

# Appraising institutional challenges in the early stages of development

## Chapter 5: South Korea in the early days of its take- off

March 2022

François Bourguignon  
*Paris School of Economics*

Jean-Philippe Platteau  
*University of Namur*

---

### **About Economic Development & Institutions**

Institutions matter for growth and inclusive development. But despite increasing awareness of the importance of institutions on economic outcomes, there is little evidence on how positive institutional change can be achieved. The Economic Development and Institutions – EDI – research programme aims to fill this knowledge gap by working with some of the finest economic thinkers and social scientists across the globe.

The programme was launched in 2015 and will run until 2022. It is made up of four parallel research activities: path-finding papers, institutional diagnostic, coordinated randomised control trials, and case studies. The programme is funded with UK aid from the UK government. For more information see <http://edi.opml.co.uk>.



## Chapter 5: South Korea in the early days of its take-off

### 5.1 Introduction

The objective of the following pages is not to provide yet another account of the Korean miracle.<sup>1</sup> In line with the preceding summary of the Institutional Diagnostic Project (IDP) and methodology, the main question asked is as follows: 'What would have been the conclusion of an institutional diagnostic of the development potential of South Korea conducted in the mid- or late-1970s, at a time when the country was still a low-income country, at roughly the same income level as the case studies in the IDP project?' Of course, the context and method of such an exercise would be different from the diagnostic exercises undertaken within the IDP project since it would rely exclusively on the existing literature on early Korea's development and on statistics available for that period rather than later on. In the 1960s or 1970s there were no institutional or governance indicators comparable to those existing in international databases for the last few decades, no surveys were run about how people felt about the institutional context of economic development, and thus no thematic study could have been launched based on the information gathered from such surveys. Yet the abundant literature that exists on Korea's development permits us to partly fill in the holes and to formulate a diagnostic that is approximately comparable to those in the IDP project.

Such an undertaking has a double objective. On the one hand, it provides a kind of test of the general approach to diagnosing institutional weaknesses and strengths in connection with economic development features and challenges, as pursued in the IDP. On the other hand, and most importantly, it offers a benchmark for the diagnostic exercises undertaken on today's low-income countries. South Korea is undoubtedly a development success story. Yet this was certainly not evident back in the early days of its take-off. It is thus particularly interesting to see what a diagnostic would have made of its institutional framework in terms of being a facilitator of, or an obstacle to, its future development at a time when the latter was still very uncertain, and what can be said *a posteriori* about the role of institutions in development achievements.

This abridged institutional diagnostic of South Korea during its take-off period is organised along the same lines as the institutional diagnostics completed within the IDP. Following this introduction, the next two sections summarise the geographical and historical context of South Korea's early phases of development. The fourth section deals with the main features of that development, the main challenges the country overcame, and those it was still facing around, say, the mid-1970s. The next section analyses the process by which key policy decisions were taken and implemented within the institutional framework that existed in those days. In view of that background, Section 4.6 then presents an institutional diagnostic of South Korean development as we believe one could have been established more or less at the middle of the 1970s. A few general remarks are then offered in conclusion.

---

<sup>1</sup> Among recent publications, see for instance Chu (2018) or Schneidewind (2016). More oriented toward policy, see also Kong (2000).

## 5.2 Geographical and early historical context of modern development in South Korea

The Korea peninsula is a stretch of land that forms a kind of bridge between the Asian continent, essentially China, in the north and Japan in the southwest. This location explains much of the historical episodes that have shaped modern Korea. The eastern part of the peninsula is mountainous, although more in the north than in the south, whereas the western and southern parts consist of hills separated by narrow valleys and coastal plains. The climate is temperate, with rainfall concentrated in summer. The south is more suitable for farming, rice being the dominant crop. Historically, the south was thus more oriented towards agriculture, and had always been a net exporter of rice before World War II. By contrast, the north of the peninsula is very rich in mineral resources, including coal, iron ore, and a wide variety of non-ferrous metals and rare earths. Consequently, the north was more industrialised than the south after the splitting of the country.

Population density has always been high in Korea. However, the separation of the peninsula into two parts at the end of World War II introduced a strong asymmetry. Around the 1970s, the period we shall focus on here, South Korea sheltered 32 million people, with a density of 365 inhabitants per square kilometre. North Korea's population was half this size, spread over the same surface area. Already at this time, South Korea was the most densely populated middle-sized country in the world. Population growth was slightly below 2% but was receding at a quick pace thanks to a fast drop in fertility – from around six in 1960 to 2.7 in 1980 (it is a little more than one today). The demographic transition was just beginning: the population was still very young, with around half being below 25. Historically, the Korean population has always been culturally and ethnically very homogeneous. This remains the case today within each of the two entities that share the peninsula, but much less so when comparing the two, in view of the markedly different paths they have followed since separation.

A major turning point in Korea's history before its separation into North and South was Japanese colonisation. It is thus convenient to divide the following brief account of Korea's history before the split according to that event.

### Korea until the Japanese annexation

The history of the Korean peninsula goes back very far. In the Common Era, three epochs can be distinguished, up until the current period. The first extends throughout the first millennium and witnessed a constant rivalry between two or three kingdoms, some of them stretching at times far north into Manchuria and even Siberia, with repeated interventions by China and Japan within peninsular conflicts. The second covers the second millennium until the early twentieth century. One of the aforementioned kingdoms had become dominant and was thus able to rule over the whole peninsula. Two dynasties, the Goryeo and the Joseon, occupied the throne for almost 500 years each, but in both cases they were in a subservient position with respect to China for a large part of their rule. The third period witnessed the entry of Korea into the modern age, essentially through its being forced to end its isolationist policy and to open up to trade, first with Japan and then with the West. The influence of Meiji's Japan and its push to promote the modernisation of Korea grew during the last third of the nineteenth century, until the first Sino-Japanese war in 1894–95 freed Korea from

China's suzerainty and saw it fall under Japanese control. Efforts to resist that pressure, notably by seeking support from Russia, failed, and Korea became a Japanese protectorate in 1905. Five years later, after the assassination of the Japanese resident general, the country became a Japanese colony.

## Japanese rule

Japanese colonisation lasted 40 years, until the defeat of Japan in World War II. It was particularly severe at the beginning of the period, as Japan sought to quickly impose its rule and way of life on Korean society, and again in the last 10 years, as Japan first prepared for the war and then fought it, first against the Republic of China and then against the Allies. During these two episodes, particularly the last one, the coloniser engaged in the forced Japanification of the Korean population and its mobilisation for its own benefit and as part of the huge war effort. This went as far as forcing Koreans to adopt Japanese names and prohibiting the Korean language in schools. In between these two periods, however, life in Korea could be said to resemble the days of allegiance to the Chinese emperor, except that the Japanese suzerain was more severe – but also more modern and entrepreneurial. Moreover, with time, Korea acquired a kind of central place in the colonial power's strategy of expanding across the Asian continent, and benefited from the development of transport infrastructure and industrial hubs aimed at supplying military equipment for the Japanese troops and settlers in Manchuria – or Manchukuo as it was called under Japanese rule.

The jury is still out about how to evaluate Japanese colonial rule and its contribution to the foundation of modern Korea. The legacy of that period is complex, with both positive and negative elements. Some historians emphasise the fact that colonial rule coincided with the modernisation of the economy and suggest that the former facilitated the latter. This view, which refers to 'colonial modernity', has much in its favour.<sup>2</sup> Undeniably, Japanese rule brought huge investments in infrastructure (railroads, roads, and ports), industrialisation opportunities, initially for both local and Japanese markets and later for war equipment and weaponry provision, up-to-date technology, a modern schooling system, high standards of efficiency in business as well as in government matters, and the effective training of local bureaucrats. Even though it cannot be discarded that such an evolution would have taken place by mere replication of what could be seen across the strait that separates the peninsula from Japan, the latter's oversight may have accelerated and deepened this process by bringing its example closer to the Koreans and by providing opportunities for new developments.

Several of the aforementioned development factors were already in gestation before Japan's annexation. For instance, education had been flourishing in the last two decades of the Joseon dynasty. Private schools were increasing in number, and a public educational system was about to be created. If the Japanese introduced new schools and a new curriculum (although the latter was initially shorter for Korean students), unlicensed private traditional schools spread because of the limited space in the formal system, especially in rural areas. This appetite for education has undoubtedly been a characteristic of Korean society ever since. Likewise, some industries already existed before Japan's takeover, although apparently concentrated in the north. Moreover, this small group of entrepreneurs was able to take advantage of, and to learn from, collaboration with Japanese business, in

---

<sup>2</sup> See Kim, Kyu Hyun (2004).

particular the *zaibatsus* present in Korea. These large Japanese business conglomerates were later to inspire the Korean *chaebols*.

The benefits from this modernisation of the Korean society and economy went primarily to the coloniser. Korean workers were underpaid in comparison with Japanese workers, and landlords and farmers were dispossessed by Japanese settlers and firms, which acquired swathes of land and transformed a portion of farmers into tenants, tenants into landless workers, and workers into jobless migrants who moved to the cities. The traumatic experience of the war period, when Japanification became the watchword of the colonisers and Koreans were controlled so as to suit the needs of the occupier, must also lie on the negative side of the balance, even though it is sometimes considered that this experience forged the national spirit that would later reveal itself in the post-colonial era. The tearing apart of families and communities through migration to various neighbouring countries, and the near-total breakdown of society, were aspects of this trauma.

Beyond these hardships, and beyond the economic legacy of Japanese colonisation, the model offered to the Korean population of Japanese state-directed economic development, first across the Korea Strait and then on its own territory, would later prove important in the post-war period and after the North–South separation. There is no doubt that key players in the modern history of Korea were very much influenced by this example.

Koreans rejoiced at the end of the war and the departure of the Japanese occupiers. They certainly thought that the trauma of war was behind them and immediately started to think about a new structure of government for the peninsula. They did not know that a still more dreadful tragedy was awaiting them.

### 5.3 Early post-independence history

The origins of the division of the peninsula between North and South are not completely clear. At the end of World War II, a decision was taken to place liberated Korea under a trusteeship, headed by the victors, for a few years, until the economy and the society stabilised. It was resolved that the Soviet army would occupy the northern part of the peninsula and the US army the southern part, in order (it was said) to guarantee a smooth and peaceful return to normality. On both sides, the trusteeship and the division were bitterly contested by the population, but steps were taken to restart political life in a unified country as soon as possible. However, ideologies quickly differed between the two sides. Under the leadership of Kim Il Sung, Communists rapidly dominated in the North, supported by the Soviet Union, whereas liberals led the game in the South, under Syngman Rhee, a pillar of the independence movement and a strongly anti-Communist public personality who had spent the last years of Japanese rule in the US.

The determination to reunify the country was strong in both the North and the South and early moves were made in this direction. The South proclaimed the Republic of Korea in August 1948, followed a month later by the North proclaiming the Democratic Popular Republic of Korea. The General Assembly of the United Nations recognised the former as the sole legal government of Korea three months later. This was seen as a provocation in the North and the peninsula was soon dragged into war.

## The Korean War

War broke out in June 1950. The North, militarily stronger than the South and counting on the support of unofficial volunteer forces from China and equipment from the USSR, saw the opportunity of unifying the country under its own rule. Its army crossed the 38th parallel demarcation line and invaded the South. After early successes, the Northern forces were repelled by the Southern army, powerfully backed by the US army and other United Nations allies. In turn, the Southern forces invaded the North, triggering a strong intervention by China, which could not accept the military presence of the US near its border. With such support, the North succeeded in crossing the demarcation line again, only to be repelled once more a few months later. A stalemate around the line then settled in, lasting almost two years, while difficult armistice negotiations involving United Nations forces, China, and the Northern army took place. A conclusion was finally reached in July 1953, which ratified the division of the peninsula into two countries. However, the treaty was not signed by Syngman Rhee for the South and the North never fully dropped the idea of reunifying the peninsula, as was evident in its multiple attempts to intervene south of the 38th parallel demarcation line, which had become a four-kilometre-wide demilitarised zone.

The damage of the war was enormous. It is estimated that approximately 3 million Koreans, or 10% of the population, lost their lives, two-thirds of them civilians killed in aerial bombings. Around 10 million families were broken apart because of the war and the division of the country. Material losses amounted to roughly one year of GDP, approximately 30% of all productive assets and infrastructure. Experts estimate that GNP in the first year after the war was 30% below the pre-war level in North Korea and a little more than half this in South Korea.<sup>3</sup> Not only was the South less affected than the North, its physical capital was less damaged and numerous refugees from the North made up for the loss of population. The North had initially been more industrialised and richer, thanks to mineral natural resources, but it would take much more time to rebound. By contrast, the South was back to its pre-war income levels by 1953, although it is fair to say this was very much thanks to generous US aid.

## Post-war politics

Three stages can be distinguished in the history of post-war South Korea: the reconstruction during the first normal years of democratic life until 1960, the dictatorship under Park Chung Hee and later Chun Doo Hwan, and the definitive return to democracy in 1987 (which is outside our period of interest in the present analysis). Interestingly, this periodisation fits rather well the main features of economic development and the strategies that were implemented during this period.

Post-war South Korea was to be dominated by the personality and authority of Syngman Rhee, who was president from 1948 onwards. Rhee was a rather rigid and authoritarian character, and had a very personal sense of the interest of the country. He headed the Liberal Party, which had no clear ideology other than seeking to enrich its most notable members. Very quickly, the issue arose of Rhee's serving a third four-year term, which required a modification of the constitution. The necessary amendment was passed (though it was one vote short of the two-thirds majority required). Rhee was re-elected in 1956, but

---

<sup>3</sup> See Koh (1993).

with a much smaller lead than in the previous elections. Ageing, heading a deeply corrupt regime that was perceived as ineffective in pushing the economy forward and curbing poverty, his personal aura as a nationalist figure had started to fade by this time, whereas the opposition, regrouped within the Democratic Party, was gaining increasing support.

Rhee stood again as a candidate in 1960, together with a vice-president who it was supposed would be his successor if he had to resign because of his age. He won by a landslide thanks to flagrant vote-rigging but his election triggered vigorous protests. Students organised a march towards the presidential residence and police fired on and killed 139 of them. Protests continued the following day, but the army refused to fire on demonstrators. Having clearly lost the little popular support that was left him, Rhee resigned. An interim government was then formed which set out to write a new constitution that would reduce the power of the executive in favour of the parliament.

The government that came out of this process faced a difficult situation. The economic recovery process was slow, inflation was accelerating, the political context was essentially unstable due to the relatively inexperienced political parties and a constitution that reduced the power of the executive, workers were striking for higher wages, students were demonstrating almost uninterruptedly, while some voices were rising in favour of opening a dialogue with the North. It was in the middle of this chaos that some high-ranking army officers, concerned about the increasing climate of corruption, the incapacity of the politicians to re-establish order, and the danger of showing too much weakness in the face of the threat posed by Communist North Korea, organised a coup in May 1961. While General Park Chung Hee was placed at the head of the military junta which would govern the country for a few years, his rule was to last almost two decades in total.

## **The Park era**

Park's career before the coup had been rather turbulent. Initially a schoolteacher, he went on to enrol in the Japanese army. After graduating from officer school in Manchukuo and spending some time as a foreign student at the Japanese Military Academy in Tokyo he served in the Manchurian Infantry Corps. He was then 27, and this Japanese experience was to have a big influence on his later views about economic development and industrialisation. At independence, he entered the Korean Military Academy and was then assigned to the US–Korean force. Before reporting for duty, however, he was arrested because of his links with Communist movements within the Korean army. He eventually got himself out of trouble and was attached as a civilian to the intelligence unit at army headquarters. Two years later he was reinstated in the army at the outbreak of the Korean War. Amid strong suspicions regarding leftist attitudes within the South Korean army, it is remarkable that Park was not only reinstated but then pursued a brilliant military career, despite his past Communist record – not only during the war, when the army expanded massively, but also thereafter. This indicates an impressive personality, which appealed to his superiors, as well as a powerful friendship network within the army.

The political platform of the junta was unambiguous in its anti-Communist orientation and its aim of reinforcing links with the US. It also had a revolutionary element, in its determination to root out corruption and to eradicate the misery of the masses. In addition to consolidating Park's control over the army, and the political system in general, the first years of the junta

were devoted to establishing the administrative structure that would be able to achieve Park's ambitions. Especially important in this respect were the Korean Central Intelligence Agency (KCIA), a formidable organisation with observers in practically all business, academic, political, and social groups, and the Economic Planning Board (EPB), staffed with highly competent technocrats and responsible for designing and managing the country's economic growth strategies, starting with the first Five-Year Development Plan.

However, the junta did not last long. The US mission in Korea, which had remained powerful since the end of its *de facto* protectorate in the post-war years, if only through the huge aid it was providing to the economy, impressed upon Park the need to return to a civil regime. Somewhat reluctantly, Park accepted, and democratic rule was re-established. Park resigned from the army and, with the implicit support of the KCIA, created his own Democratic Republican Party. He was elected president in 1963, though by a relatively small margin. His tight, quasi-military control over the political system was maintained during his term, within the apparent limits imposed by democracy. Then, in the election in 1967, with satisfactory results on the economic front, Park easily won again.

The prospect of the 1971 election reopened the issue of a constitutional amendment that would allow Park to seek a third term. The opposition tried to resist this and several student demonstrations were organised to mobilise opinion against it. Yet the amendment was passed, although allegedly in a somewhat suspicious way. However, the newly re-elected president's position was much less secure than it had been previously. Soon after, Park declared a state of emergency, officially because of renewed threats from North Korea and geopolitical changes that were leading the US to reduce its military presence. One year later, martial law was instated, the Assembly and political parties were dissolved, and the existing constitution was replaced by a new one, called the Yushin constitution, officially to permit South Korea to adjust more flexibly to the changing international security order.

Practically speaking, the new regime was a barely concealed dictatorship that empowered Park to rule without constraint and that sheltered him from legislative and judicial controls. He had become, to all intents and purposes, a life-long president, his re-election relying on a hand-picked National Congress for Unification. South Korea then entered a dark period of authoritarianism and ubiquitous repression, and in some cases elimination, of all political enemies of the president. At a later stage, Park even had to separate from old supporters he thought were becoming too ambitious as competitors. Amid mounting public discontent he became a more and more solitary ruler. The economic situation itself was becoming critical at the end of the 1970s, because of swelling domestic and foreign debt and the shocks caused by oil price booms. Had he lived, Park would probably have faced a difficult time, but he was shot in October 1979 by the KCIA director, a friend whose motivation for the assassination is still unclear today.

The rest of the country's political history is of lesser importance for our purpose since we aim to adopt a perspective that corresponds to the early history and the situation of South Korea in the mid- or late-1970s – say, some time before Park's death. For the sake of completeness, however, some major events that took place in the next decade must be mentioned because they shed light on the state of South Korean society and the inherent difficulty it faced in those times as regards installing a stable democratic regime.

## **The Chun dictatorship and the difficult return to democracy**

For a brief period, Koreans thought they would return to a freer regime and the Yushin constitution would be abolished. A kind of caretaker government was appointed until a new constitution could be voted on and a new government elected. All parties prepared to compete, but in a kind of repeat of 1961, a group of generals organised a coup and took power. Chun Do Hwan, the new strong man, easily stepped into Park's shoes. Yet the coup aroused the ire of the public. Students protested the martial law, as well as the continuation of the Yushin constitution. One massive demonstration was repressed by the army, leading to 2,000 casualties. Although forever discredited in public opinion, Chun was able to consolidate his power and ruled until the end of his term, which he had pledged not to go beyond. Chun then tried to singlehandedly impose his protégé Roh Tae-Woo as the new president. Huge protests immediately took place, with a large part of the population, not only the students, taking to the streets and demanding a new constitution. Chun gave in, the constitution was amended, and – apparently fair – elections took place in 1987. It was eventually won by Roh. His five-year term was essentially transitional, but it represented a major turn in Korean society towards democracy.

The constitution, which had gone through not less than 10 changes since the first republic in 1948, was not reformed again. Elections went on to be held every five years in a peaceful way, and with perfect regularity.

## **5.4 The pace and structure of South Korea's economic take-off and industrialisation <sup>4</sup>**

The take-off of the South Korean economy in the two and a half decades between the end of the Korean War and shortly before Park's assassination was truly phenomenal. On average, the annual rate of growth of GDP was 8%, with GDP increasing sevenfold. In the following pages, we give more details on this dazzling development, insisting first on the major structural transformation of the economy, which was both the cause and the consequence of that vibrant growth, which was essentially engineered by manufacturing exports. We then focus on how the impressive accumulation of capital and infrastructure needed for such development was made possible. We finally touch upon social aspects, including the fast progress in education and the inclusiveness of growth throughout this take-off period. The next subsection then turns to the main policy decisions and strategic orientations that contributed to such outstanding results.

### **Growth and the structural transformation of the economy**

It took some time for the rate of growth of the South Korean economy to reach the stellar level that made it possible to later approach the ranks of the advanced economies. This progressive acceleration reflects the gradual rise of its main engine, the manufacturing sector. Until 1975, manufacturing value-added systematically grew at a rate roughly double of the rest of the economy, but its contribution to overall growth increased with its size: it was small in the late 1950s, when the manufacturing sector represented only 10% of GDP (at

---

<sup>4</sup> This section owes much to the excellent review of South Korea's economic development edited by Il and Ko (2010)

current prices), but it was much more important when it approached 20% 10 years later – see Table 1.

Unsurprisingly, a major structural transformation of the economy accompanied this performance. As has been the case for practically all development experiences in history and across countries in the contemporary period, the share of agriculture fell rather regularly over time, on average by one percentage point of GDP every year. This drop in the agricultural share benefited both manufacturing and the rest of the economy, mostly the former until 1965 and both equally afterwards – at least when considering GDP at constant prices. In this respect, it may be noted that the relative price of manufactured products relative to that of other sectors tended to fall throughout the period, in line with the fact that productivity gains are faster in industry – partly thanks to a greater substitutability of labour by equipment – than in services. In the case of South Korea, this phenomenon was amplified by the outward orientation of the manufacturing sector and its exposure to foreign competition. The same cannot be said of the agricultural sector, even though it also produces a tradeable good.<sup>5</sup>

---

<sup>5</sup> The convergence between the constant and current price structure of GDP would have appeared more clearly in Table 1 if the constant price series had referred to a less recent base year than 2015, which is the base used in Bank of Korea's historical database.

**Table 1. South Korea: growth, employment, productivity, and structural transformation, 1955–1985**

Year	1955		1960		1965		1970		1975		1980		1985	
<i>GDP at factor cost (1970=100)</i>	33.0		40.3		57.4		100.0		160.8		242.6		381.0	
Five-year average growth rate			4.1		7.3		11.8		10.0		8.6		9.4	
Population	69.9		79.5		90.7		100.0		109.8		118.6		128.1	
<i>Gross national income (GNI) per capita at constant factor cost (1970=100)</i>	47.1		50.7		63.3		100.0		146.4		204.5		297.4	
Five-year average growth rate			1.5		4.5		9.6		7.9		6.9		7.8	
<i>Sector structure of GDP (market prices) (%)</i>	curr.	cons t.												
<i>(current price and constant 2015 prices)</i>														
Agriculture	42.3	31.7	38.6	27.6	34.4	26.8	27.1	17.2	23.0	13.9	15.0	8.7	10.4	7.8
Manufacturing	10.9	3.3	11.9	4.5	16.7	5.9	16.7	8.3	21.4	11.9	21.8	15.2	25.4	16.6
Other	46.8	65.0	49.5	68.0	48.9	67.3	56.2	74.5	55.6	74.2	63.2	76.1	64.2	75.5
Total employment					82.2		100.0		121.1		140.6		153.6	
<i>Sectoral structure of employment (%)</i>					59.4		50.4		45.8		33.9		24.9	
Agriculture					9.2		13.2		18.6		21.6		23.4	
Manufacturing					31.4		36.4		35.6		44.5		51.7	
Other														
Overall labour productivity (1970=100)					69.8		100.0		132.8		172.5		248.0	
<i>Labour productivity by sector (1970 overall productivity = 100)</i>					31.5		34.2		40.3		44.3		77.8	
Agriculture					45.0		62.9		85.3		121.5		176.4	
Manufacturing					149.2		204.6		276.7		295.0		362.4	
Other														
Decomposition of overall productivity gains														
<i>Productivity gains</i>							30.2		32.8		39.7		75.5	
<i>Of which: structural change</i>							8.0		0.4		23.5		20.9	
<i>autonomous gain</i>							22.2		32.5		16.2		54.6	

Source: Bank of Korea and Economic Statistics Yearbook for employment figures.

The structural transformation must also be considered from the point of view of employment. This is done in the second part of Table 1. Because employment data are not comparable before and after 1963,<sup>6</sup> the beginning of the period had to be ignored. Over the next 15 years, however, the share of agriculture in total employment, which was initially close to 60%, was halved. Given the progression of total employment, the volume of employment in the sector increased until the mid-1970s, but then decreased at a fast pace afterwards. Initially, the manufacturing sector was the main beneficiary of the net flow of workers leaving agriculture. In a later stage, however, this flow went to other sectors, among which services was the most important.

Sectoral changes in labour productivity underpin this bi-dimensional reallocation of output and labour. In this respect, it is interesting to observe that the first phase of South Korean development illustrates – but also somewhat contradicts – the familiar Lewis-Kuznets view in development theory. This theory holds that the structural transformation of the economy led by the movement of workers from rural informal production to modern industry and services is the main engine of growth in early phases of development. Capital accumulation takes place in the modern sector of the economy, which easily expands employment by drawing on under-employed workers, or surplus labour, in the informal or traditional agricultural sector. If the latter is sufficiently dynamic and labour-intensive, there comes a moment at which the surplus labour disappears in the informal sector. A ‘turning point’ is thus reached at which labour earnings begin increasing in both sectors and the agricultural sector starts to modernise. Such a scenario fits well the development of South Korea until the early 1970s: labour productivity was approximately constant in agriculture, whereas labour flowed from agriculture to (mostly) the manufacturing sector.

Where South Korea fits the theory less well is in the observation that the structural reallocation of labour away from low-productivity agriculture to the rest of the economy did not contribute much to the overall productivity gain in the economy. The latter amounted to a little less than a doubling in the decade after 1965. However, as can be seen at the bottom of Table 1, the main contribution to those gains was not so much the reallocation of labour away from agriculture – the row titled ‘structural change’ – as the autonomous productivity gain within manufacturing and other non-agricultural sectors. The reason for this is essentially that the labour reallocation took place mostly between agriculture and manufacturing, and the productivity gap between these two sectors was initially limited. The productivity gains within manufacturing and other sectors thus proved to be the dominant force behind the overall productivity gains. An explanation of this evolution within the Lewisian framework is that the composition of those sectors changed because of major policy choices and, most importantly, the deliberate export orientation of manufacturing, its necessary increase in international competitiveness, and the accompanying changes in supporting sectors. Later, things changed substantially, when the economy settled into this new regime and the productivity gap between agriculture and the rest of the economy was drastically amplified, especially with respect to the manufacturing sector – possibly because of the progressive shift there from light to heavy industry. Structural change was then the dominant contributor to overall productivity gains between 1975 and 1980, even though the average within-sector, or ‘autonomous’, productivity gains were still substantial.

---

<sup>6</sup> See Koo (2013).

The increasing productivity gap between agriculture and the rest of the economy in the early part of South Korea's take-off should be emphasised because it is somewhat original when compared to other successful development stories in Asia, particularly Japan and Taiwan.<sup>7</sup> Unlike in those countries, where initial major agricultural productivity gains permitted the development of the manufacturing sector, agricultural productivity in South Korea was low by international standards and stagnant. Such a state of affairs was due to the quality of the soil, the limited size of farms consequent upon a strongly egalitarian land reform, the low productivity of labour-intensive traditional farming techniques, and the lack of incentives and capacity to innovate in an over-populated rural sector. As a matter of fact, it is only when the development of the manufacturing and ancillary sectors had permitted absorption of the labour surplus in agriculture that productivity growth accelerated. The productivity figures in Table 1 suggest that this 'Lewisian turning point' could have been reached in the early 1970s,<sup>8</sup> and this seems to be confirmed by the fact that the volume of agricultural employment started to fall around the same time. Yet agricultural productivity and rural incomes continued to lag behind the rest of the economy, to such an extent that the government had to engage in a vigorous policy to support farmers' income, through infrastructure investment, ambitious agricultural extension programmes, and heavy price subsidies. Yet it was only after 1980, well after the South Korean economy had taken off, that agricultural productivity got off the ground.

A factor that is worth stressing – because it contributed to generate a growth in income per capita that exceeded growth in labour productivity – was the increase in the participation rate of the population to the labour force. This is due to two factors. On the one hand, the share of the population that was of working age tended to increase due to the fast reduction in fertility rates. On the other hand, an increase in the female participation rate was observed in the last 1960s, possibly because of the opening up of numerous female jobs in newly exporting factories.<sup>9</sup>

As a final comment on interpreting the figures shown in Table 1, it is important to stress that the contribution of the manufacturing sector to the overall growth of the economy went beyond its share in GDP times its growth rate. If it had not done so, then the contribution of manufacturing to South Korean growth in the earlier phases of its take-off would have been modest, despite its phenomenal growth rate. However, to argue this would involve ignoring first that the expansion of a sector that was mostly oriented towards exports fed domestic demand, and therefore the growth of domestic- oriented, or non-tradeable, sectors, and, second, the powerful backward and forward linkages between manufacturing and other sectors like transport, communication, trade, and finance. On top of this, by making foreign exchange available, manufacturing exports contributed to facilitating imports of equipment and, through them, the diffusion of modern foreign technology throughout the economy. Unfortunately, no precise quantitative estimate of the actual contribution of the manufacturing engine of growth – beyond strict accounting practice – seems to be available.

---

<sup>7</sup> This paragraph relies on an excellent analysis of agricultural issues in the early phase of South Korean development by Brandt (1980).

<sup>8</sup> There was some discussion in those days about when this turn took place – see Sedjo (1976). With more hindsight, Ranis (2004) identified that this point was reached around 1973.

<sup>9</sup> See Park (1990).

## The financing of accumulation and industrialisation

How was such a successful industrialisation take-off possible? The answer is through fast-growing investment that was largely funded by foreign sources, especially foreign aid in the first phases of the industrialisation process, quickly supplemented by growing domestic savings. Table 2 shows that the rate of fixed capital formation over GDP progressively increased from 11% in the 1955s to more than 30% by 1980, although the bulk of the increase really started only in the late 1960s. Given the limited initial stock of capital, even a low investment rate in these early years was able to generate a rapid increase in the equipment and infrastructure available for production. Young (1994, 1995) has estimated that the annual rate of growth of capital may have been above 16% on average between 1965 and 1980 for the whole economy, excluding agriculture, contributing to a little less than half of the 11% average annual GDP growth, the rest being almost all due to the growth of the labour force, after accounting for its increasing education level (on which more below), thus leaving a very limited role (roughly 1% per year) of total factor productivity.<sup>10</sup> Early growth in South Korea was thus mostly guided by factor accumulation.

---

<sup>10</sup> Young (1994) considered this fact as contrary to the view that South Korean growth was predominantly the result of major total factor productivity gain.

**Table 2. South Korea: expenditures out of GDP, foreign financing, composition of exports, 1955–1985 (current prices)**

	1955	1960	1965	1970	1975	1980	1985
<b>Expenditures out of GDP (% of GDP)</b>							
Private consumption	88.2	83.1	81.7	73.1	68.3	63.2	57.4
Government consumption	9.4	14.0	9.5	10.5	10.7	11.9	10.4
Gross fixed capital formation	11.1	11.6	17.1	27.1	28.5	30.5	29.9
of which: change in inventory	1.2	0.5	1.6	2.7	3.5	0.5	0.3
Exports	1.4	3.7	8.3	14.5	29.6	35.2	38.4
Imports	10.2	12.5	16.6	25.3	37.0	40.9	36.1
GDP	100	100	100	100	100	100	100
Net factor income from the rest of the world	1	0.8	1	0.5	-0.9	-2.6	-3.3
GNI	101	100.8	101	100.5	99.1	97.4	96.7
<b>Financing of capital formation</b>							
Domestic saving	2.4	2.9	8.8	16.4	21.0	24.9	32.1
Foreign saving	8.8	8.8	8.3	10.8	7.4	5.8	-2.2
of which: foreign aid	7	7.9	7	3	1.1	0.2	-
<b>Composition of exports (% of total)</b>							
Manufacturing		13.0	58.2	78.2	83.5	86.3	96.0
of which: miscellaneous		1.0	19.6	41.2	37.4	31.4	47.8
of which: clothing			11.9	32.5	22.9	17.9	25.4
Others		87.0	41.8	21.8	16.5	13.7	4.0

Source: Bank of Korea, Economic Statistics Yearbook, various years. Note that all ratios refer to three-year averages around the year that heads the column, so as to smoothen short-run shocks – like oil prices in 1975 or 1980.

Capital accumulation in a low-income country requires savings and domestic currency to buy equipment, which is mostly imported. In the case of South Korea, both came from foreign savings and the deliberate export orientation of industrialisation throughout the period under analysis. Up to the mid-1960s, foreign aid, the bulk of which was provided by the US, played a leading role, as it covered a major part of imports, including in the 1950s in the form of agricultural products. Things changed when the country approached self-sufficiency in the 1970s and donors' assistance was progressively phased out, at which time foreign loans were used to finance the accumulation of capital that was not covered by domestic savings, even though the propensity to save was making huge progress – part of which was generated by the implicit taxation of depositors in a fully nationalised bank system.<sup>11</sup> Relying on foreign loans implied a rapid accumulation of debt. From an almost insignificant level in 1960, foreign debt grew to 40% in the early 1970s. It then went down, only to surge again in the early 1980s during the global macroeconomic crisis that followed the second oil price boom. It is remarkable that the growth rate of GDP was little affected by debt. As a matter of fact, the investment rate kept increasing, reflecting a rather voluntaristic macroeconomic management.<sup>12</sup> As the domestic saving rate stayed on an upward trend, the country soon became autonomous in the financing of its investment operations.

Sustaining a high investment rate in a developing economy requires having enough foreign currency to buy goods that are not produced at home. Here lies South Korea's major achievement: its capacity to expand manufacturing exports, which became the true engine of growth, not only through their contribution to GDP but also through making foreign currency available for the import of equipment and foreign technology within the manufacturing sector itself, and also within the whole economy. Exports grew at an annual rate that was rarely below 15% and was frequently above 30% throughout the two decades from 1960 onwards, going from 4% of GDP in 1960 to 30% 15 years later. Exports initially comprised chiefly food products, inedible oils, and crude materials, including various types of metal ores but during the 1960s the composition of exports drastically moved towards light manufactured goods – with clothing and footwear in the first place. As a result of an ambitious and resolute policy, however, they were then increasingly directed towards heavy and chemical industries (HCI) in the late 1970s, apparently against what had seemed to be the country's comparative advantage – that is, labour-intensive exports based on cheap and high-quality labour. It is the success of this bold policy that can be fairly termed the South Korean miracle.

The destination of exports also changed radically over time. The main client in the late 1950s was Japan and exports consisted of traditional products. Then destination countries were diversified, with the US becoming the prime client at the expense of Japan, while exports concentrated on light manufacturing, mostly clothing and footwear. In the late 1970s, the composition of exports shifted again and started to include an increasing proportion of heavy industry, and clients comprised more developing and emerging countries.

Back in the early 1970s, however, foreign currency sources had had three major origins. First, Japan's reparations payments for its 40-year colonial rule, after South Korea reconciled with its former coloniser; second, payments made by the US in return for South Korea's participation in the Vietnam War; and, third, public works and building contracts in

---

<sup>11</sup> See Cho (1996).

<sup>12</sup> On debt see Collins and Park (1989), and on macroeconomic management in the 1970s see Amsden (1989: 93–108).

the Gulf countries after the first oil price boom – which, incidentally, provided Hyundai's founder, Chung Ju-Yung, with a leg up into big business. These last two items show another key feature of South Korean development: the capacity of its rulers and entrepreneurs to take advantage of all opportunities that might arise and that might be profitable for the country or for private business.

### **Social aspects: education, inequality, and agriculture**

The preceding tables and comments summarise in a very succinct way the first 25 years of South Korea's outstanding economic development. However, this picture would be incomplete without looking at their social counterpart. Here, too, the achievements were quite remarkable.

On the educational front, South Korea invested massively after its liberation from the Japanese coloniser, which had not done much in regard to the schooling of the indigenous population. Primary education was made a right in the 1948 constitution and the number of schools then mushroomed, despite a lack of resources in terms of teachers, school buildings, and textbooks. It has been said that student–teacher ratios were frequently as high as 100, and most schools operated two or three shifts a day. An important point is that this resulted as much from political will and policy decisions as from the fact that households themselves were eager to have their children educated so that they could qualify for good jobs – to such an extent that an author referred in those days to the 'widespread Korean obsession with learning'.<sup>13</sup> In many instances, however, the burden of providing schooling was on communities, with little help from local or central governments. Whatever the case, primary school enrolment was nearly universal by 1960, and the demand for secondary and tertiary schooling was also extremely high by international standards. On the other hand, the role of university students in the events that led to the resignation of Syngman Rhee in 1960, and later on in the country's political history, testifies to the importance of universities in the social and political life of the country already in those days.

This appetite for education never dwindled, so that fast progress was achieved at the level of the whole population. According to the Barro and Lee database, the average number of years of schooling in the working-age population increased from 4.5 in 1950 to 7.12 in 1975.<sup>14</sup> As a basis for comparison, the same figure is still below six in Bangladesh and Tanzania today – 45 years later. South Korea was also ahead of other late industrialisers like Singapore, Brazil, and Turkey on several key education indicators, such as secondary and post-secondary school enrolment, the number of tertiary students abroad, and the number of engineering students as a proportion of university students. As a sign of the strong demand by the population for good education, Amsden (1989) mentions the fact that teachers in South Korea were relatively well paid in comparison with army officers – at a time when the military were at the head of the whole society – or professionals and technicians.

Despite this clear quantitative advantage, several weaknesses affected the educational sector, including too generalist a curriculum, a poor vocational training programme, and, above all and for quite some time, a clear over-supply of educated workers for the existing

---

<sup>13</sup> Likewise, Seth (2002) talks about an 'education fever'.

<sup>14</sup> See Barro and Lee (2018).

demand. There were periods characterised by high levels of unemployment among highly educated people, and the preparation of the first Five-Year Plan in 1963 found an excess of high-level personnel in the bureaucracy. This issue was sufficiently serious for the Park administration to impose quotas to reduce college enrolment at a certain stage.

Another important social aspect of the early decades of South Korea's development concerns the moderate degree of inequality of the distribution of income, its stability over time, and its impact on the speed of poverty reduction. A side issue is that of the maintained income balance between the rural and the urban sector, where the engine of growth of the whole economy lay.

The relatively low level of inequality in comparison to many developing countries at the same income level is partly explained by the agricultural reform that was launched at independence, which redistributed land from Japanese and large domestic landowners to small farmers and former tenants, with a 3 hectares cap on each farm. The reform also abolished the tenant status. Given the importance of agriculture at that stage of the development process, the impact on the equality of the income distribution was substantial. This was reinforced by the relative equality in the distribution of educational levels in comparison with many developing countries.

To prevent an increase in inequality, the challenge was then to maintain a balance between the booming urban sector, led by manufacturing development, and the agricultural sector. As mentioned earlier, the balance initially moved against the latter. On the one hand, productivity was often low because farm size was too small.<sup>15</sup> On the other hand, grain production was rather heavily taxed, making life extremely difficult for small farmers. Average productivity was low – see Table 1 – and, if it increased somewhat during the 1960s, this was because of the flow of under-employed agricultural workers towards employment in the expanding industry. In the 1970s, the government's action to level off productivity and incomes across sectors yielded effective results. Especially important had been the reversal of the production tax into a subsidy through guaranteed prices that were above market level. Some of the support to agriculture went through the Saemaul programme, which was the first community-driven development experience in the world. This programme was as much social as economic, one of its goals being to achieve rice self-sufficiency.

With a roughly constant distribution of income – except for some short-run fluctuation episodes – the reduction of poverty followed the continuous increase in mean income per capita. The poverty headcount – the proportion of people below a certain income threshold defined as the 'poverty line' – cannot be computed for Korea before 1965, due to a lack of representative household income and consumption expenditure data. However, available estimates for the following 15 years suggest that the poverty headcount declined rapidly, from 40.9% in 1965 to 23.4% in 1970, 9.8% in 1980, and 4.5% in 1984.<sup>16</sup> Thus, poverty was virtually eliminated within 20 years.

---

<sup>15</sup> See Kim, S. (2021) on the distribution of land in post-land reform South Korea.

<sup>16</sup> See Choo *et al.* (1996). A rough calculation suggests that the 120,000 won poverty line for a household of five persons in 1981 used in these estimates corresponds to US\$ 3.6 per person and per day at 2017 international prices, which is a standard poverty line. The resulting poverty rate of 40.9% for South Korea in 1965 seems an

Such was the spectacular economic take-off achieved by South Korea in the 25 years or so after the end of the Korean War and the division of the peninsula that had led to it. It is now time to describe the way that such results were achieved, or, in other words, the strategies that were designed to that end, as well as the institutional framework within which they were elaborated and implemented

## 5.5 The design of early development strategy and policy

Much has been written to explain the South Korean 'miracle'. The point here is not to offer an exhaustive summary of that huge literature, which, as a matter of fact, is often focused more on East Asia rather than the single South Korean case – as can be seen from the influential 1993 World Bank report on 'The East-Asian Miracle'. The goal of the following pages is more modest. It intends to list the main policy decisions and economic practices that led to Korea's stellar development from the mid-1950s to the 1980s, as well as the institutional framework within which these decisions were taken and these practices developed.

Three periods are traditionally distinguished in the early development of South Korea: the 1950s under the presidency of Syngman Rhee and its import substitution strategy; the 1960s under the military rule of Park Chung Hee and the extremely fast development of light manufacturing exports; and the 1970s under the dictatorship of Park and the ambitious bet on the development of heavy industry. We will follow that order. Yet, because of the similarity of economic policymaking in the last two periods, they will be dealt with together, whereas a third subsection will explicitly handle the way the decision was made regarding the heavy industry venture.

### The 1950s: recovery, import substitution, and corruption

It is not clear why this early period of South Korean development has been given the 'import substitution' label. It was, rather, a disorganised period of economic recovery after independence from Japan and the Korean , which would better fit the expression 'everything goes'.<sup>17</sup> It is true that imports played a dominant role since the production capacity of the economy was limited. This explains the early formation of big trading businesses, which took advantage of the relationship with Rhee's government to obtain import rights in certain key areas. As a matter of fact, this is when the first big South Korean business groups (*chaebols*) appeared or expanded, as was the case for Samsung, which had engaged in trading activities since the period of Japanese rule, or LG, which was founded in 1958 to provide the local population with imported home appliances. Progressively, however, these trading companies got into local production, benefitting as they did from comfortable import barriers.

As was seen earlier, the generalised climate of corruption, including a government that maintained itself in power through bribery, vote-rigging, and intimidation, a flourishing black market in foodstuffs provided by the US, and rents granted to a few business groups through import rights or high-level protection, severely undermined Syngman Rhee's regime. Student protests and accompanying turmoil pushed him out of the political arena. However, the

---

underestimation in comparison with today's lower middle-income countries. Yet if the level is probably underestimated, the rate at which poverty fell seems correct.

<sup>17</sup> Seth (2013) talks about an 'unpromising recovery' when analysing this period.

democratic government that replaced him did not prove more effective in improving the country's economic prospects or in curbing corruption or political decay.

### **The economic policy under the military junta and the Park-led civilian government**

As a matter of fact, there was little difference between the military and the civilian governments headed by General Park. However, several institutional reforms that were to have long-lasting implications were imposed by the military junta, which could probably not have been effected otherwise.

### **The revolutionary objectives of the military power**

The junta that took power after the coup of May 1961 did so explicitly to end the previous era of economic and social disorder and to put an end to corruption. With General Park Chung Hee at its head, it presented itself and its overall programme as a 'National Revolution'. The words are important here because, in many respects, the beginning of Park's era as ruler of South Korea was indeed a revolution from the point of view of politics, institutions, and economic policy. This state of affairs did not change much when the junta gave way to a civil regime, with Park as president, in 1963, as the army remained extremely powerful and military personnel continued to be strongly represented in most high- and middle-tier state decision-making units. The initial revolutionary impetus of the junta thus remained present for a long time under Park's leadership. Its main dimensions may be briefly described as follows.

First, the military in power drastically modified the way the country and the economy were run. The army had inherited a strong sense of discipline from the Japanese era. Once the power struggle about who would command the junta ended, a rigorous, well-qualified, and corruption-free administration was set up. The bureaucracy was reformed by introducing within it a military structure, especially a deep respect for the hierarchy and a strict observance of orders coming from superiors. The change from the rather disorganised management that was in place before was drastic. At the same time, a powerful intelligence unit was installed whose mission was to reinforce Park's grip on the whole political and economic system, including, in some cases, some army factions. The KCIA played a key role throughout Park's rule. In particular, it was the KCIA that managed the reorganisation of the bureaucracy along the preceding lines, notably through major purges and a drastic reduction in the number of bureaucrats, by getting rid of those who were found to be ineffective and/or rent-seekers.

Second, the junta, and Park at its head, wanted to truly revolutionise the way the economy was run, which implied two big changes: (i) the introduction of serious economic planning; and (ii) fighting corruption. On the first account, a true 'planning' attitude and practice was introduced in policymaking. Planning was not new in South Korea but it was previously ineffective. In 1962, the first Five-Year Economic and Development Plan was launched, essentially a top-down set of policies designed and executed by a highly able group of civil servants, the EPB, whose head practically had prime minister rank.

In regard to corruption, the junta arrested all those who were taking undue advantage of the previous disorder within the economic system: 'illicit' profiteers of all types, tax evaders, 'hoodlums', as well as Communist sympathisers.

Of very special interest, and of key relevance for the forthcoming development of the country, was the initial threat issued to the owners of big businesses – i.e. the so-called *chaebols* – which had built up huge rents under the previous regime, that they could be dispossessed of their wealth and could see their enterprises nationalised. In a celebrated encounter between Park and Yi Pyong Chol, the founder, owner, and manager of Samsung, then the most powerful group in South Korea, the latter suggested that instead of expropriating them, it might be better to have the *chaebols* work to advance the junta's policy, while maintaining the threat of full expropriation in the case of non-compliance or misconduct<sup>18</sup> – which occurred later in the case of Samsung, which was caught up in a corruption affair and which had to hand over its fertiliser company to the state. This general deal between Park and the *chaebols*, despite the general mistrust of the former and the army in regard to business, was to become the spearhead of South Korea's astonishing industrialisation process.

Third, as part of this fight against corruption and despite the *chaebols'* owner-managers being conditionally spared, all banks were nationalised so that credit operations could be under full central control. Other state-owned companies already existed at the time the junta took power, or were created shortly afterwards. In general, they produced basic commodities or utilities like energy, water, and transport infrastructure. The most famous was the Pohang Iron and Steel Company (POSCO), created at the time the Park administration decided to launch its HCI programme.

Fourth, Park, as well as the army, were openly anti-Communist, an attitude that can be easily understood in view of the deep rivalry with North Korea. However, things went deeper than mere political divergences. Communist North Korea was a constant threat, which required permanent surveillance of its possible links with people in the South, as well as heavy military investment, especially when the US military presence started to weaken in the late 1970s. Park embarked on his heavy industry programme and on the creation of POSCO partly so that South Korea would be able to produce military equipment. Another aspect of the anti-Communist bias of the regime that succeeded to the junta was its repression of unions and labour movements.

To these basic changes brought about by the shift to a military regime, which were tightly maintained afterwards, it is crucial to add some of the key ideas held by the ruler and the small group of advisers around him. These ideas, indeed, inspired his policy during his 20-year hold over South Korea's economy and society, and to a large extent explain the development achievements that could be observed at the time of his death in 1980.

---

<sup>18</sup> Actually, the story is quite dramatic. Shortly after the coup most *chaebol* owners had been arrested and were about to be dispossessed. Their lives were threatened and, of course, their companies had stopped operating. The US representative in Korea is said to then have convinced Park that it would be bad policy to destroy the most dynamic business group in the country. Yi Pyong Chol, the head of Samsung, then negotiated this deal with Park according to which the *chaebols* would cooperate but would be dispossessed if they did not comply with Park's policy. See Kim Hyung-A (2011: 94–96).

## **Park's views about South Korean development**

A few fundamental principles inspired Park's development policy from the first moment of his accession to power. One was a strict rejection of Communism as an economic system, despite his youthful flirtation with Communist movements before the Korean War. However, this did not mean for him relying blindly on market mechanisms: the state had to have its say in development orientations. A second principle had to do with the example of Japan, which he knew rather well and had been able to observe as a former student in Tokyo's Military Academy. He reportedly repeated throughout his leadership that his goal was to reach the development level of Japan in a 'single generation'. Another principle was well portrayed in his familiar saying, 'rich state, strong army', which he understood as implying a two-way causal relationship: a strong army would allow business to prosper while being sheltered from North Korean actions, and a prosperous state would be able to afford such a strong army. But building a strong army also required developing some heavy industrial capacity. A fourth principle that guided Park's action was highly diplomatic: it was the care he took to preserve peaceful collaboration with the US administration and its representatives in Seoul. This had not always been the case under the previous regime. Some tensions arose at times between Park and the US representatives, but it cannot be denied that, overall, the US played a huge role in South Korean development, not only through its financial assistance but also through its economic advice. The US interest in such a collaboration must not be underestimated either. In the geopolitical context of those days, it was important for the Western superpower and its promotion of market capitalism that South Korea succeed and clearly overcome Communist North Korea.

With such principles, and given the rivalry with North Korea, which was able to live for a while on the strong industrial base it had inherited at the time of the separation, the economic goal of Park's regime could not be other than the pursuit of the fastest possible economic growth.

## **The light manufacturing export drive of the 1960s**

This quest for fast growth relied on two pillars: the export orientation of the economy and heavy investments in infrastructure. On both fronts, success was quick and stellar thanks to original, voluntarist, and clever policies. Yet it is the phenomenal progress in exports that calls for the most detailed explanation.

The choice of export orientation as a strategy of development was based on an assessment of development limits experienced in the previous period and the relative failure of protection to produce fast import substitution-based growth. The analysis by Park and his advisers at the EPB was that such a policy would not succeed because the domestic market was too small and economies of scale could not be developed; hence the export orientation emphasis of the first Five-Year Development Plan. But an objective is nothing without the right instruments to achieve it. This is where South Korea was extremely innovative.

The key to the extraordinary South Korean export drive in the 1960s lay partly in the reform of the exchange rate, partly in the authoritarian management of Park's team, partly in an effective bureaucracy (both in key administrations and in the nationalised banking system), and very much in the dynamism of private enterprises. There is indeed a notable difference between this pragmatic approach to export-led growth and both the neoclassical explanation

that is often given of the South Korean miracle as the mere result of moving to a 'free-market' and 'free-trade' economic regime (Balassa, 1988), as well as the heterodox view that South Korean success was essentially the result of inspired stewardship which went as far as 'getting the prices wrong', to use the words of Amsden (1986).

The civil government before the junta had rationalised the foreign exchange market by eliminating a complex multiple exchange rate regime and adjusting the official rate to the rate observed in the curbed market. The won had thus been devalued by some 160% in the space of two years, and foreign exchange management had been made simpler.<sup>19</sup> This increased the profitability of exports. The second impetus to exports was given by several types of incentives provided to exporters, which comprised: (i) tax incentives; (ii) tariff exemptions and credit facilities on imported inputs; (iii) export credits at subsidised interest rates; and (iv) foreign currency loans. Among them, interest subsidies were probably the most important: by 1965 the subsidised rate to exporters was 6.5 percentage points for an official lending rate of 26% – and a domestic inflation rate of 13.6%, making the real borrowing rate of exporters negative.<sup>20</sup> Most importantly, however, these subsidised credits were granted by the nationalised banking system conditionally on complying with export targets set by the government for large trading companies in charge of exporting the production of medium or large *chaebol* companies, which would soon be at the head of a true global distribution network. This is where a competent and non-corrupt administration and banking system were crucial. On top of this, the export targets were changed over time, based on the objective of the Five-Year Economic and Development Plan and based on firms' views on what they could achieve from one year to the next. These targets were set in negotiations with high-level government representatives, if not with Park himself for the largest *chaebols*.

Even with such advantages, it took extremely dynamic entrepreneurs to penetrate foreign markets and then to increase their market share. This is where the *chaebols* played a huge and crucial role. In a few years, between 1962 and 1971, exports of light manufacture – wigs, clothing, footwear, and plywood – increased by US\$ 700 million (7% of 1971 GDP), essentially starting from scratch. Such rapid progress is doubtless proof of the strong ability of Korean entrepreneurs not only to seize the opportunities offered by export and industrial policy incentives but also to make their way in foreign markets. At the same time, huge economies of scale made them increasingly competitive, which also suggests that, thanks to multiple export incentives, they accumulated solid rents that could be reinvested in other activities.

The economy grew rapidly. GDP was multiplied by 2.5 between 1962 and 1971. Could it have continued to expand at the same pace, based on the same line of exports? Korea's world export share in clothing trade was only 4.4% at that time, but, of course, was much less if the world market, including national production for domestic consumption, is used as the reference. Moreover, it turned out that clothing exports from South Korea would go on to increase by US\$ 1,600 million between 1971 and 1976, when they amounted to 10% of world exports. Why then did the Park regime decide to launch the HCI programme, deviating completely from successful labour-intensive manufacturing exports?

---

<sup>19</sup> See Yoo, Yungho (2017).

<sup>20</sup> See Cho (1996).

## Park's dictatorship, the chaebols, and the heavy industry venture of the 1970s

After the serious social turmoil surrounding Park's aspiration to a third mandate, which was contrary to the existing constitution, martial law was decreed, putting an end to all protest, and a new (Yushin) constitution was passed that gave Park nearly dictatorial power. He then bluntly pushed the economy towards heavy industry, despite the general opposition that had expressed itself before the promulgation of the new constitution, and against the wishes of several of his advisers and top experts in ministries and government agencies, who favoured the continuation of the light manufacturing export strategy. Park's motivation might have been his ambition to replicate the Japanese development model 'in a single generation', but he also had a firm conviction that, in the very long run, light industry, including in those days consumer electronics, was a dead end in the journey towards joining the club of rich countries.

The HCI strategy relied on two pillars. On the one hand, it was necessary to build a powerful steel industry that could provide the basic metallic inputs needed by lots of kinds of heavy manufacturing. The state-owned POSCO had already been included in the first Five-Year Development Plan as a strategic industry but had not been implemented due to a lack of resources. It was maintained in the second Five-Year Plan, despite the opposition not only of a large part of the civil society and the bureaucracy but also of the World Bank, which had turned down a loan request, and of the US representative. Funding was finally available thanks to the US\$ 500 million reparations payment made by the Japanese Government in the late 1960s. Construction started in 1970 and the first POSCO mill became operational in 1973, with a capacity that was apparently among the highest in the world.<sup>21</sup>

The second pillar of the HCI strategy relied on the *chaebols*, from which Park required extended efforts to make their way in heavy industry exports, always with the same strategy of offering huge advantages of various sorts and making them compete against each other in the pursuit of an export breakthrough in a specific industry. This kind of tournament rule of the game, plus the risk of bankruptcy in the case of failure, was indeed a clever way of making sure that competitors would do their absolute best to succeed.<sup>22</sup>

One of the best examples of that strategy was the launch of an export-oriented shipbuilding industry. South Korea was already producing small fishing ships but it did not have the capacity to produce huge vessels of the type increasingly demanded by marine transporters and oil producers. Park invited three *chaebols* to get into that business – Hyundai, Daewoo, and Samsung – providing them with the same types of incentives as had been provided for light manufacturing exports but also with particularly important subsidised credits from domestic banks, as well as publicly guaranteed foreign loans, and promising nice rewards to the winners. It was obviously a hugely risky bet for a country that was renowned for wigs, apparel, and footwear exports to get into this kind of heavy business. Hyundai won the race, with a rather daring gamble involving two simultaneous contracts: one for two tankers to be delivered to a Greek company, and another for the purchase of a shipyard design and shipyard equipment from the Japanese Mitsubishi. The tankers were built at the same time as the shipyard was put constructed. Both Samsung and Daewoo were also operational and

---

<sup>21</sup> On POSCO see Rhyu and Lew (2011).

<sup>22</sup> The following paragraphs on the *chaebols* owes much to Kim and Park (2011), whereas the part that deals with the automotive industry relies greatly on Lee Nae-Young (2011).

active in that line of business a year later. Quite remarkably, South Korea soon became a major global actor in shipbuilding.

Not all industrial ventures under the HCI project did so well. Moreover, they were not always devoid of political machinations involving Park and close collaborators competing to succeed him. It was thus not uncommon for generous state advantages to be provided to a *chaebol* for some industrial venture in return for funding political campaigns or other political expenses. The whole manufacturing export drive strategy launched in the 1960s progressively evolved towards crony capitalism due to the growing economic power of the *chaebols* and the financing needs of the political game played by the small team in power.

The car industry, an important component of the HCI programme, which finally produced Hyundai's Pony for the domestic market and then Latin America, is a good example of the intertwining of *chaebols*, Park and his close collaborators, powerful state executives in key positions, politicians, and foreign multinational companies.

The story starts in the 1960s, when car assembling companies were launched as a substitute to car imports. Various *chaebols* were present at this time, supported by a particular political faction and associated with foreign constructors. According to the competition model imposed by Park, three *chaebols* competed in the domestic market, which was much too small to exploit economies of scale. Even so, protection made the business highly profitable and fed both the *chaebols* and the political factions behind them. The EPB then imposed an increase in the number of locally produced parts and, a little later, requested the creation of a local engine plant for the whole industry, which would benefit from generous subsidised credit and access to guaranteed foreign loans. Competition then took place between a *chaebol*, Sinjin, partnering with General Motors, and Hyundai, initially associated with Ford and later with Mitsubishi. Because Hyundai intended to produce not only a local engine but a full car, it finally won the deal and benefited from additional help from Park's cabinet, drawing on the newly created National Investment Fund, based on compulsory deposits of savings collected by non-bank financial institutions. The Pony car was launched in 1975 in the domestic market, while Sinjin continued to assemble General Motors cars, which were now much less popular than the national brand. Other assemblers went bankrupt in the process.

The provisional end of the story is that Hyundai almost immediately sought to export the Pony to gain in economies of scale. The car was shipped to the Central American market. Yet, despite its record low price – in large part thanks to the huge subsidies received from the state – the car was of bad quality and exports failed to pick up. Advanced countries' markets were inaccessible because high marketing barriers and the low quality of the Pony. It took several years and the mediation of Japanese companies for Hyundai to enter the low end of the US market around 1985.

Even before the assassination of Park in 1979, the central government had lost its hold over the *chaebols*. They had become 'too big to fail' and enjoyed extensive freedom with respect to the government. Some of them had incurred big losses in several failed ventures and could not repay their huge debts. Yet they controlled too many activities and employed too many people to allow them to go bankrupt. They were generally bailed out by the nationalised banking system. It was only after the death of Park, and with a lot of difficulty,

that the fabric of the *chaebols* could be rationalised through mergers in order to reduce this kind of risk.

Meanwhile, the state-owned steel company POSCO, heavily subsidised throughout its first years of existence, had been able to achieve international competitiveness, in large part thanks to Japanese technological support. By 1981, it was supplying not only the domestic market but also the Japanese market.

It is difficult to evaluate the exact contribution of the HCI drive to South Korean development. Judging from the following decades of industrialisation it looks like a resounding success. Yet, as suggested by the preceding examples, it was costly, not only in terms of the various business failures it produced, by the cronyism it triggered, and the economic inefficiency it generated when various *chaebols* competed in markets that were too small for them, but also the damage it caused to the rest of the economy, especially to the small and medium-sized enterprises that were unable to obtain resources in a banking system almost entirely devoted to the *chaebols* and state-owned enterprises. Yet success was undeniably there. Exports increased by US\$ 18 billion – representing a stunning rate of annual increase of 22% in volume – between 1970 and 1980, with a large and increasing contribution of heavy manufacturing and with the positive effects seen above on the whole economy. The lingering question, however, is whether the same result could have been obtained with another strategy that would have extended the light manufacturing drive which had been so successful in the 1960s and continued to be so in the 1970s progressively towards more capital-intensive activities instead of this abrupt dive into heavy industry.

## 5.6 An institutional diagnostic of South Korea in the mid-1970s

It is a challenge to produce a diagnostic of a country that did so well on both the economic and social fronts as South Korea, even when considering the country at a time when its development level was comparable to that of lower middle-income countries today. It is indeed tempting to say that the country got everything right. Looking at it from the standpoint of the late 1970s, however, the feeling might have been somewhat mixed. Analysts in those days would have been looking at a country which had taken off thanks to a specific set of institutions, initial conditions, and a strong will to access prosperity after half a century of privation, a country which took its chances as a labour-intensive manufacturing exporter with phenomenal discipline and effectiveness. However, they would also have noticed some late changes in the way the country and the economy fared. Success was still as phenomenal as it had been before, but the governance of the country had changed somewhat, with an omni-president running the country together with huge business groups about to become multinational corporations and intending to push the country forwards in a kind of breakneck race. As a matter of fact, a setback was not far off when Park was assassinated. The 1979 oil price boom revealed major weaknesses in the South Korean economy inherited from the heavy industry programme that had been pursued in the preceding years: a huge foreign debt, a high rate of inflation, a nationalised banking sector crippled by non-performing loans, some major *chaebols* that were near bankruptcy (with potentially explosive effects on the whole economy), and possibly a change under way in the international trade order, with the second doubling of oil prices in a few years.

In view of such a situation, it seems logical to articulate an institutional diagnostic of South Korea in the late 1970s in two parts: one relating to the institutions built since the creation of the Republic of Korea, and the causes of their success in setting its remarkable export-led growth path; and another focusing on the changes that are perceptible when looking more carefully at the 1970s.

The 'diagnostic table' below has been developed following the same principles as those used in the case studies of the IDP project, with a central column listing readily observable institutional strengths and weaknesses (in red), a column to its right listing the main economic consequences, a column to its left listing their major proximate causes, and, finally, an additional column on the left-hand side listing the deep factors behind those causes. Note that, for the sake of conciseness and simplicity, no representation has been made of the causality relationships between the various items in each column for a given period. In effect, causality applies among whole sets of items in the various columns, rather than among items on the same row.

The originality of this table for South Korea is that it is broken down into three periods – the same periods that were used to organise the discussion in the preceding pages. The reason for this lies in the deep differences in the way institutions functioned in South Korea during the post-war period, during the period of the junta and the first Park terms, and the period after the Yushin constitution, which gave quasi-dictatorial powers to Park. Sticking to the strict diagnostic exercise announced at the beginning of this chapter, it might have been sufficient to focus on the last period. Enlarging the lens allows us to see the evolving nature of institutions and how the way they were defined and worked in a given period affected how they would perform in the next period. For instance, the 1961 military coup in South Korea and the type of institutions set up by the military junta and then by Park's administration cannot be understood without some knowledge of the previous period. Likewise, the situation in the late 1970s, which is the core subject of our inquiry, can only be apprehended by reference to the institutional setting and economic success of the preceding period.

The various entries in the table for the first two periods, as well as the list of 'deep factors', have been discussed at some length in the preceding pages and do not need further comments. The table essentially summarises what factors explain South Korea's remarkable development throughout the 1960s. Yet those entries will be helpful below in producing a diagnostic of the last period.

Examining South Korea in say 1978, at the time when its income level was roughly comparable to that of Bangladesh, Benin, Mozambique, and Tanzania in 2020,<sup>23</sup> and scrutinising it in the same way as we did for those four countries, what would be our conclusion?

The first conclusion is obviously that in the span of a few years South Korea had developed an institutional setting that was particularly effective for development purposes. While its income level was perhaps comparable to the IDP case study countries today, it could count on huge advantages in terms of the educational level of its population, an effective and competent bureaucracy, and major infrastructure capital. It could also rely on an effective

---

<sup>23</sup> It will be seen below (Chapter 7) that the comparability holds mostly for Bangladesh. Rigorously speaking, income per capita today in Tanzania is equivalent to South Korea in 1970, while the correct reference would be 1965 for Benin and 1955 for Mozambique.

economic policy machinery, based on a planning bureau populated by high-level experts and a network of correspondents in the presidency, the ministries, state agencies, and nationalised banks.

Even though it was also set to evolve, this institutional setting was an enormous asset for future development. It was itself the joint result of various factors: (i) an ethnically homogeneous population eager to get out of dire poverty after 40 years of Japanese rule and three years of a deadly war, and frustrated by an ineffective and highly corrupt government; (ii) an army that, implicitly siding with the population, had carried out a coup and installed a junta willing to operate a radical change in the way the economy worked; (iii) the Japanese model of development, which was well-known to the leaders of the junta, which could be used as a template; (iv) a well-trained elite and a sufficiently educated population which could form a competent bureaucracy; (v) the rivalry with North Korea; (vi) the support of the US ; and (vii) a gifted, clever, ambitious, and patriotic leader. In a few years, and based on a vigorous export-led strategy, the South Korean economy had taken off.

Signs did exist in the 1970s that the machinery was evolving. First, centralisation had strengthened, and the planning entity had lost some power in favour of the President's office, in an effort by the latter to impose the HCI programme, which was far from consensual among top experts in the planning bureau and other administrative entities. Park's obsession with the HCI programme had much to do with some of the 'deep factors' listed in the diagnostic table. The hostile relationship with the Northern neighbour would at some stage make armament production necessary in the South, which would require massive heavy industry inputs, steel in the first place. Also, North Korea boasted a steel industry, which caused South Koreans to feel somewhat ashamed of their apparel, wig, and footwear exports. Finally, was it not the case that the steel industry had been a key factor in Japan's development and its military power?

**Institutional diagnostic table for the three periods of South Korean development until 1979**

Deep factors	Proximate causes	Institutional strengths and weaknesses	Economic consequences
<b>First and Second Republics (1953–1961)</b>			
Education level	Reconstruction period	<u>Imprecise long-run strategy</u>	Slow growth
	Weak political regime	<u>Rent-seeking and corruption</u>	Weak macro policy (over-valuation of the currency, inflation)
Homogeneity		Land reform	Key role of imports
<b>Junta and Third Republic (Park civilian regime): 1962–1971</b>			
War legacy	Military-style National Revolution	Effective planning cum market system	Explosive labour-intensive export-led growth
	Japanese development	Control of the financial system	Fast structural transformation

	template		
Northern threat	Foreign aid	Efficient and disciplined bureaucracy	Contained inequality
		Clever export-led industrialisation incentive system	Foreign lending/debt
Difficult democratic learning process		Presidential control of big business	Increasing concentration of business sector
		Crony oligopolistic capitalism	Infrastructure development
		<u>Repression of social movements</u>	
Foreign influence	<b>Fourth Republic (Park authoritarian regime, 1972–1979)</b>		
Japan	Park's HCI objective	<u>Centralisation of decisions around Park (bypassing planning design)</u>	Move towards heavy industry exports (HCI)
US	Signs of elite capture	<u>Autonomisation of chaebols ('too big to fail')</u>	Booming exports and GDP growth
		<u>Further concentration of production apparatus</u>	Successful major industrial projects (POSCO)
		<u>Excessive distortion of market mechanisms</u>	Further development of infrastructure
			Mounting foreign debt
			Critical situation of some chaebols

Park's strong will to move on with the HCI programme to intensify industrialisation and to continue with hypergrowth was also behind the constitutional change that gave him quasi-dictatorial power (on top of the more obvious objective of muting the opposition and democratic forces). Yet this move towards heavy industry exports entailed changes in the relationship between the President and the *chaebols*, which were the spearheads of this new strategy. They had already acquired considerable economic power in the previous period. The intensification of industrialisation, which could not rely on medium-sized enterprises, gave them still more power. At the same time, because of their earlier success in international markets, they had acquired considerable autonomy with respect to the central power, through their size, the holding structure they adopted to control a batch of very diverse activities, and through their links with multinational corporations in domestic and foreign markets. Given the huge financing facilities granted to them by the central power, they were able to keep expanding, sometimes in extremely risky ventures, following their own strategies. Paradoxically, the centralisation of economic power in the presidency came with some loss of control over the *chaebols*. In addition, the *chaebols* were also important in providing resources that allowed Park to pursue political objectives at a time when the

opposition, labour unions, and the civil society were gaining vigour, in part as a result of the astounding economic progress of the past 15 years or so.

More autonomous, because more economically powerful, and essential for the continuation of fast economic growth, the *chaebols* apparently did not enter the political game. Thus, it would be an exaggeration to refer to elite capture. What seems certain is that they implicitly had a say in regard to economic policy, which had not been the case a few years before. In effect, by the late 1970s South Korea was converging with those modern societies where captains of industry or CEOs of major companies are at the same time the vectors of economic activity and progress as well as major interlocutors – and in some cases economic guides to governments. Such an evolution was not necessarily negative, even though it did not fit well with an authoritarian regime.

Another consequence of the huge advantages given to the *chaebols* to enable them to perform their breakthrough in heavy industrial exports was a deeply distorted financial market, where state-owned banks could not fully play their role of efficient resource allocation agents because of the huge funding requirements needed for the *chaebols'* ventures and, in some cases, for bailing them out. Such financial repression by the central power could have been very effective in the 1960s at the time when the manufacturing export engine needed to be kickstarted but it was not adapted to an economy whose volume had quadrupled and whose citizens were now three times richer.

The years after Park's death were difficult ones, not least because of the second oil price boom, which severely affected the heavy industry due to its energy needs, but which also revealed weaknesses in the economic fabric woven by the *chaebols*. Under Chun's dictatorship, several years were needed to put an end to the 'everything goes' attitude that had prevailed during the last years of Park's era, and to restructure the *chaebols* into a sustainable but still fantastically effective driver of industrialisation and development, thus ensuring the final success of Park's risky HCI bet.

## 5.7 Conclusion

Retrospectively, General Park's leadership was decisive in setting South Korea on a development trajectory that led the country from lower-income country status in the early 1960s to being admitted to the OECD club of rich countries less than 40 years later. There was still a long way to go when he was assassinated, and the path has not always been an easy one. Without the vigorous take-off of the 1960s under Park, however, it is unlikely that South Koreans would have attained the prosperity they enjoy today.

The development of South Korea in the 1960s should indeed be an example for least advanced countries (LACs) today. As poor as some LACs are today, South Korea was very much disorganised after passing through a major conflict, was without natural resources, had no clear development strategy, and was home to a corrupt regime, but a radical turn towards a labour-intensive manufacturing export strategy was taken in two or three years and propelled the economy on a rocket-speed development trajectory. Its key assets on that journey were a capable and disciplined bureaucracy, a dynamic entrepreneurial class, a population eager to learn, and effective and smart (although authoritarian) stewardship.

The debate will probably still last quite some time about whether the authoritarian nature of that leadership should be considered as another favourable asset in the early development of South Korea. From an economic point of view, however, the point may not be so much the nature of the political regime but rather the stability that it brought, in contrast to what had been observed in the previous post-war period.

With the Japanese development model in mind, but short of funds, South Korea was able to exploit all opportunities that arose to increase the resources that could be invested in its development. But it is certainly in its management of the business sector and the attribution of what could be called 'conditional rents' that the country was most innovative and successful. Providing heavily subsidised funds and other advantages to light manufacturing exporters conditionally on reaching pre-defined objectives proved highly effective. The same can be said of the competition imposed later on *chaebol* conglomerates in the conquest of foreign markets in heavy manufacturing. Yet this strategy would not have succeeded without a skilled and transparent bureaucracy that was able to tightly monitor business. Even though it was successful, however, it must be recognised that this strategy was a real bet. It could have failed, which would have had dramatic consequences for development.

It also bears emphasis that the South Korean economy was not devoid of corruption. Business was also often asked to contribute to the campaigns of top politicians, including Park himself, to such an extent that towards the end his era the *chaebols* had acquired real leverage over the government, which made regulating them less effective. As a matter of fact, this culture of corruption has not completely disappeared, as can be seen from the numerous scandals that continue to tarnish South Korean political life today. In the case of South Korea, however, this might appear more the consequence of a successful development strategy based on the relationship between the state and business than as a handicap for the implementation of such a strategy. This does not mean it is costless, of course.

A last lesson of South Korea's early development for today's LACs concerns the distribution of income and the accumulation of human capital. Not only was the degree of inequality moderate by developing country standards, but it was remarkably constant. This low level of inequality is to be related in part to the land reform that was implemented upon the departure of the Japanese colonisers, but also to the homogeneous progress of education within the population throughout this period. In addition, there was a constant concern on the part of the leadership to avoid mounting imbalances between the rural sector and the highly dynamic manufacturing sector and ancillary activities in urban areas. This relative stability of the distribution of income permitted economic growth to translate immediately and effectively into the reduction of poverty. At the same time, it did not prevent democratic movements forcefully expressing their discontent whenever possible in the face of essentially autocratic regimes – until democracy finally prevailed.