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ECONOMIC PLANNING IN KOREA

CHARLES WOLF, JR.*

I. Background

The task of economic development in Korea is as important and difficult as in any other country in Asia. Its importance arises from the country's exposed position adjacent to Communist North Korea and China, the natural tendency for comparisons to be made between the economic performance of South Korea and North Korea, and the prominent role which lagging economic development has played in each of the major political changes of the past several years: the ousting of Syngman Rhee in April 1960 and his replacement shortly thereafter by the Democratic Party government of Chang Myun; and the military coup of May 1961 which replaced Chang Myun by the Supreme Council of National Reconstruction (SCNR) under General Pak Chung Hi.¹

The difficulty of the task arises from Korea's harsh economic environment, both externally and in terms of its internal resource characteristics. Korea has one of the highest estimated population growth rates in Asia, estimated at 2½ to 3% annually. At the same time, arable land is only about 20% of the total area, one of the lowest ratios among the less-developed Asian countries. Much of the Korean peninsula's known subsoil resources are north of the 38th Parallel, and South Korea's own mineral resources are modest. These factors have contributed to an unusually high unemployment rate, estimated at 25% of the labor force, and make the prospective task of reducing unemployment relatively difficult and probably relatively expensive as well.

Notwithstanding these difficulties, Korea has some important advantages compared to other Asian countries in embarking on the task of development. Manufacturing, construction, transport and electric power represent over 20% of gross national product by industrial origin, which is large relative to other less-developed countries and provides a basis for future growth. Korea also has a relatively active and experienced private business sector which can be a powerful force in the country's industrial development. Levels of literacy, skill and energy among the population are relatively high—in part, due to the cumulative effects of military conscription and training. Finally, Korea has a powerful and interested source of external support through its special relationship with the United States.

* The views expressed in this paper are those of the author. They should not be interpreted as reflecting the views of The RAND Corporation or the official opinion or policy of any of its governmental or private research sponsors.

¹ For a discussion of recent political affairs in Korea, and of the urgency of economic development in the light of these events, see Robert A. Scalapino, "Which Route for Korea?", *Asian Survey*, Vol. II, No. 7, September 1962, pp. 1-13.

Against this background, what has been the history of economic planning in Korea?

National economic planning in Korea is new, and the test of its efficacy and applicability is only beginning. The first effort in the direction of comprehensive planning was a study done for the United Nations Korean Reconstruction Agency by an American firm, Robert Nathan Associates, that resulted in a broad five-year reconstruction plan after the Korean War. The report, published in 1954, was made to UNKRA but not adopted by the Korean Government. It was not until 1958 that the Korean Government itself began to develop an in-house capability and responsibility for economic planning by establishing an Economic Development Council within the Ministry of Reconstruction. The Council, under the Minister of Reconstruction as Chairman, was given responsibility for developing a long-term plan for Korea's development, preparing public sector investment plans for the annual budget, and conducting supporting economic research.

In the spring of 1959 the Council submitted a draft three-year development program to the Cabinet. The basic aims of the plan were to reduce unemployment, to increase GNP by about 5 per cent annually, which had been the approximate annual rate of growth since the end of the Korean War, and to reduce dependence upon external assistance. The macroeconomic framework used in formulating the plan was a Colm-type model which had originally been developed in connection with growth and employment projections for the U.S. economy. The Colm model stressed employment objectives, basing investment requirements on specified capital-labor ratios in particular sectors, and GNP growth estimates on the resulting estimates of increased labor productivity. The plan assumed a "balanced growth" pattern, interpreted to mean a maintenance of the base year relationships among the various sectors of the economy, as well as among aggregate consumption, savings, investment, and output. In the spring of 1960, the Cabinet approved the three-year plan; shortly after its approval the Rhee government was ousted and the plan shelved.

By the end of 1960, the new Prime Minister, Chang Myun, instructed the Economic Development Council to draw up a new five-year development plan that would improve upon and supersede the earlier plan. In May 1961 a draft five-year plan was completed. In contrast to the "balanced growth" pattern of the three-year plan, the May 1961 plan stressed a need for concentrating investment in a few "leading sectors," particularly power, coal, cement, and other industries, as well as agriculture. Whereas the three-year plan had proceeded from a labor-oriented Colm model, focusing on employment as the main objective and using capital-labor coefficients and labor productivity coefficients as the key parameters, the five-year plan was based on a capital-oriented Harrod-Domar model, focusing on growth as the main objective, and capital as the scarce factor, and using savings rates, capital assistance from abroad, and various capital-output ratios for different sectors of the economy as the key parameters. The five-year plan also assigned a relatively larger role to public investment, where-

as the earlier plan had stressed the private sector. The annual GNP growth rate for the five-year period was set at 6.1%, somewhat higher than in the earlier plan, and provided for a substantial increase in the investment rate and in domestic savings, and a smaller increase in per capita consumption. It is not necessary to go into further details on the May 1961 plan because much of its broad development strategy, planning techniques, and sectoral composition, were directly reflected in the sequel plan that is the present program of the Korean Government, the Five-Year Plan of January 1962.

Immediately following completion of the 1961 plan, the Chang Myun government was ousted, and succeeded by the SCNR. Under the SCNR, responsibilities for development planning and implementation were reorganized, and a new five-year plan formulated. However, the 1961 plan provided a core around which the new plan was formulated. Organizationally, the Economic Development Council was replaced by the present Economic Planning Board, headed by a chairman having the rank of Deputy Prime Minister, and assisted by a vice chairman with the rank of Cabinet Minister. The SCNR assigned responsibility to the Planning Board for development planning and coordination, as well as for annual budget preparation, coordination of foreign aid activities, and attracting foreign investment. Thus, the present Planning Board is intended to be a stronger operational unit than its counterparts in other Asian countries.

In assigning the task of plan formulation to the Board, the SCNR provided it with a basic plan framework which specified the broad strategy and over-all objectives of the new plan, including an average annual growth rate, and national targets for the principal macroeconomic variables, as well as for the principal sectors. Within the constraints established by this framework, which itself drew heavily on the May 1961 plan, the Planning Board was directed in July 1961 to complete within a period of a few months a final draft five-year plan. The final draft was submitted by the Planning Board to the SCNR in November 1961 where it was reviewed and approved with little change. A summary of the plan was published on January 11, 1962.²

II. The Present Korean Economic Plan

It is evident from the preceding discussion that short-term political considerations have played a major role in the brief history of economic planning in Korea. The decision to scrap the original three-year plan formulated by the Rhee regime resulted from the ouster of that regime and its replacement by the Democratic Party administration of Chang Myun. In turn, the five-year plan of 1961, formulated under the Chang Myun government, was rejected and replaced by the plan of 1962, as a result of the military coup which brought Pak and the SCNR to power. In

² *Summary of the First Five-Year Economic Plan, 1962-1966*, Republic of Korea, Seoul, 1962. Unless otherwise indicated, the data concerning the Korean plan referred to in the text are taken from this document.

addition to their effect on the chronology of planning, and on decisions to initiate and to shelve inchoate plans, political considerations have also had a significant effect on the content of the current plan. Although the planning philosophy and methodology of the preceding plan were largely retained, the new plan adopted higher aggregate and sectoral goals, at least in part for political reasons. Moreover, the new plan is interlaced with numerous harsh indictments—sometimes warranted and sometimes not—of the economic practices and malpractices of predecessor administrations. The prominence of such *obiter dicta* in the text of the plan no doubt resulted in part from a political aim of achieving a sharp differentiation between the new regime and its predecessors.

The over-all strategy underlying the Korean plan is to concentrate on three key or “leading” sectors: electric power, agriculture, and “social overhead capital.” The expansion of hydro- and thermal-power capacity, including increasing output of coal for fuel, is intended to provide a basis for an expansion of key industrial production, largely in the private sector, in such industries as cement, fertilizer, steel and iron. The aim of expanding agricultural output is to achieve self-sufficiency in food grain production and consumption by the target year 1966. The expansion of social overhead envisages concentration on the use of unemployed and underemployed rural labor to build roads, multi-purpose dams, and urban public works through the National Construction Service.

The institutional philosophy guiding the plan is referred to as “a form of ‘guided capitalism’ in which the principle of free enterprise and respect for the freedom and initiative of private enterprise will be observed, but in which the government will either directly participate in or indirectly render guidance to the basic industries and other important fields.”³ Whatever the imprecision in these words, the plan emphasizes that the development of the Korean economy requires heavy emphasis on industrialization, and that in this industrialization process the intention is to place major reliance on private enterprise.

In deriving the aggregate plan estimates, a Harrod-Domar savings-investment model was used, modified to allow for different parameters in the primary, secondary, and tertiary industries. These aggregate estimates were then checked against microeconomic schedules of demand, output, and investment for subsectors and for individual projects. The procedure for this reconciliation between the macro- and micro-economic estimates, however, is not described in the plan summary.

The plan sets an annual growth target for the 1962-1966 plan period of 7.1%, which is substantially higher than the actual growth rate in recent years, as well as somewhat higher than the rate targeted in the May 1961 plan. GNP is to rise from a level of 2,450 billion *hwan* in 1962,⁴ about

³ *Ibid*, p. 28.

⁴ Unless otherwise indicated, all *hwan* figures are expressed in 1961 prices and the exchange rate used for dollar conversions is 1,300 *hwan* per dollar.

1.9 billion U. S. dollars, to 3,270 billion *hwan* in 1966, about 2.5 billion dollars. During this period aggregate consumption is programmed to increase by about 20% over the five years. With a population growth rate estimated in the plan at 2.9% per year, per capita consumption would remain at about the same level in 1966 as in the base year 1960. On the other hand, gross investment is to increase by more than 135% above the 1960 base-year level. Thus, while the plan would entail a balance-of-payments deficit over the five-year period of over 1.4 billion dollars, requiring external public and private financing of about \$280 million annually to meet the investment targets, the general pattern of the plan is one of severe austerity and a high rate of savings and reinvestment from increases in GNP. Investment and growth are to be most heavily concentrated in manufacturing, industry and power, whose joint contribution to GNP is expected to double during the plan period, compared with the over-all planned increase in GNP of about 40% over the 1960 base year. Growth in primary and tertiary sectors—the classifications used in the plan document—will be somewhat slower at 32% and 24%, respectively.

A few physical production figures may suggest more concretely the intended emphasis of the plan. For example, coal output is scheduled to rise to nearly 12 million tons by 1966, more than doubling the 1960 production. Installed power capacity is to be increased from 360 megawatts in 1960 to over 1,000 megawatts, with something over two-thirds of the increase planned for thermal power capacity and the remainder for hydro-capacity. Large increases in production are targeted for the cement industry, fertilizers, iron and steel, and textiles, with major reliance placed upon the private sector in these industries. Agricultural output targets concentrate on increasing rice production from about 2.3 million tons in 1960 to about 3 million tons in 1966, as well as expanding the livestock industry and moving in the direction of agricultural diversification by increasing the output of cotton and other industrial crops. The plan also includes specific references to social overhead projects, involving construction of roads and bridges, waterworks and port expansion, reforestation and flood control, to be implemented largely through the National Construction Service, with a view especially toward increasing employment in both rural and urban areas.

III. General Comments on the Plan

Given the time constraints and other circumstances affecting its preparation, it is not surprising that there are weaknesses in the Korean plan. Korea's plan and planning process are, of course, not unique in this regard. In fact, they compare favorably with the initial planning efforts of other Asian countries. However, there are weaknesses in the plan which range from fairly narrow and technical points to broader, conceptual shortcomings. Of the former sort, two examples might be cited. Using the plan's figures for GNP and gross investment, I have calculated that the aggregate capital output coefficient for the five-year period is about 4. This seems

unusually high, not only in relation to other developing countries but more particularly in the Korean economy which starts from a position of substantial unemployment both of labor and tangible capital. An aggregate coefficient of this magnitude inclines one toward caution in accepting the disaggregated estimates of costs and output for individual projects.

Another technical point relates to the level of domestic savings projected over the plan period. As mentioned before, the plan calls for severe austerity but the time path of this austerity raises some questions. Using the figures from the plan document, and estimating gross domestic savings as the difference between gross investment and the deficit on current account, the marginal savings rate (representing the ratio between increases in gross domestic savings and increases in GNP) diminishes sharply from 60% for the 1962-1963 period, to 25% in the 1965-1966 period. Although the marginal savings rate over the entire period is unusually and creditably high, the diminishing pattern would seem to be anomalous from an economic, political, and administrative point of view.

Moving to somewhat broader questions, the underlying strategy of placing major emphasis on a few key sectors, which is enunciated in the plan, seems to be eminently sensible in the Korean context. Yet, despite this clear expression of intent, there are grounds for worry as to whether in fact the range of investment and production targets covered by the separate projects referred to in the plan is not too broad and too ambitious. To put it another way, there is some question whether the plan does not strive to achieve too "balanced" a pattern of development, notwithstanding the declared strategy and policy to the contrary. In this connection, one would like to have a clearer picture on the criteria applied in the actual selection of projects, as well as of the interrelations among the separate projects and sectors.

While the plan document places heavy emphasis on a "framework of financial and monetary stability," as well as on the need for raising the level of efficiency and probity in public administration, there remains a clear and important need for carefully delineating a set of fiscal, monetary, foreign exchange, labor and investment policies that will complement the enunciated sectoral and aggregate goals, and, more particularly, will provide a framework within which the private sector's own investment and financial planning can proceed with reasonable latitude and security. There is, in other words, in the Korean plan as in other development plans, a tendency to become preoccupied with the quantitative details of production, employment, investment and foreign exchange allocation, and to give only passing attention to the tax policies, foreign exchange policies, and interest-rate policies which allow the private sector to flourish and compete, and which can provide the flexibility that is needed for adapting to the inevitable errors that development plans entail.

Finally, one is surprised by the omission from consideration in the plan of ways in which Korea's substantial military establishment and defense budget may be able to complement and advance the country's

development, for example, through training programs and the use of underemployed military manpower and equipment. Notwithstanding the assumption of political power by a military regime, the plan contains very little recognition of the potentially important complementarities between defense and development in the Korean context.

However, these and other important problems raised by the plan, and the progress of planning itself in Korea thus far, should not be allowed to detract from the major accomplishment represented by the plan document and by the progress of economic planning in Korea to date. Economic planning should not, in Korea any more than any other countries, be regarded as something that results in the production of an impressive and weighty document which is then turned over to others for implementation. Rather, it should be regarded as a process which seeks to stimulate and guide development, by considering alternatives and choosing among them, subject to later revision and adaptation. The process must provide a basis for getting started, but thereafter it should have built into it the flexibility to proceed by continued modifications and adjustments in the light of the experience and information that is gained. In providing a genuine basis for getting started, while preserving an opportunity for subsequent modifications and adjustments, the Korean five-year plan represents a notable contribution to advancing the country's development.

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