KOREAN ECONOMY - PAST, PRESENT & FUTURE

Remarkable Economic Growth for Decades

No one in the 1950s could have predicted that Korea would be one of the fastest growing countries for the rest of the century and stand among the 10 largest economies in the world by the end of this century. In the 1950s many observers chastised the Korean economy 'hopeless'. It was an aid-dependent economy with per capita income lagged behind many sub-Saharan countries, including Kenya and Ghana, not to mention most Asian countries. After the independence from Japan, President Rhee Syng-Man devoted much of his agenda to building the nation, securing U.S. military commitment to ensure Korean security, securing U.S. grants for the war-devastated economy, and stabilizing inflation. In the 1950s, economic growth was modest. Korea adhered to import substitution policies while maintaining the highly overvalued exchange rate. Economic growth from 1954 to 1960 averaged 3.7 percent per year.

The turning point in Korean economic development came in the 1960s. President Park Chung-Hee mobilized national energy for the industrialization of the country. Although his authoritarian rule had negative socio-political consequences, he guided the Korean economy on to the fast track. He motivated people, closely monitored the progress of every important development project while using carrot-and-stick methods to govern industrialists. He effectively steered economic policies away from the short-sighted and pervasive intervention for political reason to a long-term development goal.

In the early 1960s, Korea's savings ratio was less than 10 percent of GNP (e.g., 8 percent during 1962-66 period), and tax revenue was also less than 10 percent of GNP, which was low even by the standard of other developing countries. In 1960, the total value of exports was only $32 million, primarily in tungsten and agricultural products. In 1994, Korea's saving ratio recorded 35.2 percent; tax revenue was 19.9 percent of GNP; and total exports reached $96 billion, ranking 13th in the world.

The industrial structure has also substantially changed. The Korean economy was predominantly agricultural in 1960. In 1990, manufac-

Trends in Major Economic Indicators

	Domestic Savings Rate (% of GNP)	Tax Revenue (% of GNP)	Export (US$mil)	Per Capita GNP (US$)
1960	7.3*	10.1	32.8	79
1970	15.8	16.5	835.2	253
1980	24.8	20.4	17,504.9	1,597
1990	36.4	19.4	65,015.7	5,883
1994	35.2	19.9	96,013.2	8,483

Note : * denotes 1965 data.

turing constituted 29.2 percent of total output, more than doubling its share of 13.6 percent in 1960. How could Korea achieve such a remarkable economic development? Below is a brief sketch of Korea's path to success.

Economic Reforms and Export-led Growth in the 1960s

In response to the bottleneck in economic development that was caused by poor domestic resource mobilization and declining U.S. aid, Korea made an extensive effort to mobilize domestic resources to finance rapid growth.

During 1964-66, a series of reforms were undertaken which many observers characterized as "the most dramatic and vivid change in any developing country since World War II". The first action was the elimination of multiple exchange rates, which was soon followed by a 100 percent devaluation, the benchmark of an export-led growth strategy.

Second, tax system was reformed to give export incentives. The system gave exporters various tax deductions (domestic commodity taxes, business taxes, and income taxes) and generous wastage allowances that granted them preferential terms for importing a greater amount of intermediate inputs than required in production, granted tariff exemptions to direct and indirect exporters, and allowed concessional credits.

Third, the interest rate reform was instituted. In 1965, the one-year time deposit rate was increased from 15 percent to 30 percent overnight, while interest rates on loans rose to the rates between 26 and 30 percent, thereby creating negative margins for the banks. This reform enabled the businesses to mobilize private savings through domestic banks. In the mean time, the Foreign Capital Inducement Act was revised in 1965 to facilitate the inflow of foreign capital and technology.

Also in the 1960s, there was significant institutional reform. The government created the Economic Planning Board (EPB) by merging several policy-making functions of different ministries, e.g., the budget from the Ministry of Finance, and the collection and evaluation of national statistics from the Ministry of Internal Affairs. Since the effective coordination of policies among ministries required both jurisdiction and power, the EPB was transformed into a super-ministry, which enabled to make important contributions to Korean economic development for the next 30 years, until it merged with the

Changes in Industrial Structure

(% of GDP)

	Agriculture, Forestry, Fisheries	Mining	Manufacturing	Service and Others
1960	36.9	2.1	13.6	47.4
1970	26.6	1.5	21.0	50.9
1980	14.7	1.5	28.2	55.6
1990	8.7	0.6	29.2	61.5
1994	7.0	0.3	26.9	65.8

Ministry of Finance and Economy last year. The government also created other institutions such as the National Tax Administration to facilitate tax collection.

In addition, the government built up the country's infrastructure to facilitate private investment and export. In the early 1960s, the level of Korea's infrastructure ranked well below that of Turkey, Colombia, or Taiwan (China), but by 1980 the average annual growth in such infrastructure benchmarks as electricity generation and length of highways far exceeded those in these countries. The construction of the Seoul-Pusan highway and many dams for electricity generation contributed greatly to the subsequent export growth.

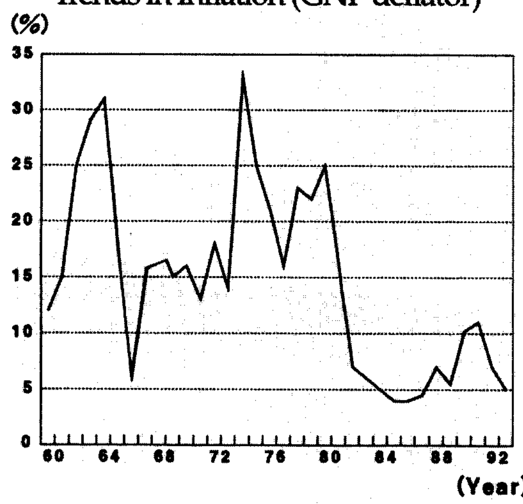
Big Push for HCI Development in the 1970s

In the 1970s, industrial policy shifted toward promoting the buildup of Heavy and Chemical Industries (HCI). The HCI policy consisted of targeted (directed) credit subsidies, selective protection, entry regulations, and government-directed industrial decision making. This industrial policy had strong positive results, e.g., rapid industrialization so that some firms developed into world-class businesses and inroads into lucrative, Japanese-dominated markets were made. The industries that evolved during this period became the leading export sectors in the late 1980s, now effectively competing with those of major industrial countries. This policy also had negative consequences: inappropriate scale choices, excessive capital-intensive investments in targeted sectors, and the retardation of trade and financial liberalization.

A Search for Liberalization in the 1980s

In the 1980s, Korean industrial policy shifted away from direct government intervention toward indirect assistance through, for instance, R&D. Nonetheless, the government remained closely involved in directing bank loans and intervening selectively in other areas, such as entry restriction to industries where economies of scale were thought necessary for maintaining high export, and regulating the business conglomerates' share of total bank credit allocations. At the same time, however, it substantially liberalized trade regime. Tariff and non-tariff barriers were lowered. It also started financial liberalization albeit with limited progress. Major commercial banks were privatized, interest subsidies on directed credit were reduced, and entry requirements for non-bank financial institutions (NBFIs) and foreign financial institutions were relaxed. Because NBFIs were governed by fewer regulations than were the banks, the former soon proliferated,

Trends in Inflation (GNP deflator)



creating a more competitive financial market.

Korea has not been quite successful in maintaining price stability in the three-decade period of high growth. The macroeconomic policies oriented toward industrialization and the large amount of directed credit issued by the central bank tended to produce significantly high inflation rates, which contributed to unequal distributions of income and wealth. However, Korea did not blind itself to the consequences of rampant inflation. The moderately expansionary fiscal management did not much exert an overbearing inflationary pressure. The real exchange rates remained competitive, and real wages stayed largely in line with production growth. In addition, the government began to implement comprehensive stabilization measures in the early 1980s, resulting in a substantial deceleration of inflation since then.

Acceleration of Economic Deregulation in the 1990s

In the 1990s, Korea has initiated a comprehensive deregulation program. With the change in both internal and external economic environment, the government attempts to boost the role of market and private sector in economic decision making and resource allocation through deregulation of finance and industry. This comprehensive deregulation program, if it proceeds successfully, will create a major change in the role of government in economic development. However, this does not necessarily imply the reduction of government's role, but rather, the refocusing of its role.

Prospect of Korean Economy

Korea has achieved remarkable economic growth during the last 30 years, which many developing countries hope to emulate. Korea has now applied for membership to the OECD, and its industrial strength is comparable to many advanced industrialized countries. Will Korean economic performance be as promising in the future as it has been in the past? In fact, we may not have an affirmative answer to this question unless we are able to effectively address the problems that we are facing now.

In essence, the Korean economy should be able to compete with advanced industrial countries with quality products. Korean products could expand their market share with competitive price based on the low wages and the economies of scale as it did in the past. However, it now seems clear that the advantages no longer prevail. Technological advancement and productivity growth should be the main source of future Korean economic growth. But this is not an easy task by any means. In order to achieve this, an extensive economic reform is necessary. There should be a fundamental change in the way the government, industrial firms and banks operate. These institutions and organizations should be managed with new perspective and training. Not only education reform is crucial, but also policy reforms in finance, industry, and trade are necessary.

This implies that Korea needs to implement a comprehensive social and economic reform to lift its economy to the level of major advanced economies in the 21st century. This will require much effort and sacrifice on the part of people. In retrospect, it is clear that the rapid economic growth during the last 30 years was possible through many painful decisions; it was based on courageous reforms and sacrifices. If we could be as decisive in the future as in the past, in making necessary reforms, we believe the future of Korean economy will continue to be bright.

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