The Tortuous Path of South Korean Economic Development

This book explains how South Korea has uniquely transformed itself from a developing to a developed country by combining economic analysis with historical perspective, an approach badly needed but rarely taken by previous studies. The book shows that the country has done so through a tortuous process. It first explains how Korea failed earlier in history to emerge as a developing rather than a developed country after the Second World War but South Korea began to grow rapidly in the 1960s. It then explains that the country has sustained growth while undergoing recurring crises, examining three conditions for sustaining growth: macroeconomic management, structural transformation, and social conflict management. While doing so, the book interprets some important subjects differently from the previous studies; it also explains some other important subjects they have not covered sufficiently. The book finally discusses questions for the future briefly.

JAYMIN LEE, PhD (Harvard), is Professor Emeritus of Economics at Yonsei University, Seoul, South Korea. He was Vice Chairman of the National Economic Advisory Council of the Republic of Korea (2019–21), president of the Korea Development Economics Association (2006–7) and president of the Korean Economic History Society (2001–3). Jaymin also served as Editor of the International Economic Journal for 2002–15. As an economist, he combines theoretical analysis with historical perspectives and policy insights to explain South Korea’s economic development.
The Tortuous Path of South Korean Economic Development

JAYMIN LEE
Yonsei University
## Contents

List of Figures .............................................................. viii
List of Tables ............................................................... x
Preface and Acknowledgments ........................................... xi
Notes on the Romanization of the Korean Language ............... xiii
List of Abbreviations ....................................................... xv

1 South Korean Economic Development in Perspective ............. 1
   1.1 A Unique Case ......................................................... 4
   1.2 A Tortuous Path ..................................................... 9
   1.3 The Great Divergence and the Great Convergence .............. 13
   1.4 Sustained but Crisis-Ridden Growth ............................. 15
   1.5 Questions for the Future ......................................... 20

2 The Great Tradition That Failed ..................................... 21
   2.1 Traditional Korea .................................................. 21
   2.2 The Failure ........................................................ 28
   2.3 The Colonial Economy .......................................... 38

3 Some Lights in the Dark ............................................... 48
   3.1 Division, War, and the Consequences ........................... 48
   3.2 The Exception to Work ........................................... 56
   3.3 Growth with Aid .................................................. 67
   3.4 The Long-Run Growth and the Short-Run Crisis ............... 76

4 Kicking Off the Miracle ................................................ 83
   4.1 Explaining the Kickoff ............................................. 83
   4.2 The Contours of Economic Policy ................................. 91
   4.3 Trade Policies and Export-Oriented Industrialization ......... 104
   4.4 Overcoming the Bottleneck and Beyond ......................... 115
vi CONTENTS

5 Contours of the High Economic Growth 122
  5.1 An Aggressive but Vulnerable System 122
  5.2 Crisis, Stabilization, and Boom 131
  5.3 Macroeconomic Performance after the Boom 140
  5.4 A Crisis-Bound Economy? 149

6 Industrial Policy and Chaebol 158
  6.1 Structural Transformation and Industrial Policy 158
  6.2 The Role of Chaebol 171
  6.3 Liberalization and New Industrial Policy 178
  6.4 Chaebol in Transition 188

7 Growth with Equity? 198
  7.1 Jobs, Poverty, and Inequality 198
  7.2 Slowing Inequality, More Oppression, and Beyond 210
  7.3 Sustaining Growth with Democratization 218
  7.4 Inequality and Reform after the Democratization 228

8 Crisis and Reform 239
  8.1 The Nature of the Crisis 239
  8.2 Understanding the Resolution Process 247
  8.3 The Response 254
  8.4 The Reforms and Their Consequences 262

9 The Slowing Engine of Growth 272
  9.1 The Slowdown and the New System 272
  9.2 Current Account, International Investment Position, and Self-insurance 282
  9.3 The 2008 Crisis and After 292
  9.4 New Challenges 301

10 Industrial Policy and Firms 315
  10.1 Industrial Policy and Structural Transformation 315
  10.2 Whither Chaebol? 329
CONTENTS vii

10.3 Venture Business and Foreign Direct Investment 337
10.4 The Plight of Small and Medium-Sized Enterprises 345

11 Inequality, Jobs, and Welfare 357
  11.1 The Changing Inequality 357
  11.2 Labor Market Problems 364
  11.3 Capital, Labor, and Industrial Relations 378
  11.4 The Welfare System 389

12 Questions for the Future 400
  12.1 The Changing International Environment 403
  12.2 The New International Political Economy 409
  12.3 South Korea and the Great Powers 412
  12.4 Does History Help? 416
  12.5 Domestic Politics Matters 418

Appendices 423
References 446
Index 465
Figures

4.1 Export ratio and import ratio, 1953–2022 (percent)  
4.2 Unemployment rates, 1963–2022 (percent)  
5.1 Gross investment rate and gross saving rate, 1953–2022 (percent)  
5.2 Debt-equity ratio and interest coverage ratio, manufacturing sector, 1962–2021 (percent)  
5.3 The composition of government expenditure, 1970–2020 (percent of GDP)  
5.4 The composition of gross investment rate, 1970–2022 (percent)  
6.1 R&D expenditure by fund sources as a percentage of GDP, 1970–2020  
6.2 School attendance ratios, 1980–2022 (percent)  
6.3 Top chaebol’s shares in value added, 1973–1995 (percent)  
7.1 Top income shares, 1958–2021 (percent)  
7.2 Capital gains on land as a percentage of GDP, 1965–2021  
7.3 Unionization rate, 1963–2021 (percent)  
7.4 Propensity to strike, 1965–2021  
8.1 Short-term foreign debt and international reserves as a percentage of GDP, 1964–2022  
9.1 The shares in lending by general banks, 1989–2021 (percent)  
9.2 The composition of gross saving rate, 1975–2021 (percent)  
9.3 Real effective exchange rate (2010=100), 1964–2022
LIST OF FIGURES

9.4 Financial account and the changes in net international investment position as a percentage of GDP, 1980–2022 (three-year average) 289

9.5 Fiscal balances as a percentage of GDP, 1970–2021 303

10.1 Relative labor productivity and employment share by industries, 1980–2021 (percent) 324

10.2 The share of venture business in employment and venture capital investment in GDP, 1998–2021 (percent) 341

10.3 Foreign direct investment on report basis as a percentage of GDP, 1980–2022 343

10.4 Foreign direct investment and direct investment overseas on balance of payments basis as a percentage of GDP, 1980–2022 345

10.5 Relative debt-equity ratio and profitability: Small and medium-sized enterprises to large enterprises, manufacturing sector, 1970–2021 (percent) 347

10.6 Productivity-related indices, small and medium-sized enterprises relative to large enterprises, 1983–2020 (percent) 351

10.7 Employment share, small and medium-sized enterprises relative to large enterprises, 1982–2020 (percent) 354

11.1 Gini coefficients, 1990–2021 359

11.2 Employment rates, 1989–2022 (percent) 369

11.3 Labor share of income, 1975–2021 (percent) 379

11.4 The composition of capital share of income, 1975–2021 (percent) 384

11.5 The sources of government debt as a percentage of GDP, 1997–2021 394

11.6 Dependency ratios, 1960–2070 (percent) 398
Tables

4.1 Fiscal expenditure and revenue as a percentage of GDP, 1953–1970

4.2 Interest rates on major loans and inflation rate, 1961–1988 (percent)

4.3 Exchange rates for exports, 1955–1990


6.1 Protection and subsidies for targeted and untargeted manufacturing industries, 1963–1995 (percent)

11.1 Employment shares by enterprise size and worker status, 2002–2021 (percent)
Preface and Acknowledgments

This book explains the economic development of South Korea as it has unfolded, from the beginning of Korean history to the present, mainly focusing on the period following the 1960s when the economy began to grow rapidly. The title Tortuous Path has been chosen to highlight the fact that, while the country’s economic development is a great success story, it has not been a smooth process, but one accompanied by twists and turns.

I have written this book thinking that, though much ink has been spilled over the subject, it can still make some scholarly contribution. The book tries to interpret economic development in historical perspective; it tries to explain the development process from the 1960s with a consistent framework about growth and crises. The book also tries to explain some important subjects differently from the existing studies and discuss some subjects they have not covered sufficiently.

I have tried to keep the economic analysis in the book as non-technical as possible. There is only one simple equation presented in the book. I have mainly used narratives, citing the statistical numbers for economic variables when necessary. In cases where showing the trend of economic variables is important, I have used more figures than tables because figures show summary trends better, especially when the data have long time series.

I have benefited from the discussions and comments of many of my colleagues made in the conferences and seminars where the ideas for the book were presented. I thank those who helped me obtain unpublished data, including the researchers at the Bank of Korea and the Korea Institute for Industrial Economics & Trade. I especially thank the anonymous readers of the manuscript during the review process of the book, who read it carefully and made constructive
comments. My assistants during my days of teaching and research at Yonsei University also helped to write the book. My family also aided me in writing the book through giving me peace of mind and by making some helpful comments. I also appreciate the financial support provided by the National Research Foundation of Korea to write the book.\(^1\) I finally thank Cambridge University Press for publishing the book.

\(^1\) This work was supported by the Ministry of Education of the Republic of Korea and the National Research Foundation of Korea [NRF-2017S1A6A4A01022143].
Notes on the Romanization of the Korean Language

The romanization of the Korean language does not conform to a single, uniform system. In the past, the McCune–Reischauer system was widely used, and many authors still follow it. However, the National Institute of Korean Language has formulated the official guideline for romanization. This book follows the guideline as the first reference. It thus places, for example, the family name before the given name in writing personal names in the text.

However, some exceptions are inevitable, mainly because the official guideline fails to consider the possibility that the same English vowel can be read in different ways. This book revises the official guideline taking this possibility into account, when it seems necessary. The book thus retains, for example, the conventional spelling of the Korean family name Lee rather than changing it to Li following the official guideline.

A related problem is how to spell internationally known Korean words. This book retains the well-known words like chaebol, and the spelling of the brand names of Korean firms like Hyundai and Samsung, which would have to be spelled in a different way according to the official guideline. It also retains the spelling of Korean authors’ English names appearing in the referenced scholarly journals and books, regardless of whether they are in line with the official guideline. The book also does not follow the official guideline in writing the personal names of internationally known Koreans. The alternative guideline here is the spelling from Wikipedia, if the personal names appear there. It is arbitrary, but may help the readers to identify the referenced persons. Furthermore, for the purpose of consistency, the book follows Wikipedia and places a hyphen between
the syllables of the given names for the persons who do not appear on Wikipedia.

In the end, the exceptions outnumber the regular cases that follow the official guideline, but this is more or less inevitable given the current changing state of the romanization of the Korean language in the globalized world.
Abbreviations

BOK       Bank of Korea
CPI       Consumer price Index
DTI       Debt-to-Income
ERP       Effective Rate of Protection
FDI       Foreign Direct Investment
FKTU      Federation of Korean Trade Unions
HCI       Heavy and Chemical Industry
HEG       High Economic Growth
ICT       Information and Communication Technology
KCTU      Korean Confederation of Trade Unions
KOSDAQ    Korea Securities Dealers Automated Quotation
LTV       Loan-to-Value
NBFIs     Non-Banking Financial Institutions
NIIP      Net International Investment Position
NPLs      Non-Performing Loans
NPS       National Pension Service
NSO       National Statistical Office
PPP       Purchasing Power Parity
REER      Real Effective Exchange Rate
SMEs      Small and Medium-Sized Enterprises
TIs       Targeted Industries
TFR       Total Fertility Rate
UIs       Untargeted Industries