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The Politics of Foreign Aid and Development of the Private Sector: A Case Study of the Republic of Korea*

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Recognizing the critical role of the growth of a local private sector in achieving economic development and poverty reduction, through a case study of the Republic of Korea, this study focuses on the relation between foreign aid and the rise of local businesses. Adopting a comparative historical institutional approach and recognizing various international and domestic contextual factors, this study argues that unlike in many other aid dependent countries where foreign aid largely failed to bring the growth of local businesses, in Korea aid played a positive and critical role in the rise of a sound local private sector. Specifically, this study focuses on the role of the state and shows that in Korea the government utilized aid resources to actively support the local private sector. In other words, this study highlights politics and adopts the perspective of political economy in understanding a complex interplay amongst state, business, and foreign aid.

Keywords: *Foreign Aid, Private Sector, Chaebol, State-Business Development Partnership, Republic of Korea*

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Introduction

One cannot overemphasize the role of the private sector in achieving economic growth and sustainable development: it is the key institution that creates wealth and jobs in a society. Indeed, following the logic of the free market economy, international financial institutions (IFIs) including the World Bank and the International Monetary Fund (IMF) and traditional donors have widely recognized the private sector as the 'engine of growth' (OECD 1995; 2005). For instance, successful economic development paths of East Asian countries have demonstrated the importance of the existence of a sound local private sector (Gereffi and Wyman 1990). Yet, a number of partner countries (especially in Africa) still suffer from the lack of sizable, sound, local firms. Recognizing the critical role of the growth of a local private sector in achieving economic development and poverty reduction, this study focuses on the relation between foreign aid and the rise of local businesses, through a case study of the Republic of Korea (hereafter, Korea).[1]

As is widely known, the Korean economy experienced a miraculous level of growth in one generation and the country successfully transformed itself from one of the poorest, aid-dependent countries to a member of the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD), a group of advanced, major donor countries: Korea joined DAC in 2010. The rapid economic growth of Korea went hand in hand with the rise of the local private sector, especially family-owned and managed big business groups or chaebol. Today, the Korean economy is often characterized as one of chaebol dominance: as of 2012, Korean private chaebol accounted for 46.13 per cent of the total national asset (Wee 2014, p. 5). In particular, it is notable that the growth of this local private sector came about *despite* the country's heavy reliance on foreign aid; in fact, in many other cases, foreign aid has played a negative impact on local businesses in partner countries (Kalu and Kim 2014). In this study, I show that aid played a positive role in the development of local businesses in Korea.

Key research questions include the following: How could the Korean local private sector grow and play a leading role in national economic development when the country was heavily reliant on foreign aid? To what extent did foreign aid play a part in the expansion of the local private sector? Adopting a comparative historical institutional approach and recognizing

[1] In this study, the private sector refers mainly to local private firms unless otherwise noted.

various international and domestic contextual factors, this study focuses on the role of the state and shows that in Korea the government utilized aid resources to actively support the local private sector. In other words, this study highlights politics and adopts the perspective of political economy in understanding a complex interplay amongst state, business, and foreign aid.[2]

Foreign Aid, Growth of Local Private Sector, and Development

In this section, I present the conceptual framework of this study by raising relevant theoretical questions about the development of a private sector and foreign aid. Since after the rise of foreign aid regime after the end of the World War II, the international society has invested a large amount of Official Development Assistance (ODA)[3] to support economic development in many recipient countries. Yet as Hubbard and Duggan (2009) wrote, donors have paid relatively little attention to the development of local businesses while much of aid has been devoted to charity. In their work of *The Aid Trap* (2009), the authors highlight the importance of the development of local business sector as the leading source of economic development and emphasize that more energy, will, and aid should be invested in supporting the local businesses.

By the 1990s, backed by supporters of the neoclassical view, the international development cooperation society reached the following consensus in regard to development (cooperation) and the private sector role: (a) poverty reduction is the main objective of development (cooperation); (b) economic growth is central to development; (c) economic growth is best achieved through the private sector; and (d) government has a role to play in making the private sector flourish and ensuring that growth contributes to poverty reduction (Schulpen and Gibbon 2002, p. 2). Since this period of time, donors have developed a series of private sector development plans that focus mainly on the improvement of the 'investment climate'. According to the

[2] Such an approach could be defined as a comparative institutional analysis as it focuses on domestic political economic dynamics (which is a typical method of a comparative analysis) and highlights various institutional factors (including historical legacy, international context, and political economic institutions). See Morgan et al. (2010) for more about the comparative institutional analysis.

[3] The ODA includes official transactions that are (i) administered with the promotion of the economic development and welfare of developing countries as the main objective and (ii) concessional in character and convey a grant element of at least 25 percent (OECD, 2007).

OECD, donors spend about 26 per cent of all foreign assistance to mobilize private investment, and their activities include improving the regulatory, institutional, and physical business environment (OECD 2005). Specifically, the existing private sector development efforts focus primarily on macroeconomic stabilization plans (for example, inflation and fiscal sustainability) and creation of an enabling environment for investment (for example, relevant legislation, governance, and infrastructure).In short, following the neoclassical perspective, most of donors' efforts toward private sector development have targeted removing barriers to free markets and have fallen short of dealing with the issue of 'building' a sound free market and, more specifically, the local private sector.

Despite decades of neoclassical structural adjustment programs (SAPs) and private sector development efforts by donors, many developing countries have still failed to achieve sustainable economic development with a sound local private sector. Moreover, critics have pointed out that a series of reform measures, including privatization and donors' practices of tied aid, have further expedited the process toward dominance of large foreign companies and decline of local companies in many recipient countries.[4] For instance, most local firms in sub-Saharan Africa are small enterprises engaged in the provision of trade and services. They display little division of labour, very low levels of technical capability and productivity, and few or no linkages with larger, more dynamic enterprises (McCormick 1998). Furthermore, much of foreign direct investment (FDI) to the region has been focused in 'capital-intensive extractive sectors that have few forward and backward linkages with the rest of the economy' (Kelsall 2013, p. 4).

While relatively few have paid attention to the importance of local businesses as a development partner in the field of foreign aid, various studies about Asian development model have highlighted state-business alliance as a key characteristic of the Asian miracle.[5] In particular, a critical and active role of the state in the process of building a sound market has been widely supported by various studies about Asian developmental states. For instance, pointing out the limitation of free trade theory, Robert H. Wade (2012) highlighted the important and effective role of the state in the economy, proposing that via protectionism and strategic industrial policy, in many countries especially in Asia, states in fact often intervene in the market and

[4] See, for instance, Kalu and Kim (2014) for the destructive impact of foreign aid on Ghanaian local companies and Schulpen and Gibbon (2001) for the problem of tied aid and the advancement of foreign companies into a developing country.

[5] See for instance, Evans (1995), Gereffi (1990), and Kim (1997), among many others.

protect local business interests. Also, defining developmental states as those states that play a leading role in producing industrial transformation, Peter Evans (1995) highlighted 'embeddedness', connecting networks between the state and the private sector, together with 'autonomy' as key characteristics of a developmental state. For the author, East Asian countries including Japan, Korea, and Taiwan are the good examples of developmental states (Ibid.). In addition, Zhang and Liu (2013) studied private sector development in Zhejiang Province, China, and showed that the existence of mutual protection between local elites and private entrepreneurs was a critical factor in the development of a strong local private sector in the region.

As a matter of fact, a growing number of studies in recent years have highlighted the importance of local businesses and state-business partnership in achieving economic development not only in Asia but in other parts of the world, especially in Africa. For instance, in her comparative study of four African countries (Ghana, Zambia, South Africa, and Mauritius), Antoinette Handley (2008) stressed the existence of 'mutually constitutive interactions' between business and the state as a key contributing factor for successful national development. Peter Arthur (2014) also emphasized the importance of effective statist intervention in creating the 'Golden Age of business' in Ghana. Likewise, Kunal Sen and Dirk Willem TeVelde (2003) examined 19 sub-Saharan African countries during the period from 1970 to 2004 and concluded that those states that have shown improvements in state-business relations have witnessed higher economic growth. Evidently, state-business relations are often very complex and the working mechanism between the state and business varies across countries. Said that, most of these existing literature that recognize the importance of state-business development partnership highlights effective role of the state in guiding and managing the economy by maintaining a relative autonomy from and at the same time closely communicating with the business sector as elaborated in Peter Evans (1995)' concept of the 'embedded autonomy'.

Korea has been widely recognized as a success case in both fields of international development cooperation and Asian developmental state model. Yet, as mentioned, there have been relatively few attempts to link the two fields and discuss the role of aid in the process of Korea's economic success. Recognizing such a vacuum in academic discussion, this study examines dynamic interplay amongst state, local business, and aid in Korea. In particular, following those existing studies that highlight the important role of the local private sector and state-business cooperation in the process of economic development, this study proposes that in Korea, aid contributed to national development by financing and supporting the governmental policy to develop the local private sector.

Foreign Aid and the Rise of Korea's Early Entrepreneurs

As is widely recognized, Korea achieved a miraculous level of economic development in one generation and was frequently referred to as a model case of the developmental state.[6] I highlight that what distinguished Korea's developmental path most from those of many other slow economies was not necessarily having 'good policies' per se but rather Korea's successful implementation of these policies. More importantly, despite a serious level of government-business corruption especially during the Rhee era, throughout Korea's era of rapid industrialization, it was primarily the local private business sector that carried out various governmental economic development initiatives and policies. In this sense, Gary Gereffi (1990, p. 97) was correct in highlighting the importance of business in achieving growth 'not so much in formulating development strategies, but even more importantly, in implementing them'.

On 15 August 1948, the Republic of Korea was established after three years of US trusteeship. Korea had a long history as a unified nation going back (at least) to the Goryeo period (918–1392) before Japan colonized the Chosun Kingdom (1392–1910): Japanese rule lasted about 35 years, from 1910 to 1945. Throughout the Japanese colonial period, local Korean business people suffered harsh suppression and discrimination by the colonial government, and most were engaged in small, petty businesses:[7] Toward the end of the colonial era, Japanese owned 94 per cent of Korea's industrial capital and local Korean industrial capital accounted for only about 6 per cent (Yi 2004, p. 57). However, during the post-independence period and into the 1950s, local Korean firms rose quickly, especially in sectors like light manufacturing, construction, and trading. As of 1955 (right after the Korean War armistice in 1953), there were 8,600 manufacturing companies (with

[6] While various studies have recognized a leading and effective role of the Korean state in the process of Korea's fast economic catch-up (see for instance, Amsden 1989, Evans 1995, and Vogel 1990), more recent studies have pointed out transformation of Korea's developmental state since after the Park era highlighting the importance of external factors in shaping the nature of Korea's developmental state and various side effects of state-led development in Korea during the authoritarian period (see for instance, Yoon 2006, Park 2009, and Kim 2017).

[7] Notably, a small number of Korean firms such as Samyang and Hwashin survived and made a huge profit during the colonial period by collaborating with the Japanese government.

22.1 million manufacturing workers) with trade volume of about 18 million US dollars (Kim Doo Gyum et al. 2008, p. 32). In addition, many of the top chaebol were established during the Rhee era, the First Republic of Korea.[8]

Born in 1875 in Pyungsan, North Korea, Syngman Rhee fought for Korea's independence mostly in the US, and after independence Rhee successfully defeated political rivals to become the first president of the Republic of Korea in 1948. Yet, throughout his political life, Rhee suffered from weak domestic political support and, as a result, had to fight against various political enemies. Under such political circumstances, it was critical for Rhee to build a loyal domestic support base. For this purpose, Rhee allied with government bureaucracy and determined to develop local capitalists. So, it was Rhee's very intentional political decision to develop and support Korean entrepreneurs. In particular, in December 1950 (in the midst of the Korean War, which broke out in June 1950), the Rhee government announced a law on vested properties and began selling previously Japanese-owned firms and properties to local Korean entrepreneurs under very favorable terms for the latter. About 2,700 firms were sold (basically handed over) to local Korean businesspeople; foreigners were prohibited from participating in the bidding. Thanks largely to this policy, numerous early Korean entrepreneurs were able to begin or expand their businesses. In fact, various studies about Korea's development and political economy have been critical about state-business relations under Rhee's presidency, which was often characterized as 'mutually corrupt' (Kohli 2004, p.81). That said, I underline that under the rule of Rhee, the local private sector experienced a substantial level of growth in the number and size of companies and played a key role in bringing about the country's fast economic recovery (if not development per se).

However, it is one thing to have political will and another to successfully implement the relevant governmental policy to carry out that will. In particular, for a developing country, lack of financial resources is a critical obstacle to effective enforcement of a governmental policy. For Korea, during the Rhee period, it was mainly foreign aid, especially aid from the US, on which the government relied for financial resources: between 1945 and 1960, the US provided about 80 per cent of the total ODA to Korea, and most of this (98 percent) was provided as grants (KOICA 2004).[9] Between 1953 and 1961, foreign aid accounted for, on average, 15.3 per cent of GDP, 72.5 per

[8] As of 1983, 13 of the top 30 chaebols were created during the Rhee era (the corresponding figure for the Park period was seven) (Kim 1997, pp. 125–6).

[9] This excludes aid from the UN. Because UN funding also came mostly from the US, the actual proportion of total ODA Korea contributed by the US is much higher.

cent of imports, and 99.3 per cent of the country's foreign savings and far exceeded domestic saving (Ibid.). In fact, the US poured aid into Korea because of the international geostrategic context of the time. With the encroachment of communist revolutions throughout the world after World War II, the US adopted containment as its single most important foreign (aid) policy. Viewing Korea as the critical bulwark against the spread of communism in Asia (especially after the start of the Korean War), the US provided a large amount of aid to Korea.[10]

The Korean War marked a critical juncture for the aid regime in Korea. Most of all, with the outbreak of war, aid from the US rose rapidly and the UN began to provide aid to Korea. Without a doubt, the nature of foreign aid during the Rhee era was largely humanitarian, whose main purpose was to provide emergency relief goods to the Korean people. Humanitarian purposes aside, however, during the postwar period, a substantial amount of aid was invested for the country's reconstruction including sectors such as transportation, housing, and industry (Korea Development Institute 1976). In particular, the United Nations Korean Reconstruction Agency (UNKRA) aid program began in 1951 whose primary goal lay in the country's economic rehabilitation, specifically in reconstruction and industrial development: except for commodities sustaining imports, industry accounted for the largest share of the UNKRA aid program (Ibid.). Between 1951 and 1959, a total of around 1.2 billion U.S. dollars of the UNKRA fund was invested in Korea, and transportation, industry, and mining accounted for about 37 percent of the whole UNKRA package.

So, how did foreign aid contribute to the rise of local businesses during the Rhee period? In what follows, I show that the Rhee administration actively utilized aid resources to support the growth of the local private sector. In fact, it is worth noting that compared with other aid-dependent countries, the Rhee government extended relatively strong ownership in management of aid resources. The US obviously intervened heavily in the process of aid management in Korea during the Rhee period. That said, recognizing Korea's geopolitical importance to the hegemonic power, the US, the Korean government expanded its ownership in management of aid without seriously worrying that US aid might be withdrawn, especially after the start of the Korean War.

To begin with, upon the arrival of aid goods (mostly finished products,

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[10] During the Cold War, Korea received the record high amount of ODA per capita in the history of US foreign aid.

since US grant aid was provided in kind), the Korean government sold (basically distributed) aid goods to local businesspeople at far under market prices. Local firms, in turn, utilized the goods to expand or begin businesses. The so-called 'three-white industry' emerged as the major industrial sector during the 1950s and into the 1960s, thanks largely to aid goods: three-white industry refers to milling, sugar manufacturing, and textile industries, and the rise of these industrial sectors was largely attributable to the inflow of enormous amount of three-white aid goods (flour, raw sugar, and raw cotton) from the US.[11] As of 1955, three of the top ten major business groups in Korea were engaged in three-white industry, and this number increased to 5 by 1965 (Kim et al., 2005, p.7). For instance, with raw sugar provided as aid goods from the US, in 1953, Byung-chul Lee, founder of Samsung (established in 1936), established CheillJedang (CJ), a sugar manufacturing firm, and began to produce sugar for the first time in Korea. In addition, in 1954, he founded Cheill Woolen Textile Company with raw cotton supplied by the US as aid goods. To note, Lee of Samsung relied heavily on foreign aid in building these manufacturing companies and in diversifying business activities (Yi 2004).

Also, the Rhee government actively utilized the aid-management system of the 'counterpart fund' to mobilize more aid resources and achieve faster reconstruction during the postwar period, and, importantly, it joined with the local private sector to achieve this goal. The Agreement on Foreign Aid signed by Korea and the US in 1948 and the Agreement included the following clause on the counterpart fund: 'Government of Republic of Korea should deposit a significant portion of aid revenues to a special account in Bank of Chosun, namely the counterpart fund account, and this fund shall cover activity costs of representatives of the US aid program and the remaining shall be used in accordance with the agreement between the two governments.'[12] Since Korea depended heavily on aid during the Rhee era, the counterpart fund accounted for a significant portion of governmental expenditure; counterpart fund expenditures represented 32.26 per cent of total governmental spending in 1953, including national defense, and that

[11] It was called three-white industry because raw materials for this industrial sector were all white in color.

[12] Funds accrued mainly from the sale of aid goods from the US to local consumers (mainly businesspeople). In addition, money from sales of farm surpluses under US Public Law 480 was also deposited to the counterpart fund. Between 1956 and 1969, the Korean government purchased about 8.2 billion US dollars' worth of farms surpluses from the US (Korea Development Institute 1976).

increased to 46.73 per cent (a record high) by 1957.[13]

Table 1 shows a summary of counterpart operation of ICA and CRIK (grant aid) between 1954 and 1961: the amount reached almost 4.44 trillion won, and about one-half of the fund (2.08 trillion won) was used for direct military support, suggesting that the US aid was critical in building and sustaining a national defense system. Table 1 also shows that a large proportion of the fund was used for transportation (75 billion won), agricultural & natural resources (73 billion won), and health & sanitation (20 billion won). Transportation included highways, railways, port facilities &harbor improvement, ship operation, and air transportation. The counterpart fund for the transportation sector was managed mainly by the Office of National Construction and Ministry of Transportation, and they made contracts with various local construction companies to (re)build the nationwide transportation system. Indeed, during and after the war, a group of construction companies emerged and further expanded their businesses by participating in national reconstruction projects. In particular, people called five major business figures in the construction industry—namely, Yong-beom Lee (Daedong), Yong-san Kim (Gukdong), Ju-yung Chung (Hyundai), Jeong-gu Cho (Sambu), and Eui-seong Hwang (Chohung)—the 'Top Five Supporters of the Liberal Party', and these companies were most successful in winning various government construction contracts. Unquestionably, Hyundai emerged as the leading construction company during the postwar period. In January 1950, Ju-yung Chung, founder of Hyundai, established Hyundai Construction Company and expanded business by winning contracts for construction work from the US Army in Korea. After the war, Hyundai won numerous government-financed reconstruction contracts, including the construction of the Hangang (Han River) Bridge in 1957, and emerged as one of the leading chaebol by the end of the 1950s.

In addition, the Rhee government utilized the counterpart fund to develop the local manufacturing sector by providing loans to various local companies. According to the USAID database, between 1954 and 1961 a total of about 83 billion won from the counterpart fund was extended as loans for various industrial projects (Korea Development Institute 1976). In particular, almost 80 per cent of it was used to support local industrial sectors, including textile, primary metals, fertilizer, and chemicals & chemical products, and these cheap public loans were extended directly to numerous local private firms (Ibid.). For instance, Lee of Samsung took a governmental loan of

[13] Korea Development Institute Database at https://www.kdevelopedia.org.

TABLE 1
Summary of Counterpart Operation: Grant (1954-1961)
(Unit: in thousand Korean won)

Field and Project Title	ICA	CRIK	Total
Direct Military Support	20,449,953	365,000	20,814,953
Agricultural & Natural Resources	7,319,783	-	7,319,783
Industry and Mining	909,203	-	909,203
Transportation	7,512,870	30,187	7,543,057
Health and Sanitation	1,987,782	71	1,987,853
Education	980,998	-	980,998
Public Administration	322,829	-	322,829
Community Development, Social Welfare & Housing	856,148	-	856,148
General Miscellaneous	3,634,689	103,310	3,737,999
Total	43,974,255	498,568	44,472,823

Source.—Korea Development Institute (1976)

180,000 US dollars to build a sugar manufacturing company (Cheil Jedang) and 1 million US dollars (provided by US aid) to establish Cheill Woolen Textile Company. Lucky (today's LG) received 340,000 US dollars of US aid loans to build the Lucky Oil and Fat manufacturing factory: raw oil and fat were also imported as aid goods from the US.As of the mid-1960s, the ten largest Korean firms included (in order of total assets) Samsung,Samho, Lucky-Gold Star, Tai Han, Gaipoong, Samyang, Ssangyong, Hwashin, Panbon, and Dongyang (Kim 1997, p. 124), and all of them received aid-funded public loans.[14] In fact, during this early era, the level of economic and political instability was high and domestic and foreign private resources for business investment were quite limited, so the government was almost the only source of business resources for Korean entrepreneurs. Under such circumstances, Korean businesspeople depended heavily on loans provided

[14] For instance, Ssangyong was the first textile manufacturing company in Korea which was established in 1948. The founder, SeongKon Kim took over Dong Kyung Textile Company which was previously owned by the Japanese. Ssangyong received a significant amount of UNKRA fund and aid-funded government loans to establish and begin the textile manufacturing business and over time expanded its businesses to include the cement industry (Yi 2004).

by the government, and the Rhee government actively utilized foreign aid funds to provide cheap loans to local businesspeople.

Clearly, besides governmental support and aid, other factors such as entrepreneurship of individual local businessmen and the colonial experience of industrialization played a role in the rise of early Korean entrepreneurs. In fact, this study is not necessarily arguing that aid was the only, or the most important factor in explaining the growth of the local private sector in Korea. Moreover, as highlighted, state-business relations during the Rhee era were highly collusive. Loyalty to Rhee, his regime, and his party (Liberal Party) was the most important precondition for businesspeople to gain access to various governmental supports, including foreign aid.[15] Having said that, as explained in this section, I maintain that without foreign aid, such rapid growth of the local private sector during this very early period of the Republic of Korea would have been highly unlikely particularly because it was a key financial resource to support governmental policy to build the local private sector.

Foreign Aid, Developmental State, and the Expansion of Chaebol

As discussed, the Rhee era saw the establishment of more Korean businesses than subsequent eras; nonetheless, it was during the Park period that many of the local private firms transformed into chaebol, family-owned and -managed Korean large business groups. Indeed, it was during the Park era that the Korean economy began to be characterized by chaebol dominance: as of 1975, the top 20 Korean chaebol accounted for 10.6 per cent of Korea's total GDP and 30.2 per cent of manufacturing GDP (Jones and Sakong 1980, p. 266). The share of chaebol in the Korean economy (especially in the manufacturing sector) grew rapidly over time: by 1987, the top five Korean chaebol (Daewoo, Samsung, Hyundai, Lucky-Gold Star, and Ssangyong) accounted for 75.2 per cent of manufacturing GDP (Kim 1997, p. 183). Importantly, I stress that Korean chaebol were largely the product of state-led, export-led economic development of Korea. Specifically, in this section, I analyze the impact of foreign aid on the rise of chaebol, focusing on the

[15] For instance, people referred to the five major construction companies as the top five supporters of the Liberal Party because it was an open secret that a significant portion of the government construction project funds were transferred back to the Rhee regime as political support funds.

political economy of the aid regime during the Park period.

Pressured by a series of massive demonstrations against the Rhee regime triggered by a rigged general election held on March 1960, Rhee stepped down on 26 April 1960, ending the First Republic. On 19 August 1960, the Second Republic began with Chang Myon as the new prime minister. However, the Second Republic did not last long: on 16 May 1961, a military coup led by General Park Chung Hee toppled the Chang government. Park ruled the country for about two decades, until he was assassinated on 26 October 1979. Without a doubt, the Park regime was authoritarian and repressive; yet it was during this era that Korea's developmental state reached its high point with miraculous levels of economic growth and industrial transformation. In particular, a full-scale export-led industrialization drive began with the Park era. Evidently, as has been widely studied, the role of the state under Park was effective and pervasive. That said, it is also important to note that the role of the local private sector, especially chaebol as an implementation agency, was critical for Korean growth during this period, as, after all, 'most of the decisions leading to output expansion were taken in the private sector' (Mason, Kim, and Perkins 1980, p. 275).

Like his predecessor Rhee, Park reached out to local private firms, mainly for political reasons.[16] On 28 May 1961, just 12 days after the coup, Park formed a committee for the investigation and execution of Charges of Illicit Accumulation of Wealth and arrested and jailed chairmen of major private firms, including Byung-chul Lee of Samsung and Hong Chae-Son Hong of Keum Sung, as well as many high-ranking politicians and military officers. The move was largely to justify an illegal coup and enhance the political legitimacy of the regime; Park fervently attacked the corrupt Rhee regime, and businesspeople were criticized as key accomplices. Yet, soon after proving its power and dominance over the private sector, Park drastically changed his policy from anti-chaebol to pro-chaebol, based on political and economic calculations. With weak political legitimacy and a threat from North Korea, Park adopted the end of poverty and economic development as the utmost national goals and a critical means of securing political support from the general public, and, for Park, cooperation with chaebol was inevitable to achieve this end. In fact, it was not only the private sector but also public enterprises played a role in Korean growth. Yet, the establishment of a socialist economy in which state-owned enterprises (SOEs) are the main

[16] For information and historical data on state-business relations during the Park period this study mainly referred to Yi (2004), Kim (1997), Kim (1997b), and Gereffi (1990).

economic actors was out of the question in the Korean context as it was not in accordance with Korea's constitutional order supporting development of a free, capitalist economy. Moreover, with the communist enemy in North Korea, all political leaders of the Republic of Korea had little choice, ideologically, but to actively support construction of a free, capitalist market economy. In addition, after the colonial experience and war, Korean leaders as well as the public were highly nationalistic, which largely explains why Korea's government did not actively pursue foreign direct investment (at least prior to the 1990s) from multinational corporations. Furthermore, until the 1960s, the Korean economy was hardly an attractive place for foreign investors. All these factors explain why Park's government made a development partnership with local firms.

In general, both the absolute and relative importance of aid continuously decreased throughout the Park era, with a sharp increase in other types of foreign resources (including commercial loans, FDI, and bank loans) over time. Yet, it is important to note that foreign aid remained one of the key sources of foreign income throughout the Park era. Above all, the Korean government continued to rely significantly on foreign aid for its military defense and, as of 1965, foreign aid still accounted for 32.2 per cent of total imports (Krueger 1980, p. 108). However, there were important changes in the aid regime with the beginning of the Park administration. Most of all, starting in the late 1950s, aid (especially grant type aid) from the US to Korea experienced a sharp decrease, and the major type shifted from grant to loan.[17] For instance, total foreign aid from the US and the UN to Korea reached its high point in 1957 with 38.2 million US dollars and then decreased sharply, recording 22.2 million in 1959, 14.9 million in 1964, 9.70 million in 1967, and only 0.11 million US dollars in 1975 (Korea Development Institute 1976, p. 51). Notably, throughout the Park era, most aid was provided as loans, namely public loans: with limited levels of domestic saving and income, economic growth in this period relied so heavily on foreign loans (both public and private) that it was often called the era of 'a loan economy'. Also, pressured by a drastic decrease in aid from the US, in 1965, Korea's government normalized diplomatic relations with Japan (despite nationwide protests against it) and received a large amount of aid (mainly as loan type aid) from the latter. In addition to public loans, Japan provided a

[17] This resulted largely from changes in US aid policy during this period. Specifically, in 1961 the Kennedy administration announced a new aid policy that emphasized economic development, self-reliance, and accountability of the recipient country, replacing the existing Mutual Security Act (MSA) with the Foreign Assistance Act (FAA).

total of 8 billion US dollars as a reparation fund (3 billion as grants, 2 billion as public loans, and 3 billion as commercial loans) to Korea between 1966 and 1975 (KOICA 2004).

A successful and fast recovery of the Korean economy from war devastation further convinced donors of the Korean government's high level of capacity and political will for carrying out national development programs (Kim 2011). With the beginning of the Park regime, ownership of the Korean government in management of aid was rapidly expanded; indeed, during the Park era there was little friction between donor and recipient (Ibid.). Foreign aid during the Park period was under the direct management of the Economic Planning Board (EPB), the 'super agency' established in 1961 primarily to lead the Five-Year Economic Development Plan that started in 1962. The EPB was composed of the most talented, smartest government officials, was powerful and relatively autonomous from various social and political pressures (it was under the direct control of President Park), and was the key agency responsible for leading national economic development. In particular, to implement various national development policies, the EPB directly managed all kinds of foreign resources, including foreign aid, so that, in Korea, aid and other foreign resources were centrally managed and used for the goal of national development. More importantly, this study highlights that, on the basis of a strong state-business development partnership, the local private sector, especially chaebol, benefited heavily from the process of aid management during the Park era, as a considerable amount of aid was actually spent to support the expansion of these large businesses.

Above all, together with private loans, a dominant portion of foreign aid was invested in building key social overhead capital (SOC) for economic development and the expansion of the manufacturing sector. Table 2 shows the inflows of foreign loans (both public and private) to Korea as of September 30, 1975. A total of about 5.9 billion US dollars of loans were invested in Korea by this time, and public loans accounted for about 39 per cent (2.3 billion US dollars) of total foreign loans.[18] Table 2 also indicates that it was the SOC and manufacturing sector in which most loans were invested: about 62.7 per cent of public loans went into SOC, and about 30.8 per cent into the manufacturing sector. For private loans, it was the manufacturing sector that received the largest amount (2.0 billion US dollars, about 56 per cent of total private loans), followed by SOC (1.4 billion US dollars, 39.7 per

[18] Note that reparation funds from Japan are not included in this figure because the Korean government did not consider it 'aid'.

TABLE 2
Status of Foreign Loans By Sector (Arrival), as of September 30, 1975
(Unit: in thousand U.S. dollars)

Sector	Public Loans Amount	%	Private Loans Amount	%	Total Amount	%
Agriculture	133,857	5.9	4,615	0.1	138,472	2.4
Fishery	-	-	141,263	3.9	141,263	2.4
Mining	13,466	0.6	1,500	-	14,966	0.3
Manufacturing	699,838	30.8	2,022,327	56.2	2,722,165	46.4
Social overhead Capital	1,422,555	62.7	1,426,847	39.7	2,849,402	48.6
Total	2,269,716	100	3,596,552	100	5,866,268	100

Source.—Korea Development Institute (1976); there were some miscalculations in the original table and these were corrected by the author; numbers may not add to 100 percent because of rounding.

cent of total private loans). In addition, as of 1975, a total of 750 enterprises received loans and 182 of them received public loans (Korea Development Institute 1976, p. 67). Clearly local Korean firms relied more on private loans than on public loans, especially during the latter portion of the Park era. That said, even in the case of commercial loans, the role of government was critical because a governmental guarantee was essential for a private firm to secure a foreign commercial loan.

I stress that foreign aid played a significant role in the expansion of chaebol, as these big businesses actively participated in various aid-funded government projects, especially in building infrastructure and national efforts to develop the manufacturing sector.[19] First of all, various chaebol companies carried out aid-financed infrastructure-building projects. For instance, Hyundai alone carried out 40 per cent of all highway construction projects throughout the country during the Park era. Besides Hyundai, major construction companies including Daelim, Samwhan, Sambu, Life, and

[19] Besides foreign aid, a significant portion of Japanese reparation funds (5 billion US dollars, excluding commercial loans) was spent to support the manufacturing sector and SOC: more than half the fund was invested in manufacturing (43 per cent or about 11.98 million US dollars was invested in building Pohang Steel Company), followed by SOC (EPB 2013, p. 36). In addition, a substantial portion of the fund was provided to major chaebol companies, including Samsung, Ssangyong, SK, Korea Explosives, Hanil Textile, and Samyang (Yi 2004, p. 131).

Gukdong emerged as chaebol during the 1960s, thanks largely to Park's nationwide development (infrastructure-building) projects (Yi 2004). In addition, in this period, Korea experienced a rapid industrialization led by the rise of the manufacturing sector. It is also notable that the major industrial structure of Korea's economy transformed from light industry (especially 'three-white' industry) to heavy and chemical industries, including construction, automobiles, electronics, chemical, steel, pesticides, and oil refining. In particular, it was mainly the local private sector, and especially chaebol, that implemented Park's heavy and chemical industrialization (HCI) projects; public loans were used to finance various HCI efforts, which began in full force in 1972. Between 1972 and 1981, 960 million US dollars were invested in heavy and chemical industries, and 580 million US dollars, or 60 per cent of the total, came from foreign public loans (Chung 2007, pp.331–2). The Park government selected only a small number of large businesses to participate in the HCI drive, including Hyundai, Daewoo, Kia, Ssangyong, Samsung, Hyosung, and LG. Notably, all of these chaebol groups experienced a major jump after participating in HCI.[20]

Also, a closer look at the contents of the US counterpart fund during the Park era reveals that ODA was actively utilized to enhance the financial power of the Korean government. Throughout the Park era, the counterpart fund was utilized in financing various government projects, including military budget support, public administration, and education. According to KDI (1976) database, about one-half of AID-funded government project counterpart funds (grant) supported the military budget. In particular, a significant portion of the fund was used to finance public administration, and much of the aid fund directly financed an economic development special account (EDCA) administered by the Ministry of Finance. It is also notable that a substantial amount of the fund was used to support financial institutions, including the Korean Development Bank, National Agricultural Cooperations Federation, Medium Industry Bank, and Korea Housing Bank (KDI 1976).

Before we continue, a brief note on the Park government's financial sector reforms seems necessary. Soon after Park came to power, the military

[20] History of all of these chaebol groups reveal that foreign aid played a key role in the process of establishment and expansion of these local companies (Yi 2004). For instance, LG began producing plastic goods which was provided as aid goods during the 1950s. LG also received 340,000 US dollars of ICA aid fund to establish an oil company in 1959 and during the Park period, the company received 5 million aid-funded government loans to establish an oil refining company (Ibid.).

regime implemented a series of financial sector reforms, including nationalization of commercial banks. Specific measures included the following: 1) in August 1961, National Agricultural Cooperatives Federation (NACF) was established; 2) in August 1961, Medium Industry Bank (MIB) was established to provide loans to small and medium-sized firms; 3) in late 1961, the government nationalized commercial banks; 4) a revised charter of the Korean Development Bank (KDB) increased its capital and authorized it to borrow funds from abroad and to guarantee foreign loans obtained by Korean enterprises; and 5) in May 1962, Bank of Korea (BOK) law was revised to bring the central bank under the control of the Ministry of Finance (MOF) (Cole and Park 1980). Through these measures, Park's government succeeded in developing an institutional structure for the centralization of financial power. The next step was obviously to make these financial institutions function, namely to increase the financial income of these institutions; as explained, foreign aid was actively used to meet this goal.

With its centralized financial power, the Park government pressured and supported local firms to partake in various national development projects. In fact, with limited domestic resources, Korean firms relied heavily on loans provided or guaranteed by the government (specifically, national financial institutions). As shown in Table 3, a substantial amount of public loans was directly invested to support the local private sector during the Park era via various financial institutions, including the Korean Development Bank, Long-Term Credit Bank, Korea Foreign Exchange Bank, and Medium Industry Bank.

In addition, as the Korean market at the time was still viewed as 'risky' for most international investors, a governmental guarantee was essential for a private firm to secure a foreign commercial loan. In fact, the Korean government provided low-interest loans and governmental guarantees only to those companies selected to participate in national development plans.

In sum, foreign aid during the Park period played a role in the expansion of chaebol by financing various national development projects, including building key economic infrastructure and governmental efforts to develop the manufacturing sector, especially heavy and chemical industry. In addition, as discussed, foreign aid was actively mobilized to empower the financial sector of the Park government, and this was critical for expansion of the local private sector as it enabled the government to provide cheap loans to various local firms, especially those chaebols selected by the government. In particular, I highlight that the role of government and the existence of state-business development partnership was central to this whole process of aid

TABLE 3
Major Public Loan Project for Private Sector Development in Korea
(Unit: in million U.S. dollars)

Inducer	Project	Donor	Amount	Year
Korean Development Bank	Supporting fund for small and medium-sized enterprises (SMEs)	U.S. Germany	US$42 DM30	1966, 1970, 1972 1966, 1970
	Supporting fund to raise industrial efficiency	Japan	￥30,800	1972, 1974
	Supporting fund for private sector development	IBRD, ADB	US$373	1973-1978
Long-Term Credit Bank	Supporting fund for private sector development	IBRD, ADB	US$388	1968, 1969, 1971 1973, 1978
	Supporting fund for SMEs	IDA	US$18	1968
Korea Foreign Exchange Bank	Supporting fund for export industry	Japan	￥5,400	1971
Medium Industry Bank	Supporting fund for SMEs and machinery industry	U.S. ADB Japan	US$8 US$25 ￥16,200	1966 1969, 1971 1966, 1967, 1971
	Supporting fund for private sector development	IBRD, ADB	US$184	1973-1978

Source.—Ministry of Finance and KDB (1993); Data extracted and reorganized by the author; Japanese loans included the reparation fund.

and the expansion of the local private sector in Korea.

Conclusion

One might ask: In contrast to many other developing countries with a large amount of foreign aid and loans, why did Korea not fall into a permanent economic and debt crisis? The answer is rather simple: Park's export-led economic development was so successful that Korea's GDP grew from 303.56 billion US dollars (GDP per capita of 1,180 US dollars) in 1961 to 1299.63 billion US dollars (GDP per capita of 3,463 US dollars) by 1979,[21] and the

[21] The World Bank database, World Development Indicators (WDI) & Global Development

country began to pay back foreign debt: Korea's debt-to-GNP ratio began to decrease markedly after the 1970s. This drastic rise of the Korean economy went hand in hand with or was due largely to the growth of local private sector. One cautionary note, as the Park Geun Hye government-Samsung gate revealed, the problem of state-business corruption has been a deep-rooted side effect of Korea's fast economic development and furthermore, it is likely that the centralized usage of foreign aid by the government exacerbated the problem of state-business corruption. In fact, it is far from the intention of this study to justify such a corruptive relationship. Said that, recognizing the importance of the local private sector as a national development partner for many developing countries, from a comparative perspective, this study has highlighted the positive and more active role that foreign aid played in the process of developing local businesses in Korea.

The Korean case offers valuable empirical as well as theoretical implications on the existing discussions about the role of aid and the growth of private sector as well as Asian developmental state model mainly in the following ways. To begin with, by tracing the political economy of foreign aid in Korea, this study has highlighted the important role of aid in the process of Korea's economic development, specifically, the emergence of a developmental state and a sound local private sector. I have explained that the Korean state actively utilized aid resources to support the local private sector. Secondly, while much of the existing perspective about Korea's development path has been largely critical to the Rhee era, this paper has revealed that the Rhee government played a positive and important role in the process of the rise of early local entrepreneurs and actively utilized aid resources to support the local private sector. In this respect, this study has stressed the importance of adopting a historical and institutional perspective in understanding Asian developmental state model. In addition, challenging the existing neoclassical view of foreign aid and the growth of local private sector, which focuses largely on the role of aid in building a sound business environment, this study has highlighted the importance of state-business development partnerships for successful national development and growth of local businesses, especially for many slow economies in which a sound capitalist market is yet to be developed. It also suggests more attention should be given to the question of how donors might support building local private sectors in recipient countries. Last, by highlighting a critical role of the state in this whole process, the Korean case further emphasizes the importance of ownership

Finance (GDF).

and the role of aid in building government capacity and good governance in recipient countries.

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