The Role of Government in South Korea’s Miracle Economic Growth Lessons for Developing Countries

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Abstract
This paper focuses on the role of the government in the economic growth miracle happened in Korea. The main objective of the study is to identify the contributions of the government in the country for its rapid economic progress through designing several economic and social development policies. For this paper, the literature has been thoroughly and deeply reviewed. The main argument of this paper is that the highly interventionist government of Korea, during its early development stages, has played a very significant role in the transformation of the country from an agrarian and poverty stricken economy into an industry based advanced economy. In general terms, the governments of Korea played this significant role of stimulating economic growth of the country through three ways:

1) Construction of basic infrastructure for economic development;
2) Encouraging and supporting the private firms in priority sectors and maintaining necessary macroeconomic stability, and
3) Boosting investment through the organization of public firms during the early development stages of the country.

Keywords: Government, Public Policy, industrial policy, export, investment, role, Korea

Introduction
The East Asian Tigers namely, Republic of Korea, Singapore, Taiwan and Hong Kong, have experienced a dramatic increase in economic growth during the last five decades. The economies of these countries have been hailed as models of economic achievement for other less developed and developing economies in the world. Particularly, the Republic of Korea, (hereafter called Korea), is one of the countries which achieved unprecedented economic and social development in the 20th century.

What causes this rapid economic growth? Many scholars have been trying to identify the causes of this dramatic economic development. Consequently, many articles have been published to explain the causes of the economic growth and the other East Asian Tigers. Yet there is no consensus among economists concerning the major factors that enable the growth miracle to happen. In fact, there are two divergent views namely the neoliberal and revisionists view.

The neoliberal school of thought argues that the economic miracle happened in East Asia because of the market forces. In contrast to this the revisionists argue that the unprecedented economic growth happened due to the intervention of the government in the market. According to the World Bank outward orientation, macroeconomic stability, high saving and investment rates and other good public policies were accounted as the factors that cause the economic phenomena (World Bank, 1993).

This paper argues that the government of Korea was interventionist and playing a pivotal role in stimulating economic growth in the country. The literature on why and how the government of the Republic of Korea stimulated economic growth is thoroughly reviewed in the following sections.

This paper is organized into two parts.

a) Part one discusses about the general views on the reasons for the economic miracle in the East Asian Tigers.
b) Part II deals about the role of the Korean government in formulating growth policies and strategies.

The overall objective of this paper is to assess the causes and approaches of the economic development of Korea and the role of the government in stimulating and regulating growth policies and strategies.

Methodology of the Study
Even though there is no consensus regarding the role of governments, there is a vast literature on the economic miracle which happened in East Asia in general and in Korea in particular. In order to investigate the contribution of government, by initiating and implementing industrial policies, in the process of transforming the poverty ridden economy of Korea into an advanced industry based economy, many books, articles, websites, working papers, and reports have been reviewed.

Divergent Views on the Causes of Economic Growth in South East Asia
The causes of the unprecedented sustainable economic growth of the four East Asian countries namely Korea, Taiwan, Hong Kong and Singapore, is subject to a di-
verse views. Particularly, there is a strong debate among scholars concerning the role of government policy in stimulating the astonishing economic performance during the past four decades of the 20th century. Theoretically speaking about the role of government in the economic development of Korea, it is possible to argue in support of any of the following four propositions:

a) Government policy was impediment, but these countries overcame it nevertheless;
b) Government policy was extraneous, not helping but not hindering in either;
c) Government policy was helpful, though not indispensable that is, it speeds up a process which would have happened anyhow;
d) Government policy was essential for the development of these countries.

Amongst the possible variety of policy explanations, two wide outlooks namely, the neoclassical and the revisionist have been emerged. A review of the two major views and concerning the factors that caused a rapid economic performance in the countries is presented in the following paragraphs.

The Neoclassical View
The neoclassical approach to economic growth in the countries, advocates a fundamental belief in orthodox liberalism. According to this view, the production possibilities of any economy at any time are determined by the availability of physical resources such as minerals such as petroleum, human resources etc. and combining with that of innovative technology. The rate of economic growth in the long run is determined by the rate of technological progress, which is itself a natural outcome of fierce competition in the laissez-faire economic system. Since the neoliberal approach regards markets as an efficient mechanisms, this view maintains that government should confine itself to providing public goods and to getting the basic right and should abstain from any further intervention in the market (Michael, 1996). Accordingly, the secret for the transformation of these countries from agriculture based economy into an industrial economy is the countries’ adherence to the liberal market economic system.

The neoliberal view wishes to limit the role of government in the economy, but it is not totally anarchistic state of affairs. It assigns the government both microeconomic and macroeconomic functions. In its microeconomic aspect, the government should ensure property rights, law and order, and adequate provision of public goods. Further, the government shall avoid charging high tax rates, relaxing price controls, and other distortions. In other words, the tax rate should not be cumbersome that can discourage economic activity and prices should be determined by the supply and demand in the market mechanism. On the other hand, at the macroeconomic level, government should ensure stable and low inflation, avoid excessive budget deficits, promote the integrity of the financial and banking systems, provide for open markets, and strive for stable and realistic exchange rates. Proponents of this view see the success of the countries as the natural outcome of these cautious policies (Michael, 1996). In other words, according to this view the factors that led for the rapid economic progress recorded in the four East Asian economic tigers include ensuring property rights, law and order and the adequate provision of public goods at micro level. Furthermore, there were also other factors such as maintaining suitable taxation system, exchange rate system, and management of inflation and wise administration of government budgets.

The Revisionist View
The other opposing view regarding the causes of the rapid economic growth in those countries is the revisionist approach. Proponents of this view have successfully shown that East Asia does not wholly conform to the neoclassical model that is they were not only confined to those activities which are thought government’s appropriate roles by the neoliberals. Instead, beyond to accomplishing the tasks which are proposed as appropriate by the neoliberals, the government of Korea was intervening in the market so as to solve the market failures and coordination problems.

Within the neoclassical model, industrial policy and intervention in the financial markets cannot be easily reconciled. Industrial policies in South Korea were much more in accordance to the models of state-led development. In addition, while neoclassical model would explain growth with a standard set of relatively constant policies, the policy mixes used by Taiwan and Korea were diverse and flexible. Revisionists argue that East Asian governments in general and government of Korea in particular led the market in critical ways. In contrast to the neoclassical view, which acknowledges relatively few cases of market failure, revisionists contend that markets consistently fail to guide investment to industries that would generate the highest growth for the overall economy. In East Asia, the revisionists also argue, governments remedied this by deliberately “getting the basics right”; and altering the incentive structure -to boost industries that would not otherwise be thrived (Amsden, 1989). In other words, according to the revisionist view the factors that caused economic miracle in the East Asia during the past half a century include mainly the industrial policies designed and implemented by the then interventionist governments.
Role of Government in the Economic Development of Korea

As mentioned above, the proponents of the neoclassical view the development of the Korea, argue that the spectacular economic development was caused by the market forces and they disagree with the positive contribution of the role of government policies. For instance, according to Yoo (2009), Korea’s export expansion and industrial growth starting from the early 1960s was because of market liberalization and three devaluations, which corrected the currency over valuation there by resorted the signaling function of the exchange rate as a price. The neoclassical economists are the advocates of Adam Smith’s invisible hand principle. Adam Smith while developing the theory of free market economy assumed that consumers choose for the lowest price, and that entrepreneurs choose for the highest rate of profit. His argument is that through excesses or insufficient demand reflected in market prices, consumers “directed” entrepreneurs’ investment money to the most profitable industry.

However, in a poor country where there are no entrepreneurs with sufficient access to finance and where information is not easily available for both customers and entrepreneurs, it is difficult to attain development as fast as possible through market mechanism alone. Cognizant of this fact, the previous government of Korea starting from early 1960s led the market through designing public policy in various sectors and ultimately succeeded in achieving an economic miracle. It is termed as miracle because Korea’s and the other East Asian Tigers’ economic performance is unprecedented phenomena. Most of today’s Western industrial countries did not achieve their development as fast as those countries.

How the previous governments of Korea did led the market and induced economic growth? There were several heroic development actions accomplished by the Korean government right from the early 1960s such as greater spending on infrastructural facilities and other public services, getting the basics right and deliberate price distortion, promoting and supporting the establishment of big private business firms (private firms development), organizing and owning public business corporations in key sectors, and promoting exports. Each of these policies is discussed, in detail, in the following section.

Infrastructures Development Policy and Strategy of Korea and the government’s role

It is obvious that a well-established infrastructural facility is one among the basic factors for accelerating national economic development. The availability of full-fledged infrastructural facility is a prerequisite for fast and sustainable economic and social development. Hence “the Korean government has been investing a great share of expenditure for the infrastructure development in the post war period. The first five year economic development plan of Korea (1962-66) focused on the development of light industries and building the country’s import substitution capacity. Infrastructure construction to support these economic activities included the construction of railway lines and several small highway projects (Jaebong, 2002).

Besides, the second five year development plan (1967-71) sought to stimulate exports. In this development plan investment in railways and highway construction were accelerated. Korea’s major first highway project was to connect the country’s two largest cities Seoul in the Northwest and Pusan in the Southeast. This project was particularly momentous because not only did it establish a vital industrial corridor in Korea, it also served as Korea’s emerging self-confident. As the country’s sectorial focus shifted to heavy and chemical industries, comprehensive programs were planned to develop the country’s air ports, seaports, highways, railways, and telecommunication systems to support these industries. The sea ports Pusan and Ulsan as well as the subway system in Seoul were built during the 1970s (Ibid). Construction of roads, high speed trail power stations, and communication (information infrastructure) extra created jobs and stimulated the economy of the regions, and thereby increasing regional production. Investment in infrastructure was able to reduce the production costs in directly and raise productivity (Byoungki, 2006).

Moreover, Byoungki also argued that the constructions of infrastructure facilities during the post war period resulted in correcting the regional income disparities between rural and urban area, manufacturing and agriculture sector in Korea. This happened because the previous investments were concentrated in major metropolitan cities where there was a relatively better access to basic infrastructure and this led to income disparity between rural and urban areas and agriculture and industrial sectors. This problem was later on solved through heavy investment in infrastructure across all parts of the country. This argument gives sense since investors would not be motivated to invest their money in regions where there is no well-developed infrastructure. Therefore, the governments of Korea starting from the early 1960s had given credit and they were quite committed, conscious and cautious in building the afore mentioned infrastructures which are fundamental for boosting investment and export, usually considered as the engines of economic growth. Reinfeld (1997) argues that Korea’s impressive economic performance since early 1960s stems from a commitment to infrastructure development. Strong leadership and efficient coordination for installing the infrastructure necessary to spur economic performance, a well-defined focus and priorities on in-
frastructure development, and willingness and flexibility were among the critical factors for Korea’s spectacular economic performance (Reinfeld, 1997).

Human Resource Development Policy of Korea
Another vital factor which contributed for the success of Korea’s economic performance is the availability of well-educated human capital. What was the role of the government in ensuring the supply of qualified human power for the traditional and emerging industries? During the Korea’s reconstruction period (1945-1961), the role of government in educational development was considered insignificant as its financial resources were limited. However, the government did a lot to decrease the rate of illiteracy among adult people through initiating a “national campaign for literacy.” Consequently, the adult literacy rate increased from 22 percent in 1945 to 80 percent in 1960 (Lee, 1997).

In the period starting from 1962 onwards, the government of Korea recognized the need for a skilled labor force to promote export oriented industrial development and launched a various human resource development programs. At the first stage of industrialization in the 1960s and 1970s, which necessitated less skilled workers, the government implemented an effort to expand vocational training and the supply of secondary school technical graduates. Later in the 1980s in order to absorb a more advanced technology, more support was given to two years junior technical colleges and universities for a supply of skilled workers and technicians. Beside this, the government also provided subsidy for the employers to send their workers who fulfilled certain vocational training standards to vocational training centers. By doing so, about 70,000 workers were trained in vocational training institutions (Lee, 1997).

Exchange rate, Interest rate, and Taxation Policies of Korea
It is known that the Korean government during the reign of President Park Chung-hee (1961-1979) was authoritarian and highly interventionist. It is also a day light fact that the economy of Korea took off in the early 1960s. The government of President Park was committed to economic growth and had developed successive five years economic development plans. In order to effectively achieve the objectives of the development plans, the government intervened in the economy through designing and implementing various economic development policies. Those policies include exchange rate, interest rate, taxation, and export promotion policies. However, the most debatable issue concerning the development of Korea is whether the intervention of the government in the market had facilitated economic growth or not. In reality, by considering the level of development of the country and its future requirements the government was changing these policies from time to time.

According to the views of both neoclassical and selective interventionist views the government was “getting the basics right” and made deliberate price distortion. This means the government was creating an enabling environment, in which the economy could flourish by making sure that the exchange rate reflects the economic fundamentals; the interest rate yields a positive return and that inflation is kept under control; and tax is not so burdensome as to discourage economic activity. These are general or functional incentives to induce the economic growth in the country.

The neoclassical economists argue that Korea’s economic growth is attributed to the market forces. The 1960s rapid expansion of manufactures export led the government to adopt export promotion policy. Clearly the government did not lead the events but was led by events in the 1960s (Yoo, 2009). Yoo’s argument is that the market was leading the government to design and implement export promotion policies. He further argues; had the government of Korea not intervened in the market, Korea could have been grown much faster. However, in poor countries like Korea in 1960, the economy was characterized by limited credit services, absence of wealthy private entrepreneurs who can start a business and the market is a skirmish in which foreign and domestic firms savage one another and the public suffer from unfair trade practices. Production could have been created unintended undesirable effects such as pollution (externalities). Cognizant of this, the Korean government was intervening in the economy and moderated the market or coordination failure so as to assist the orderly development of the economy by acquiring technology and allocating funds for useful projects that promise a good rate of return. This was in line to the revisionists’ view that the government should jump-start the industrialization process by transforming economic structure faster than private entrepreneurs would. Korea succeeded for she has confirmed to this conviction. Therefore, the Korean government was not only getting the basics right but also leading the market, often systematically through targeted and subsidized credit to selected industries, low deposit rates and ceilings on borrowing rates to increase profits and retained earnings, protection of domestic import substitutes, subsidies to declining industries, the establishment and financial support of government banks, public investment in applied research, firm- and industry-specific export targets, development of export marketing institutions, and wide sharing of information between public and private sectors (World Bank, 1993).
**Investment and Export Promotion Policies of Korea**

In the early 1960s, President Park’s administration started it successive five years economic development plan by promoting the export of light industries products such as textile products, cloth, leather, wigs, umbrella etc on which Korea had a comparative and competitive advantage. The slogan of the country at that time was ‘export number one’ which was intended to make the country number one exporter in the world. In order to achieve its development target, the government was working closely with private sector and providing support for it. The supports or export incentives being provided for the exports were both financial and nonfinancial measures. The financial export incentives include preferential interest rate on export credits, local letter of credit system, and accelerated depreciation, tariff exemption on the importation of inputs, and priority of access to loans (Yoo, 2008). In order to encourage investment on export items, the government provided preferential interest rate on export credits that is credits on a lower interest rate. In addition, using the local letter of credit system, the exporters enjoyed access to loans from foreign banks without having any collateral. The local credit it to be issued by the local bank of the exporter served the exporter as a guarantee for the bank of Korea and the bank of Korea promised for the foreign creditor to pay in case the local bank of the exporter failed to do so.

Moreover, as a financial incentive, the exporters were given privilege to accelerated depreciation on their capital goods. This was to depreciate the value of their capital goods rapidly so then exporters pay less property tax. Besides, the exporters were given an opportunity to import inputs at a duty free. By doing so, the government solved the exporters’ financial problem.

Beyond to the financial measures, the exports in the 1960s were also provided with non-financial export promotion measures. The nonfinancial export promotion measures included export-import link system, identifying export targets, establishment of institutions helping export, and monthly expanded meeting on export promotion. The export-import link system was a system designed to induce export performance through letting the exporters use all of their revenues from export for the importation of inputs. The government of Korea also identified the target markets (USA and Japan) for the exportable product of the country. Moreover, a number of organizations such as the Korea Trade Promotion Agency (KOTRA) and Korea International Trade Association (KITA) have worked as institutions helping exporting firms in cases of export related barriers such as motivational and lack of information about international markets. Furthermore, the government carried out a monthly extended meeting on export promotion. The participants in the meeting were Ministers, governors of the Bank of Korea, heads of economic institutions like KOTRA, chamber of commerce, and heads of financial institutions and so on. This meeting was chaired by President Park. Those incentives induced many entrepreneurs to engage in investing export products manufacturing. Consequently, the export values of Korea increased from US$87 million in 1963 to US$ 17.5 billion in 1980 and then to US$ 365.3 billion in 2009 (Mah, 2010).

**Private Firms Development Strategy of Korea**

The government of Korea decided a development mechanism through the establishment of big private firms. Consequently, the government stimulated the organization of family owned large conglomerates. Hence, the industrial structure of Korea is characterized by big family controlled corporations or large conglomerates called Cheabols. Those highly diversified firms of Korea are distinguished by strong ties with government agencies. The name, chebol refers to business association, is properly pronounced chaebol. Before the years of the advent of President Park into power in 1961, there were family-owned enterprises in Korea, but the particular state-corporate alliance came into being with the regime of President Park (1961-1979). President Park modeled this arrangement on the zaibatsu system which was developed in Japan during the Meiji Era. There were significant differences between the zaibatsu and the chaebol, the most significant of which was the source of capital. The zaibatsu were organized around a bank for their source of capital. The chaebol in contrast were prohibited from owning a bank1.

For achieving its national objectives, the Park regime nationalized the banks and channeled the limited capital to industries and firms that the government considered necessary. The government-favored chaebol had special privileges and grew large. This gave the impression of economic success for the chaebol that was not always valid. In some cases chaebol grew not because they were profitable but merely because they could borrow vast funds. Though this was made possible at the expense of the tax payers (general public and light industries and firms that did not get favor), it built the globally competent corporations such as Samsung, LG, Hyundai, SK, Daewoo, extra which currently are having significant contribution to the Korean economy. Therefore, the government’s efforts to strengthen these giant corporations made them competent enough to successfully penetrate the highly competitive international market. Without the government’s support, those World’s top multinational corporations could not have been successful.

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1 http://www.sjsu.edu/faculty/watkins/chaebol.htm
Public Enterprise Development and Privatization Policy of Korea

The Korean government established and owned several public enterprises for the purpose of expediting economic growth in the country. Public enterprises were organized in many countries in order to accelerate the economic and social development. In the time of globalization, where there is stiff competition and income and level of technology between developed and third world countries is so huge, there is no best way to start stimulating economic activities in poor countries other than establishing state owned enterprises and then gradually privatizing them. Hence, during the early 1960s the Korean Government established several state owned enterprises in key industries to alleviate poverty and bring sustainable development.

In its five years development plan the government was very much ambitious to achieve economic development. During that time Korea was even far more poor than most of the Sub Saharan African and Latin American countries. There was lack of capital for entrepreneurs to invest in key sectors that are capital intensive by their nature like steel and iron, telecommunications, electric power generation etc., industries. In addition to consolidating the expansion and growth of the chaebols, the government found the establishment of public enterprises in those obviously capital intensive sectors as a means of achieving the very ambitious economic targets. For instance, the Pohang Iron and Steel Company (POSCO), one among the World’s leading steel industries, was established as a public enterprise in the year 1968. Regardless of the criticisms by the World Bank and other international institutions against it, the government persisted on the realization of POSCO. Nevertheless, the government started privatizing those state owned enterprises from time to time.

In the 1980s, an important function of public enterprises was the introduction of new and expensive technology ventures. In 1985 the public enterprise sector consisted of about 90 enterprises employing 305,000 workers, or 2.7 percent of total employment in the nonagricultural sector. There were four categories of public enterprises: government enterprises (staffed and run by government officials), government-invested enterprises (with at least 50 percent government ownership), subsidiaries of government-invested enterprises (usually having indirect government funding), and other government-backed enterprises. Government-invested public enterprises, such as the Korea Electric Power Corporation (KEPCO) and POSCO, represented the core of the new enterprises established during Park’s regime. In the late 1980s, roughly 30 percent of the revenues produced by public enterprises came from the manufacturing sector and the other 70 percent from such service sectors as the electrical, communications, and financial industries. This indicates those public enterprises were playing a pivotal role in the introduction of new technologies and the provision raw materials and other services necessary inputs for sustained economic growth in the country.

In a nutshell, the role of the government of Korea in the development of the country can be categorized into three ways:

1. construction of basic infrastructure facilities for economic development;
2. supporting the development of private firms in priority sectors and maintaining necessary macroeconomic stability;
3. Boosting investment through the organization of public and private enterprises during the early stages of development of the country.

Conclusions

1. During the early developments stages of the country, the government of Korea was highly intervening in the economic development.

2. The government had developed successive economic development plans, strategies, and industrial policies. In early 1960s, in Korea the industrial policy was import substitution. Later on, it shifted the industrial policy from import substitution into export promotion. Through those policies and strategies the government directed resources into the sectors where there was comparative advantage for the country.

In a nutshell, the governments of Korea played significant role in stimulating economic growth of the country through the following three ways:

a) construction of basic infrastructure facilities for economic development;
b) supporting the development of private firms in priority sectors and maintaining necessary macroeconomic stability, and
c) Boosting investment through the organization of public firms during the early development stages of the country.

3. Specifically, the construction of roads, high speed railway, power stations, harbor, airports, and communication (information infrastructure) and so on by the Korean government created jobs and stimulated the economy of in all the regions of the country, and thereby increased regional production. Investment in infrastructure was able to reduce the production costs in directly and

2 Ibid
raise productivity, and it raised the production in the regions. Overall, the availability of these facilities accompanied by educated human power, stable macro economy and political stability laid the foundation for the growth of investment and export, which are usually considered as engines of rapid economic progress.

4) The Korean government was also devoted to the development of private sector in the country. Establishment of big family owned conglomerates called chaebol was pursued by the president Park as means of promoting the private sector. Those large firms were very much diversified and they were provided with several privileges such as subsidy, credit at lower interest rate, tax benefits, access to foreign exchange and so on. Though the subsidy and other supports which were provided to the large conglomerates was at the expense of the tax payers, it built the globally competent corporations such as Samsung, LG, Hyundai, SK, Daewoo, extra which are currently the base of the current Korean economy. Therefore, the government’s efforts to strengthen these giant corporations made them competent enough to successfully penetrate the highly competitive international market. Without the government’s support, those World’s top multinational corporations could not have been successful.

5) In addition to consolidating the expansion and growth of the chaebols, the government found the establishment of public enterprises in those obviously capital intensive sectors as a means of achieving the very ambitious economic targets. The public enterprises were playing a pivotal role in the introduction of new technologies and the provision raw materials and other services necessary for sustained economic growth, which were beyond the capacity of the private firms.

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