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Author(s): Sudip Chaudhuri

Source: *Social Scientist*, Nov. - Dec., 1996, Vol. 24, No. 11/12 (Nov. - Dec., 1996), pp. 18-35

Published by: Social Scientist

Stable URL: https://www.jstor.org/stable/3520100

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SUDIP CHAUDHURI*

*Government and Economic Development in South Korea, 1961–79***

Korea was a colony of Japan from 1910 to 1945. Following Japan's defeat and surrender in the Second World War, Korea was divided into two parts. The southern portion, South Korea, was put directly under the control of the American Military Government till 1948. A South Korean government was established in 1948 under Syngman Rhee, who remained in power till a Student Revolt forced him to resign and retire in 1960. A military coup in 1961 led by a Major General of the South Korean army, Park Chung Hee, overthrew the government which succeeded Rhee. Park became the President and ruled South Korea as a dictator till his assassination in 1979.

The economic condition of South Korea in the 1950s was dismal. In fact when Park took over, the economy was passing through a severe crisis with decreasing growth and rising unemployment (Schwartz, 1989, p. 240). Park initiated and implemented an economic strategy, which transformed the economy and achieved remarkable economic progress. In the 1950s, South Korea like India was a typical low income Third World country. Today she is way ahead. With a GNP per capita of US$ 8260 in 1994, she is closer to such high income countries as Portugal (US$ 9320) and Spain (US$ 13440) than she is to low income countries such as India (US$ 320) and Ethiopia (US$ 100) (World Bank, 1996, pp. 188–89). As in developed countries, the rapid growth has been accompanied by significant structural changes. Like the other Third World countries, South Korea was basically an agrarian economy around 1960 with about 68.3 per cent of the work force depending for their livelihood on agriculture, forestry and fishery and only 1.5 per cent on manufacturing. As a result of rapid economic growth, manufacturing became more important than agriculture by the late 1980s, with the former accounting for 27.7 per cent of the employment and the latter 20.7 per cent (Yoo, 1990, p. 7).

We concentrate in this paper on the South Korean economy during the 1960s and the 1970s when Park was in power. Park gave top priority to

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* Economics Group, Indian Institute of Management, Calcutta.

** Enlarged version of a part of the paper presented at the seminar on 'The State and Development in Asia', Centre for Economic Studies and Planning, Jawaharlal Nehru University, New Delhi, November 11–13, 1995.

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economic growth, which was regarded as a chief factor that would legitimatize the military regime (Mason *et al.* 1980, p. 46). In fact he declared that 'the key factor of the May 16 Military Revolution was to effect an industrial revolution in Korea' (cited in Alam, 1989, p. 41). As we will see below, the government under Park introduced several new measures, which in their entirety reflect a particular strategy for economic development. After his death, there have been some changes in the approach of the government. Much of South Korea's dramatic economic changes took place during Park's regime. Gross investment as a proportion of GNP increased from 12.8 per cent in 1962 to 35.7 per cent in 1979. Exports increased from 2.4 per cent of GNP in 1962 to 31 per cent in 1979. GNP at constant prices increased at 9.5 per cent per annum during 1962–71 and at 9.6 per cent during 1971–79. The share of manufacturing increased from 13.6 per cent of GDP in 1960 to 30.6 per cent in 1980. By 1980, manufacturing absorbed 21.6 per cent of the workforce (Suh, 1989, pp. 14, 21; Yoo, 1990, p. 7).

Park's government did not neglect agriculture. The development of agriculture was actually impressive by international standards (Wade, 1983; Whang, 1987). But what transformed South Korea into one of the fastest growing economies of the world was the development of industries. We highlight below the role the government played in Park's industrialization strategy.

GOVERNMENT AND EXPORT PROMOTION

The growth of exports was a major factor behind South Korea's economic success. It went up from US$ 55 (2.4 per cent of the GNP) in 1962 to US$ 14705 (31 per cent) in 1979. The real (deflated by US wholesale price index) average annual rate of growth of exports was as high as 40 per cent during the first two five-year plans (1962–72) and about 28 per cent during 1972–79 . The growth was predominantly in manufactured goods, with its share in total exports increasing from 27 per cent in 1962 to 90.1 per cent in 1979 (Koo, B., 1986, p. 6; Amsden, 1989, p. 55; Song, 1990, p. 61).

Export promotion was one of the first things which Park's government did in an organized way. Steps were initiated to change the biases against export activities. A conscious attempt was also made to make production for exports more profitable by providing incentives. Some of these measures were initiated by the previous governments. Others were added later. All these were combined to form a coordinated plan of action under Park.

The steps taken to eliminate the biases against exports included (i) devaluation (in 1961, 1964 and periodically thereafter), (ii) free trade regime for exports (completed by 1967) and (iii) no indirect taxes on domestic inputs used for exports (introduced in 1961).

South Korea went beyond this and provided different types of incentives to exporters such as accelerated depreciation (since 1966), reduced rates for infrastructure, electricity, rail and road transportation services (since 1967), reduced rates of income taxes, subsidized credit. Moreover, as a wastage allowance, exporters were permitted (since 1965) to buy duty free inputs in

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quantities greater than what are required for production for exports and use these for production for the domestic market (Mason *et al.* 1980, pp. 127–32).

The government also intervened to reduce the risks and uncertainties facing the exporters. Guarantees were provided for repayment of foreign loans. Additional foreign debt burden due to devaluation were compensated by low-interest loans. The government also started the policy of buying merchandise from exporters with high inventory ratio and reselling them in the market or later to the original sellers. The risks of exports of new items were reduced by offering to the exporters the opportunity to earn higher profits from domestic sales. For TVs, for example, the domestic market was protected and the exporters were allowed to charge higher domestic prices to subsidise exports. In 1978, for black-and-white TVs, the domestic price was US$ 180 against the price of about US$ 42 in the export market. They were also allowed to import high quality radios, TVs, etc. and to sell these in the domestic market at high margins (Lim, 1981, pp. 23–29; Haggard and Moon, 1983, p. 161).

The government in South Korea however not only relied on these price incentives and subsidies. Under Rhee, exports did not pick up despite export promotion subsidies (Jones and Sakong, 1980, p. 92). What was crucial under Park was that a number of non-market instruments were also used to promote exports.

South Korea enjoyed some advantages which were not available to other Third World countries which tried to promote exports later. For political reasons, she enjoyed the advantage of preferential access to the large US market. Only a handful of developing countries received the majority of benefits under GATT's Generalized Scheme of Preferences. South Korea was the third largest beneficiary of American GSP with 63 per cent of her exports going to USA duty free even in 1980 when she developed into a major exporting country (Haggard and Moon, 1983, p. 162). The timing was also very important. South Korea started the export promotion policies in the 1960s when the world capitalist economy was on an upswing and world trade was expanding at a fast rate (Koo, H., 1986, p. 162). What is distinctive about South Korea (and a few other countries, for example, Taiwan) is that she took full advantage of these favourable conditions and implemented a strategy which relied not only on market instruments but on direct intervention by the government in many ways. It is important to note that the US Agency for International Development and the World Bank played active roles in devising the export oriented policies (Cole and Lyman, 1971, p. 205; Koo, H., 1986, p. 162). Some of what South Korea did as listed above do form a part of the standard neoclassical trade policies which these organizations promote. But as we shall discuss now, South Korea did much more than that.

The system of export targeting was introduced in 1962. The targets were comprehensive and specified the firms, the commodities and the markets to be penetrated. These targets were closely monitored. Daily contacts were made with the major exporters and problems, if any were directly tackled. A monthly trade promotion meeting chaired by the President himself and

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attended by ministers, bankers, successful exporters, both big and small used to be held to supervise the progress and act accordingly (Jones and Sakong, 1980, p. 97; Westphal, 1990, pp. 44–6).

The government provided institutional support to exporters in various other ways. The Korean Trade Promotion Corporation was established in 1964 to conduct overseas marketing activities for Korean exporters. Korean Traders Association was authorized to collect 1 per cent of the value of imports from the importers and to spend for export promotion. Industrial estates were established, which not only provided the utility services but also had branch offices of ministries/departments dealing with imports, exports, finance etc. The government encouraged the formation of 'General Trading Companies' since 1975 to supplement the efforts of the Korea Overseas Trade Association (set up in the 1960s) to displace the Japanese and Western transnational corporations in export distribution and to increase the Korean gain from trade (Mason, *et al.* 1980, pp. 129, 138, 472; Schwartz, 1989, p. 259).

The government made a distinction between foreign direct investment (FDI) for the domestic market and that for the export market. While the former was regulated, the latter was accorded red carpet welcome as we will discuss below.

With an underdeveloped industrial structure to start with, most of the raw materials and capital goods required for exports were imported. While exports were increasing at impressive rates, imports were going up at an even faster rate. To tackle the consequent worsening trade balance and the foreign exchange problem, if South Korea had tried to control the imports, then exports would have suffered due to shortages of inputs. Reflecting its commitment to growth referred above, the government never resorted to contractionist measures of restraining imports to combat chronic trade deficits. It actually allowed the imports to increase and preferred the expansionist policy of financing the foreign exchange gap by ever-increasing external borrowings (Watanabe, 1985, cited in Chakravarty, 1987, p. 10). This turned South Korea into one of the major debtor countries. But she did not face a debt crisis. As discussed below, by promoting industries, the government tried not only to sustain the increase in exports but also to substitute imports. The earnings and savings of foreign exchange were sufficiently high to confine debt servicing to reasonable proportions. By 1986, the trade balance actually turned positive (Song, 1990, Table 5.1).

GOVERNMENT, IMPORT SUBSTITUTION AND DEVELOPMENT OF INDUSTRIES

Initially the manufactured goods exported by South Korea were technologically simple and labour intensive. South Korea not only promoted these goods for which she had a comparative advantage. She also consciously promoted domestic production of goods for which at that time, following the neoclassical logic, she did not have a comparative advantage. The most dramatic perhaps is the development of steel industry. A consortium of ten Western

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countries and five international financial organizations approached by Park's government refused to help South Korea in setting up an integrated steel mill. The World Bank and countries such as USA and West Germany felt that the project was economically infeasible. Ultimately with Japanese technical assistance, the Pohang Iron and Steel Co. was established in 1968 in the public sector which turned out to be one of the most efficient in the world (Chang, 1985, pp. 113–14; Amsden, 1989, p. 291).

Export promotion and import substitution are often posed as two alternative development strategies. South Korea did not believe in any contradiction between the two. Import substitution was meant not only for domestic markets but also for subsequent export diversification. In some cases (steel and ships), such export activity followed import substitution almost immediately. For others (chemicals, machinery, automobiles) it followed after a lag (Amsden, 1989, p. 155).

Government expenditure decreased from 21 per cent of the GNP in 1961 to 19 per cent in 1979. It would be misleading to infer about the role of the government from such a decline. While the total government expenditure declined, government investment expenditure actually increased from 2.8 per cent of the GNP in 1961 to 5.8 per cent in 1979. When Park took over in 1961, government savings was negative (-1.8 per cent of the GNP). But the situation was soon reversed and government savings amounted to about 7 per cent of the GNP by 1979. By controlling the consumption expenditure and by increasing the tax revenue, the government started mobilizing resources for capital formation in the public sector. In the more recent years, indirect taxes have been the more important source of the increase in the tax revenue. But in the 1960s, the share of direct taxes in total taxes increased from about a third in 1961 to about half in 1970 (Whang, 1989, pp. 14, 16, 24). This was largely the result of improvement in tax administration and control of tax evasion. The Office of National Tax Administration was created with full political support from the President and a clear mandate to increase tax collections (Mason *et al.* 1980, pp. 320–21).

Apart from steel, public enterprises (PEs) initiated the manufacturing of a number of vital products in South Korea, for example, fertilizers, petrochemicals, refined petroleum products. The policy was to set up PEs in areas which are considered as essential but where the private sector were not yet ready to invest (Westphal, 1990, p. 49; Song, 1990, pp. 117–19).

The PEs played in South Korea a role which was more important than that in most of the countries of the world (Jones, 1975). But it was the private sector which has played the more dynamic role. Private investment increased at a much faster rate resulting in a decrease in the ratio of public investment to total investment from 26.7 per cent during 1962–66 to 16.5 per cent during 1977–81 (Choi and Lee, 1990, p. 62).

The Korean private enterprises however did not operate independently. Park, the chief architect of South Korea's industrialization strategy believed that government intervention is necessary for achieving rapid economic

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growth. The launching of the five year economic plans was announced within 100 days of the assumption of power by Park (Amsden, 1989, p. 50). Allocation of resources were not be left to the market mechanism. The government was to decide the important economic activities to be promoted and mobilize and direct the flow of resources accordingly. The Economic Planning Board (EPB) was set up in 1961. The leadership's commitment to planning and economic development was reflected in the wide powers vested in the EPB. It not only prepared the plans, it also had budgetary powers to actually influence the flow of resources to different activities. It functioned as a superministry operating under the deputy prime minister enjoying strong presidential support. It coordinated the policies and programmes of all the economic ministries and was the main actor behind the heavy intervention of the government in South Korea's industrialization (Suh, 1989, p. 11; Choi and Lee, 1990, p. 65).

The government masterminded every major industrial project in the country during the 1960s and the 1970s (Amsden, 1989, p. 80). It promoted selected industries at a time. The industries designated as priority industries received massive support from the government for their development (Chang, 1993, p. 141).

Following the success of the petrochemical and steel mill projects during the Second Five Year Plan (1967–71), the development of heavy and chemical industries (iron and steel, non-ferrous metals, ship building, machinery, electronics, fertilizers, oil refining, cement, etc.) in fact became the government's priority. The Heavy and Chemical Industries (HCI) drive was officially announced by Park in 1973 in a Press Conference. The main motive of the HCI drive was import substitution of vital intermediate and capital goods and the creation of new sources of export industries. It was felt that development of HCI would reduce the import dependence for raw materials and machinery and hence contribute to the trade balance, which worsened throughout the 1960s. Another area of concern was the long term prospect of the labour intensive manufactured exports. Till about the mid-1970s, the main items of manufactured exports were such labour intensive goods as cotton textiles, apparel, plywood, wigs, consumer electronics which required simple technology. With rising protectionism in the West, especially in USA against labour intensive manufactured goods from the developing countries and the competition being faced from other developing countries with still lower labour costs, the export outlook was not optimistic. Diversification to new areas through HCI was visualized as an answer to these developments. Gradually the structure of manufactured exports changed in favour of capital and skill intensive products such as ships, steel, machinery, automobiles, computer electronics. The increase in South Korea's exports in the 1980s, for example, were most visible in the products which were promoted under the industrial policy of the 1970s (Haggard and Moon, 1983, p. 173; Kim, 1990, pp. 1–18; Yoo, 1990, pp. 18–27, 110; Amsden, 1989, p. 154).

Korean private enterprises were the main implementing agents of the

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government's industrial policy. Business and government worked in close association with the latter as the senior partner. The pattern was established right at the beginning of Park's regime. Under a Law for Dealing with Illicit Wealth Accumulation, Park's government arrested the country's leading businessmen and threatened to confiscate of their assets. But in a meeting with ten of the business leaders, a deal was struck whereby criminal prosecution was dropped against them and they agreed to participate in South Korea's industrialization under government direction (Jones and Sakong, 1980, pp. 69–70). Except for the nationalization of the commercial banks, the government did not confiscate their assets. One outcome of such a close harmony between business and government was the rise and growth of 'chaebols', the large Korean business groups engaged in diverse activities and owned and controlled by one or two interrelated families. The government felt that the goal of rapid economic development can be attained not only by identifying target industries, but also target firms and helping these industries and firms to grow. The targeted firms were favoured over others. In return they were expected to deliver the goods. The chairmen of these firms were in fact personally accountable to the government. The government was not against monopolies. Rather the predominant view in the government was that big business is necessary to compete against the Western and Japanese oligopolies and penetrate the world markets. As a result, South Korea developed into a highly concentrated economy. The combined sales of the five largest chaebols (Samsung, Hyundai, Lucky-Goldstar, Daewoo and Sunkyong), for example, accounted for about a quarter and the top ten about a third of the GNP by 1979 (Steers, Shin and Ungson, 1989, pp. 19, 35; Amsden, 1989, pp. 73, 116, 136; Kang, 1989, p. 31).

To direct the flow of resources to the desired industries and firms, the government used a wide variety of instruments, including control over credit, industrial licensing, import control, foreign exchange control, control over foreign investments, tax incentives, etc. (Mason *et al.* 1980; Westphal, 1990). During the 1970s, the effective tax rate on the marginal return to capital was about 20 per cent for the favoured industries compared to 50 per cent for the other industries (Yoo, 1990, p. 37). Import regime was liberal in the export industries. But imports meant for the domestic market were tightly controlled through a large number of tools including, trader licensing, quantitative restrictions, foreign exchange controls, customs tariff. Under the HCI drive, the proportion of items in the machinery sector, for example, which could be imported without government's permission decreased to 35.4 per cent in 1976 from 55.9 per cent in 1968 (Koo, B., 1986, p. 8). But regardless of what the declared rules said, Korean authorities could and did use their wide ranging powers to stall any imports they thought were not desirable (Luedde-Neurath, 1986, ch. 3).

By nationalizing the existing banks and by setting up the new banks in the public sector, the Park regime gained full control over domestic credit. In the early 1960s, the government introduced the system of foreign loan guarantees

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which paved the way for massive foreign borrowing by private entrepreneurs. By providing the guarantees on a discretionary basis, the government exercised control over the cheaper foreign funds also. Such a complete command over financial flows was one of the most potent instruments used to influence the pattern of investments in the economy (Mason, *et al.* 1980, p. 475). The favoured industries not only received preferential loans. The rate of interest paid by them was about 5 to 12 percentage points lower than the discount rate charged by the commercial banks in the first half of 1970s and about 3 percentage points lower in the second half. Except in one year, the inflation rate being higher, the real interest rate was effectively negative (Yoo, 1990, p. 43). Much less important than the control over financial resources, but not to be ignored is the control over material resources through public enterprises (Chang, 1993, p. 153). As we have mentioned above, the government set up and owned several strategic industries including, oil, steel, electricity and gas.

Most of the instruments used by the government to influence industrialization are fairly well known and have been employed in many other countries. What is striking about South Korea is the combination of the different instruments and the co-ordinated plan of action to promote industries. Let us refer there to the electronics industry.

Among the major industries which contributed significantly to South Korea's development, electronics ranks high on the list. Starting from scratch in the 1960s, the Korean electronics industry became a force to reckon with in the world within two decades. The electronics industry was identified as one of the strategic industries to be nationally developed. Electronics Industry Promotion Law was passed in 1969 and a series of Basic Plans for Electronics Industry Development were announced by the government. In each of these plans, the approach has been to fix the targets to be achieved within the time frame, to identify the problems and weaknesses and to formulate and implement a set of co-ordinated strategies and policies. The projects selected received various financial, fiscal, administrative and technical help. A number of specialized agencies were created to provide administrative and technical support, for example, Korea Institute of Electronics Technology and Fine Instrument Centre (FIC), later incorporated into the Electronics Industry Association of Korea. FIC in particular played a very important role and acted as the main agency for implementing the government policy (Seongjae, 1988, pp. 1–9; Michell, 1988, pp. 143–45). Initially the stress was on assembly operations. In the late 1970s a conscious attempt was made by the government to develop the industry beyond the assembly stage. As a part of her Fourth Five Year Plan (1977–82), 57 items including semiconductors, computers, etc. were selected for simultaneous import substitution and export promotion. The government established an industrial estate for production of semiconductors and computers. It also set up a research institute in the industrial estate to look after importation of foreign technology and its further development. Among the other steps taken were to protect the domestic market against foreign competition and to restrict the entry of foreign enterprises. Joint

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ventures were favoured over subsidiaries of foreign enterprises (Amsden, 1989, pp. 82–83).

The fast economic growth in South Korea during Park's regime was accompanied by a high degree of inflation. As the sharp increase in investment outstripped the resources mobilized, inflation accelerated to about 18.4 per cent during 1962–79, which is lower than that experienced in Latin America but significantly higher than that observed in most other countries (Amsden, 1989, p. 49). The government preferred growth to stability. We referred earlier in the context of rising imports and trade deficits that the government did not adopt contractionary policies of import reduction. Similarly here, the government did not contract investment but continued with its expansionary policies. As in the case of trade deficits, however, was brought under control in the 1980s (Song, 1990, p. 73).

It is not that the industrial policies pursued by the government never faced any problem or opposition. For the first time since the country began her industrialization in the early 1960s, exports declined in real terms in 1979 and the GDP in 1980. Negative economic effects in the late-1970s culminating in such a dramatic reversal of its growth in 1979 and 1980 have often been attributed to the HCI drive and it has been contended that but for the reversal of the HCI drive in 1979, the costs would have been dearer. The stabilization programme initiated in 1979 and the reforms of the 1980s which liberalized the controls on imports, financial sector, foreign investments, etc. and put greater reliance on the market mechanism and gave greater autonomy to the private sector are cited as evidences of the reversal of the HCI drive. It has been argued that the liberal incentives offered by the government lured many entrepreneurs to set up plants in the targeted heavy industries. This resulted in over capacity creation in these sectors and under investment in the light industries which were not favoured under the HCI drive. The sharp rise in aggregate investment was financed not by budget balances but by creation of credit through state controlled banks and increase in money supply. Demand increased in the economy but the supply situation deteriorated with the bottlenecks in the light industries. As a result inflation accelerated. Exports also suffered due to the apathy towards labour intensive light industries (Suh, 1989, pp. 26–31; Yoo, 1990, pp. 102–07; Haggard and Moon, 1983, pp. 175–79; Kuznets, 1982, pp. 71–81; Kim, 1990, pp. 29–39).

It is not proper to attribute all the negative economic consequences in the late 1970s to the HCI drive. The economy suffered from the second oil shock and crop failures in 1978 and again in 1980. The oil shock was particularly disastrous because it shrank the markets for the HCI products at a time when the new investments were being realized (Kim, 1990, p. 44).

Mistakes may be committed in implementing any programme of the size and scope of the HCI drive. These as such do not imply that the entire programme is a failure. Of course, the mistakes need to be tackled and it is significant that the government under Park before his death actually initiated corrective actions. Even if it were to be admitted that some of the investment

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decisions were not proper, it does not follow that planning by the government was a failure. To properly assess the role of the government, it is important to analyze and understand whether the shift in the industrial structure could have taken place by relying on the market mechanism and whether the high growth of the 1980s could have materialized without such a structural change. It is important to note that the annual rate of growth of manufacturing in South Korea was 11.7 per cent between 1979 and 1988. This was significantly above the rate achieved by other countries at comparable levels of development, for example, Chile, Spain, South Africa. This would not have been possible without the 17.2 per cent growth in the heavy industries in South Korea. Moreover, as we have already mentioned, HCI contributed significantly to the revival and spurt in exports. Import substitution also improved. In fact almost all the industries promoted through HCI showed improvements in trade balances in the 1980s (Chang, 1993, pp. 135–36).

GOVERNMENT AND FOREIGN DIRECT INVESTMENT

With the defeat of Japan in the Second World War, Japanese capital in Korea was confiscated and eliminated. And during Japan's rule of Korea there was no Western direct investment. Hence, unlike typical colonial countries, South Korea did not have any FDI when the colonial rule ended. Thus South Korea started with an advantage. Controlling foreign capital became very difficult in other colonial countries in general because foreign capital dominated these economies and they continued to operate despite the politically independent status of these countries.

Japanese investments did not resume before 1965 when the relationship between the two countries was normalized. It also appears that the Western corporations were not too keen to invest in South Korea at least initially. There was no FDI project during the 1950s. FDI from the West began as late as in 1962 with a joint US–Korean venture to produce nylon filament yarn (Mason et al., 1980, p. 200). The home market was small. South Korea lacked most of the natural resources. And the political situation was uncertain.

The South Korea government on their part pursued highly nationalist economic policies. Unlike the Rhee government, most of the members of the 'administrative elite' of the Park government were educated not in Western countries but in Korea, Japan and Manchuria and were more conversant with the ground realities of Korea (Oh, 1990, pp. 32–33). Uncontrolled FDI was considered to be a threat to national development goals (Mardon, 1990, p. 119). The crux of their policy was the distinction between desirable and non-desirable FDI. They did invite and welcome desirable FDI and provided incentives for that purpose. But they also tried to control the other activities.

FDI for exports was identified as one of the desirable areas. South Korea was ready to do whatever the foreign enterprises wanted for export oriented investments. Among the incentives provided to foreign enterprises for production for exports were 100 per cent foreign equity, special laws ruling out industrial disputes/strikes, attractive tax and capital repatriation concessions,

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duty free imports (Haggard and Moon, 1983, p. 150; Stoever, 1986, pp. 231–32). In labour intensive products where technology is simple and can be manufactured by indigenous enterprises, FDI was allowed basically for providing international market access for increasing exports. Consequently, in these industries the share of export sales of foreign enterprises was found to be high but that of domestic sales low. Thus in textiles and apparel, the foreign enterprises accounted for 76 per cent of exports but only 7 per cent of total industry sales in 1978. Similar variations were observed in electronics, toys, musical instruments etc (Park, 1984, Table 2–2).

Even for FDI for the domestic market, on paper, the foreign capital policy does not appear to have been restrictive. On several occasions, as in the late 1960s, the government in fact offered liberal incentives, for example those related to profit repatriation, permissible foreign equity, tax treatment, purchase guarantee, duty free imports, guaranteed profit margins, 'one stop service office', to reduce bureaucratic problems. Public-relations firms were also hired in Western countries to promote FDI. Later in the early 1970s, the FDI policy announcements combined the incentives with some restrictions (Stoever, 1986, pp. 231–36). But what is distinctive about South Korea is the gap between the law on paper and the law in practice. FDI was welcomed and encouraged but on a selective basis. FDI proposals were routinely screened in a discretionary way and approvals were not granted unless national objectives were satisfied (Luedde-Neurath, 1984, pp. 19–22). The incentives offered to FDI were effectively meant only for these approved projects.

One of the major tasks of the Economic Planning Board was in fact to co-ordinate the inflows of foreign capital and technology with the development plans. For the import substitution projects, the basic policy was to permit FDI in only those projects which were considered to be necessary but technology was not available locally and could not be imported through licensing. Government explicitly sought to limit foreign investment in sectors where Korean enterprises can be internationally competitive, where the foreign enterprises can be potential competitors to domestic enterprises in the overseas markets. FDI was excluded, for example, from most sectors that produce consumer goods. Till the late 1970s, FDI in the financial sector was strictly regulated. As the economy developed, foreign investment was no longer considered as a major threat to national control. It was only thereafter that the sector was opened up for foreigners (Coolidge, 1980, p. 374; Mardon, 1990, pp. 116–17, 122–24)

The government also tried to control the activities of those foreign enterprises which were allowed to operate in South Korea. Export requirements, discussed above, limited their access to the domestic market, while local content requirements in certain sectors have resulted in greater domestic linkages. Imports were monitored to check transfer pricing and to ensure that only those capital goods are imported which are necessary but cannot be produced in South Korea. No foreign enterprise was allowed to take over an existing Korean enterprise. Over 20 per cent of FDI was reacquired by the

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Korean enterprises after they gained the technical knowledge. Such purchases were encouraged by the government by insisting on divestiture requirements in the agreements and providing subsidized credit for the purpose (Haggard and Moon, 1983, pp. 151–52; Mardon, 1990, pp. 134–37).

The control over FDI insulated most of the industries from foreign control. Except perhaps the electronics export industry, especially till the early 1970s, none of the industries were dominated by foreign enterprises. As a result, the influence of external interests in the industrialization process was checked. Even when FDI increased, as for example in the export processing zones, the role of foreign enterprises were restricted by limiting the access of these zones to the local economy (Schwartz, 1989, pp. 250, 255). South Korea was able to pursue such nationalistic economic policies without retaliation from developed capitalist countries. USA tolerated these policies because South Korea served America's security interest in northeast Asia (Mardon, 1990, p. 115).

The government recognized the need for foreign funds and technology. But unlike in many other developing countries, conscious attempts were made in South Korea not to depend on FDI for the purpose. It encouraged the Korean enterprises to go in for foreign loans rather than FDI. Where FDI was unavoidable, joint ventures were preferred. Fully foreign owned subsidiaries were discouraged except in the export processing zones. The long term burden was perceived to be less in the case of loan funds. Once the loan is paid off, ownership and profits remain in the country, whereas FDI continually drains the country through remittances. The Korean authorities also will have a greater say over the deployment of loan funds as per the national priorities. This was considered to be another major advantage of loan funds. As a result, not surprisingly, FDI played a minor role accounting for only 4 per cent of the net inflow of foreign capital during 1962–71, 7.9 per cent during 1972–76 and 4 per cent during 1976–84 (Mason *et al.* 1980, p. 477; Mardon, 1990, pp. 120–21).

A large part of the initial light export industries and the early import substitution projects in HCI required standardized and mature technologies. Necessary technology was imported through machinery imports and through workers with experience in foreign plants rather than through FDI. As South Korea entered the more sophisticated industries in the 1970s, the more complex technologies could not be imported in such a way. But South Korea encouraged Korean enterprises to import the required technology through technology licensing rather than through FDI (Kim and Lee, 1990, pp. 87–88). As we have already mentioned, FDI was allowed when it was unavoidable to import the necessary technology.

Technology imports through licensing were carefully regulated. The contracts for imports were screened to ensure that undesirable terms, for example restrictions on exports, on local R & D, and high royalty rates are excluded. Foreign technology was not seen as substitutes for local technology, but as its complement. The objective was to ensure that the advanced technologies

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imported are properly assimilated to help further development of technology in the country. Hence efforts were made, in particular to see that there were no restrictive clauses on local R & D (Kim and Lee, 1990, pp. 88–90). A law was promulgated in 1973 which stipulated that enterprises importing technology will have to spend an amount, usually equal to the cost of imports for adapting and absorbing the foreign technology. To facilitate the assimilation of foreign technology and to enhance the level of local technological capacity, the government set up specialized technical agencies such as Korea Institute of Technology and Korea Advanced Institute of Science. The government also took the initiative and provided financial help to encourage the enterprises to have research institutes for specific industries (Bagchi, 1987, pp. 52–54). The foreign partners were also required to train the Koreans in technology, engineering, managerial and other skills. After the Koreans learnt the technology to operate the plants, further foreign help was avoided and expansion was carried out indigenously (Mardon, 1990, pp. 129–30).

GOVERNMENT AND DISCIPLINE OVER PRODUCERS

The government not only provided support to the private sector to influence the growth path of the economy. In exchange for the support provided, it imposed performance standards on private enterprises. Discipline has been exerted not only by rewarding the good performers but also by penalizing the poor ones (Amsden, 1989, pp. 8, 15). As we shall discuss below, behaviour was sought to be influenced not only by 'field manipulation', i.e., providing opportunities and hoping that they will perform but also through the 'command' mechanism, whereby the government compels them to perform (Jones and Sakong, 1980, ch. 4).

The emphasis on exports introduced the discipline of the international market. The government insisted on exports even when there were shortages in the economy, as for example in steel, the shortages being tackled through imports. Naturally the exporters were required to be internationally competitive to succeed. Enlargement of the market through exports also helped them to reap the benefits of economies of scale. Firms were often instructed to set up plants of efficient production scale which compelled them to export so as not to incur losses due to low capacity utilization (Chang, 1990. p. 140). Imports were allowed not on the basis of domestic market share or production capacity but on the basis of export performance. This motivated the firms to export more (Lim, 1981, p. 21). Those who produced primarily for the domestic market were also required to be internationally competitive. Suppliers of inputs to export industries were required to do so at international prices.

South Korea had a tight performance monitoring system. The firms in the targeted industries were required to report regularly to the government about their performances. The efficient firms were favoured with more opportunities to expand. But the poor performers were penalized in different ways. The government used to refuse to bail out firms which performed badly in an otherwise healthy industry. The inefficient firms have often been forced into

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mergers, sales and liquidation. The assets of the largest cement producer in the 1970s which went bankrupt was transferred to a chaebol. Such reorganization of inefficient firms took place in most of the major industries such as automobiles, electronics, heavy electrical machinery, shipbuilding (Amsden, 1989, pp. 14–15; Chang, 1993, pp. 142, 148–49).

A number of mechanisms, for example, tax audits, suspension of bank credit or recall of loans, disconnection of infrastructure services, and so on, were adopted by the government to discipline the firms which did not follow the official priorities. Detailed and lengthy investigation on tax returns initiated on disloyal firms and threat of action restrained the firms (Song, 1990, pp. 144–45).

A law enacted in the 1960s made any illegal overseas transfer of $1 million or more punishable with a minimum sentence of ten years' imprisonment and a maximum sentence of death. In the 1960s and 1970s in particular this law was strictly implemented. This acted as a deterrent to investors who otherwise could have used public money for building personal fortunes abroad (Amsden, 1989, pp. 17–18). Those indulging in illegal activities were severely dealt with. A firm importing more than the permitted quantity of an input was forced to forfeit the bulk of its equity to the government. Tax evaders were not only required to pay penalties. They had to face criminal prosecution (Jones and Sakong, 1980, pp. 114, 117).

It is not that corruption was unknown in Park's regime. But as Cole and Lyman (1971, pp. 252–53) argue, corruption in South Korea did not destroy the emphasis on growth. Many of the principle investment projects approved by the government in the mid-1960s for which payoffs were obtained, were actually those which would have been approved in any case on the basis of feasibility studies.

A common problem with government regulation is that it is ineffective. Administrative inability or extra economic interests of the top political leadership often make government intervention counterproductive with government controlled resources diverted for non-development uses (Cole and Lyman, 1971, p. 4). South Korea under Park provided a concrete example of a 'hard state', where policies are rigourously enforced. In fact according to Jones and Sakong (1980, p. 140), effective implementation via hardness has been a major causal factor behind South Korea's phenomenal economic success.

CONCLUSION

In the 1950s, SK was a typical low income developing country. But the economic policies of the 1960s and 1970s transformed the economy and made it one of the fastest growing economies of the world. The government played a very important role in this strategy. The government under President Park decided the important economic activities to be promoted and mobilized and directed resources accordingly. Allocation of resources were not left to the market mechanism. To promote the targeted industries and activities, the

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government relied not only on price incentives and subsidies. It intervened directly using various non-market instruments.

Park and his team of decision makers did not believe in any contradiction between planning and capitalism or between export promotion and import substitution. But their economic policies suggest that they believed that the contradiction between foreign and indigenous capital is of fundamental importance.

Park was a pragmatic man, as such neither against Korean private enterprise nor against public enterprise. In fact, he relied significantly on Korean private enterprise for translating the plans into action. He also promoted public enterprises wherever necessary. But private business was expected to operate in close association and under the leadership of the government.

Again, export promotion and import substitution were not considered as two alternative and conflicting development strategies. South Korea emphasized exports. She also developed industries which not only substituted imports but also subsequently helped export generation. South Korea shows how both can be pursued and how one aids the other.

Economic nationalism appears to have been the guiding spirit behind many of the government's actions. South Korea's development model actually can be characterized as one of government intervention for national capitalist growth. It was believed that the Korean economy cannot be developed unless the Korean enterprises develop. Foreign enterprises were not allowed to grow at the cost of Korean enterprises. Uncontrolled foreign direct investment was considered to be detrimental to national development goals. Foreign capital and technology were used but were regulated to fit in with the national priorities.

The government in South Korea was not only interventionist. It was also expansionist. Long term growth was preferred to short term stability. Thus investment was not contracted to check inflation or imports to control trade deficits.

The government policies were rigourously enforced. The political leadership's commitment to economic growth prevented the diversion of government controlled resources to non-development uses. In exchange for the support provided, the government was able to extract performance standards from the producers.

Park being a dictator could use some methods which are not always feasible in more democratic situations. For example, to ensure a cheap and disciplined labour force, labour activities were strictly controlled. Unions were weak and labour unrest were severely punished (Koo, H., 1986, p. 171). As a result of single-minded concentration on economic growth, social development was neglected (Cole and Lyman, 1971, p. 167; Yeon, 1989, pp. 1–3; Amsden, 1989, p. 18). The government was also not bothered about such costs as inflation for extended periods.

South Korea's very special position in the international political system also contributed to the success of her economic strategy. South Korea was basically

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created by USA as an anti-communist buffer state for the protection of her security and strategic interests in the area. South Korea was an economic beneficiary of such a neocolonial dependent relationship (Im, 1987, p. 243). USA was indulgent towards South Korea and provided support in different forms. USA's involvement provided opportunities to South Korea for her economic development which were not available to most other developing countries. South Korea received enormous amounts of US aid (Lee and Sato, 1982, pp. 24–25, 153). While much of it were unproductive, it helped investments in infrastructure, especially education (Koo, H., 1986, pp. 159–161; Bagchi, 1987, pp. 32–33). Thanks partly to American influence, educational facilities at all levels–elementary, high school, vocational, higher education–were greatly expanded. As a result the literacy rate increased from about 22 per cent in 1945 to about 72 per cent in 1960 (Suh, 1989, p. 6). Thus South Korea started her industrialization with a much more educated labour force. Absence of land reforms has been a major hindrance to the development of poor countries. Successful land reforms initiated by the Americans destroyed the power of the landlords and facilitated capitalist development. The land owned by the Japanese sold to tenants at a low price by the American Military Government in 1948. In the second phase of land reforms completed under the Rhee government in 1958, the land owned by absentee landlords and those owned by owner-farmers in excess of three chungbo (one chungbo is equivalent to 0.992 hectare) were distributed to tenants and landless farmers (Whang, 1982, p. 1; Schwartz, 1989, p. 238). Preferential access to the US market was an important factor behind South Korea's export success. South Korea relied heavily on foreign borrowings to finance her development. It was generally felt that USA will not allow South Korea to fall into default on debt payments (Cole and Lyman, 1971, p. 182). In the absence of American backing, it is unlikely that the international financial community would have had faith on such a small and poor country especially in the earlier years.

What is distinctive about South Korea, however, is that she took full advantage of these favourable conditions and conceived and implemented a strategy to industrialize her economy.

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