each author provides an analytical assessment of the impact of a particular measure and a detailed examination of how government and business interacted and cooperated in its implementation. These policy measures and reforms in some instances played a critical role in transforming the structure of the Korean economy and helped put it on a rapid growth path. Some policies, however, not only failed to

7. The assassin was Kim Jae-Kyu, a long-time friend of President Park. He was about to be removed from his powerful position as head of the Korean Central Intelligence Agency and was locked in a rivalry struggle with the president's bodyguard, Cha Jae-Chul. Kim actually planned to shoot only Cha, but having done so, he assassinated the president as well.
achieve the intended results but also led to circumstances in which another corrective measure was needed. The policy measures included in this book are by no means exhaustive, and it might be argued that some measures excluded from this study are equally important. The editors believe, however, that the measures selected for this study represent the critical policy events underlying the rapid economic development of the 1960s and 1970s.