Korean Economic Development Strategy

Part I: History of Economic Development

Part II: Economic Crisis Management

Part III: Kazakstan Implication

Part IV: Concluding Remarks

Korea Development Institute (KDI)

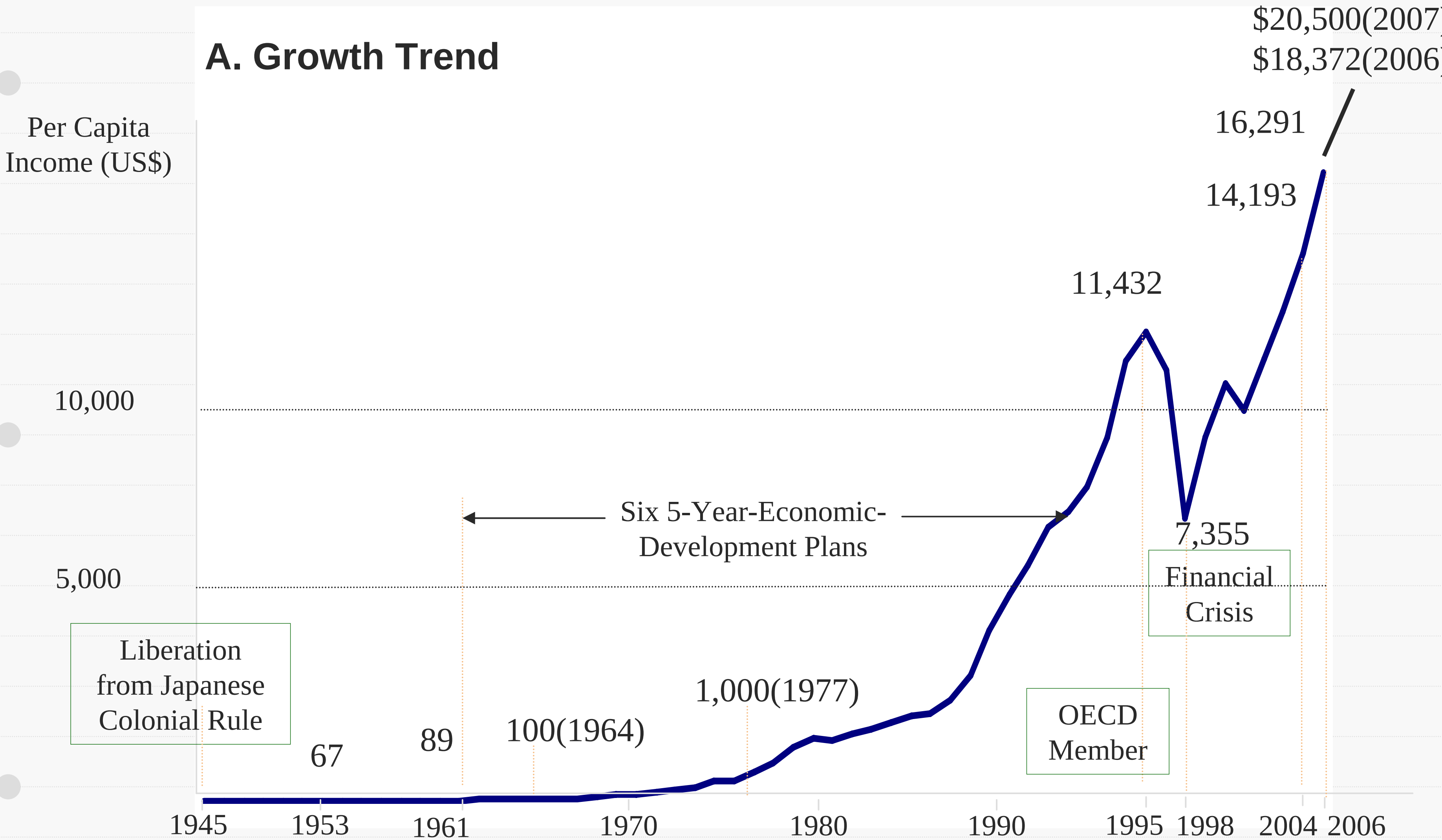
Ji Hong Kim

Part I: History of Economic Development

1. Transformation of the Korean Economy
2. Economic Take-Off with Outward Looking Strategy
3. Pitfalls of Government-led Development
4. Delayed Economic Reform and Financial Crisis

1. Transformation of the Korean Economy (1945~2006)

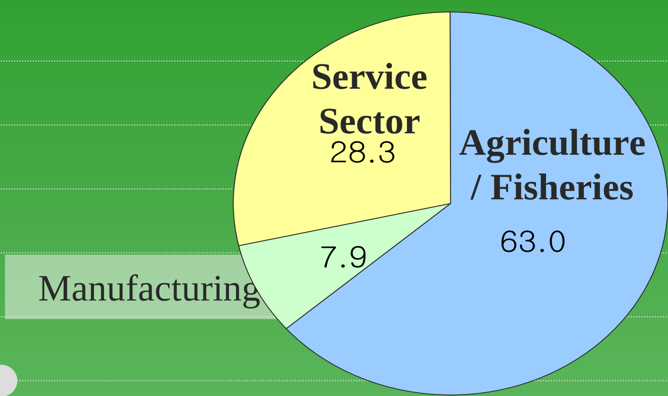
A. Growth Trend



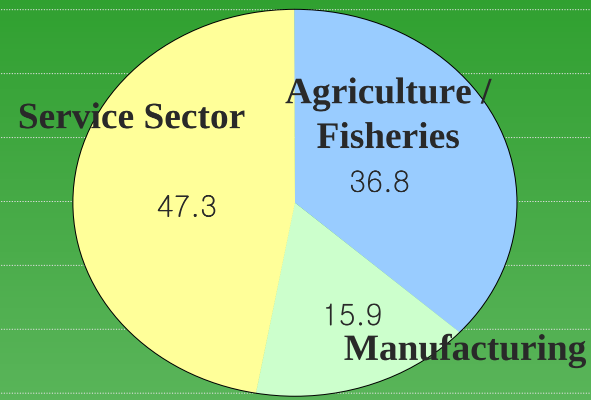
Source : Bank of Korea

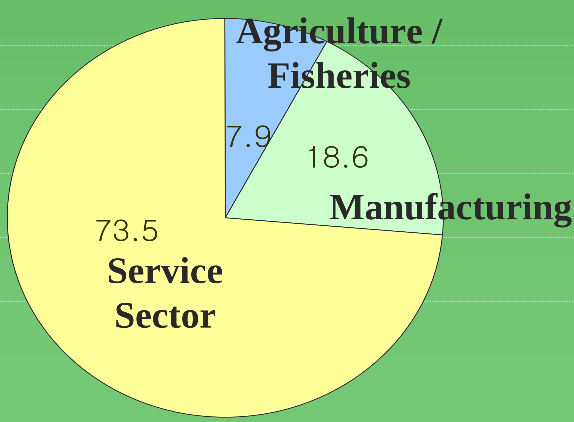
B. Changes in Industrial Structure

Changes in Employment Structure | **Changes in GDP Structure**

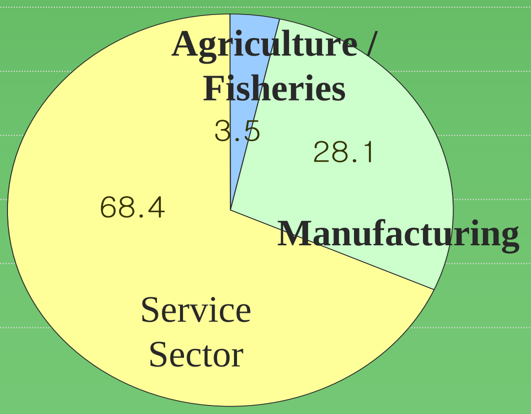


1960





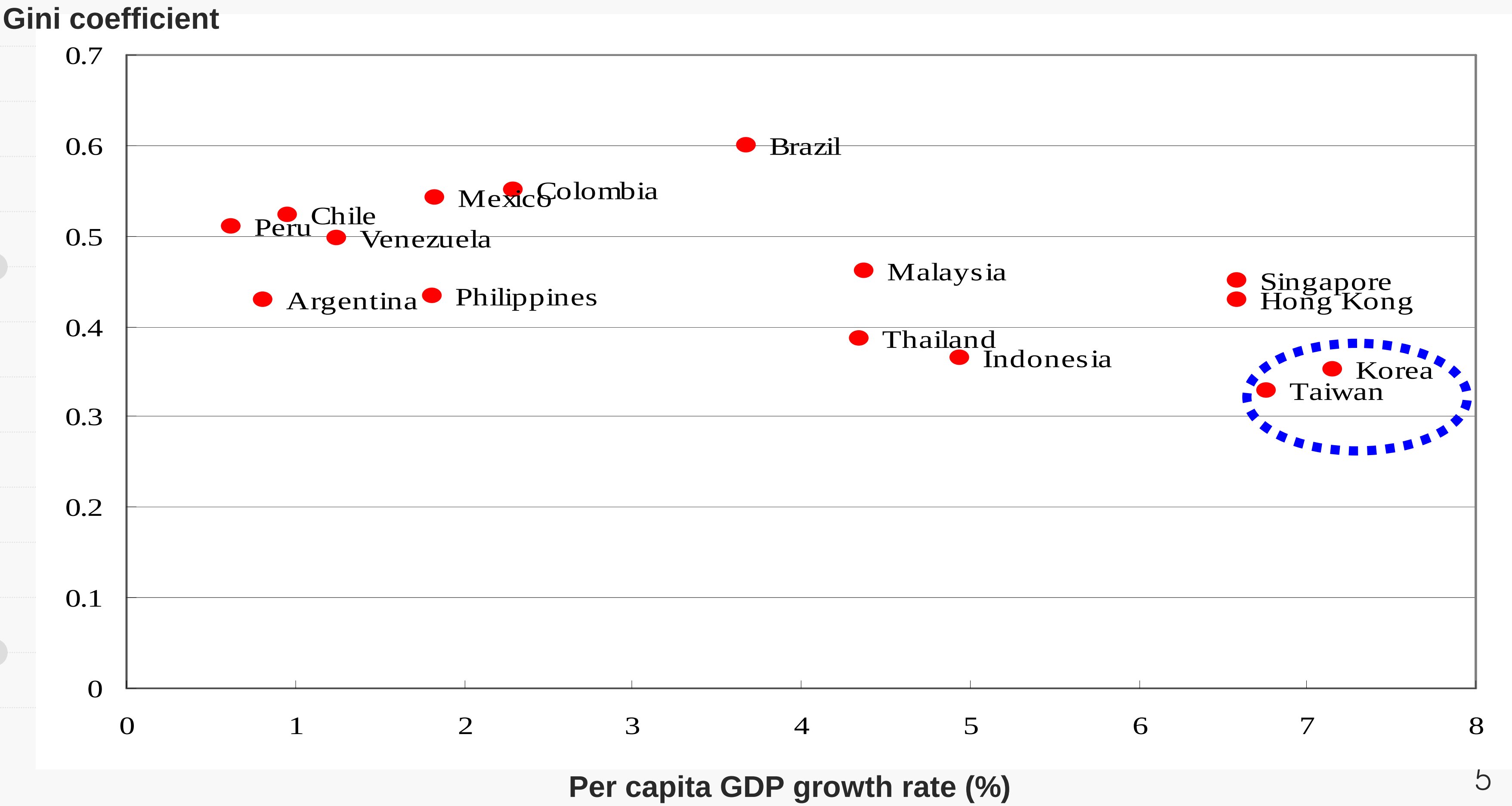
2005



C. Equity

Korea has been cited as one of successful countries with relatively low income inequality and rapid growth.

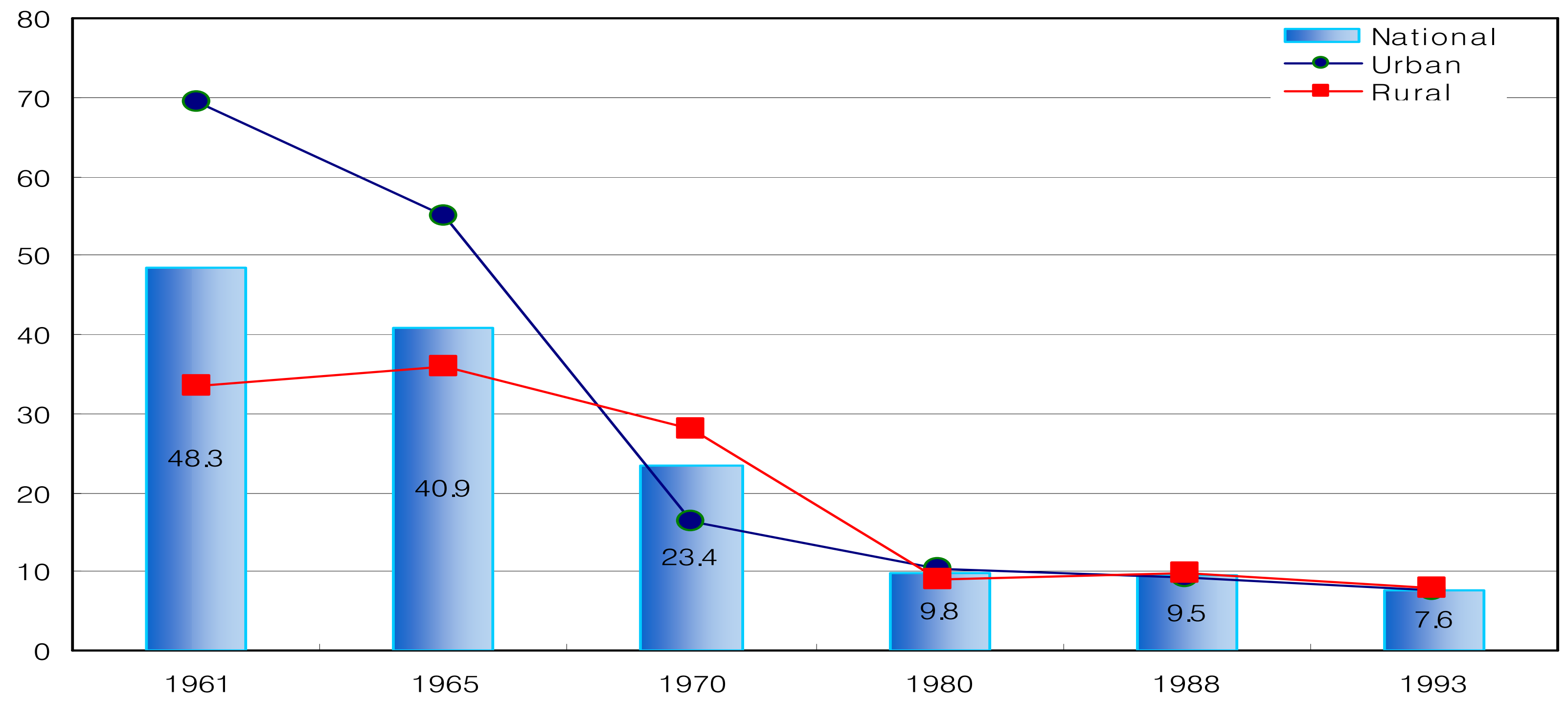
<Gini coefficient and GDP per capita growth rate: 1965-1990>

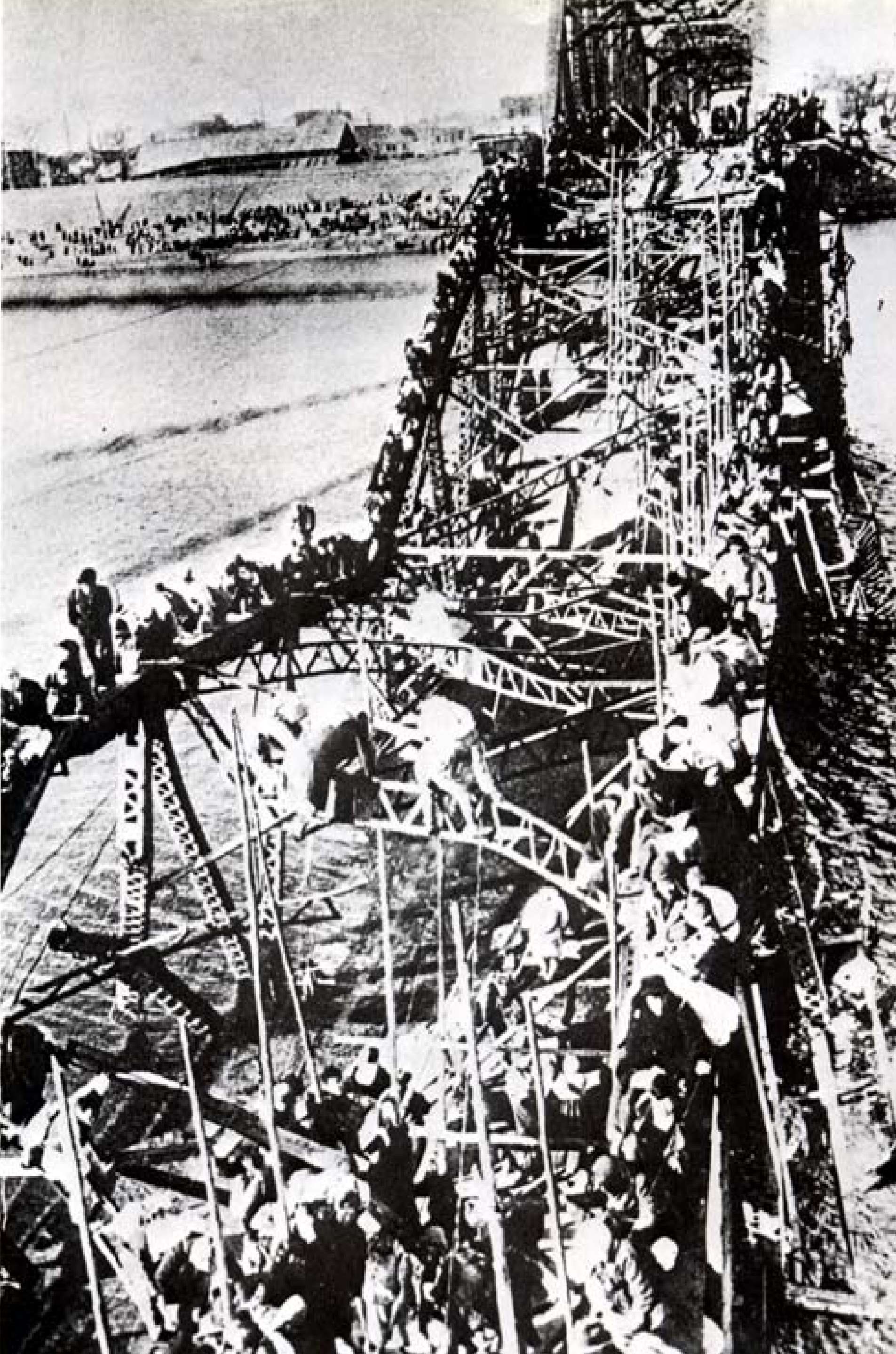


D. Reducing Poverty

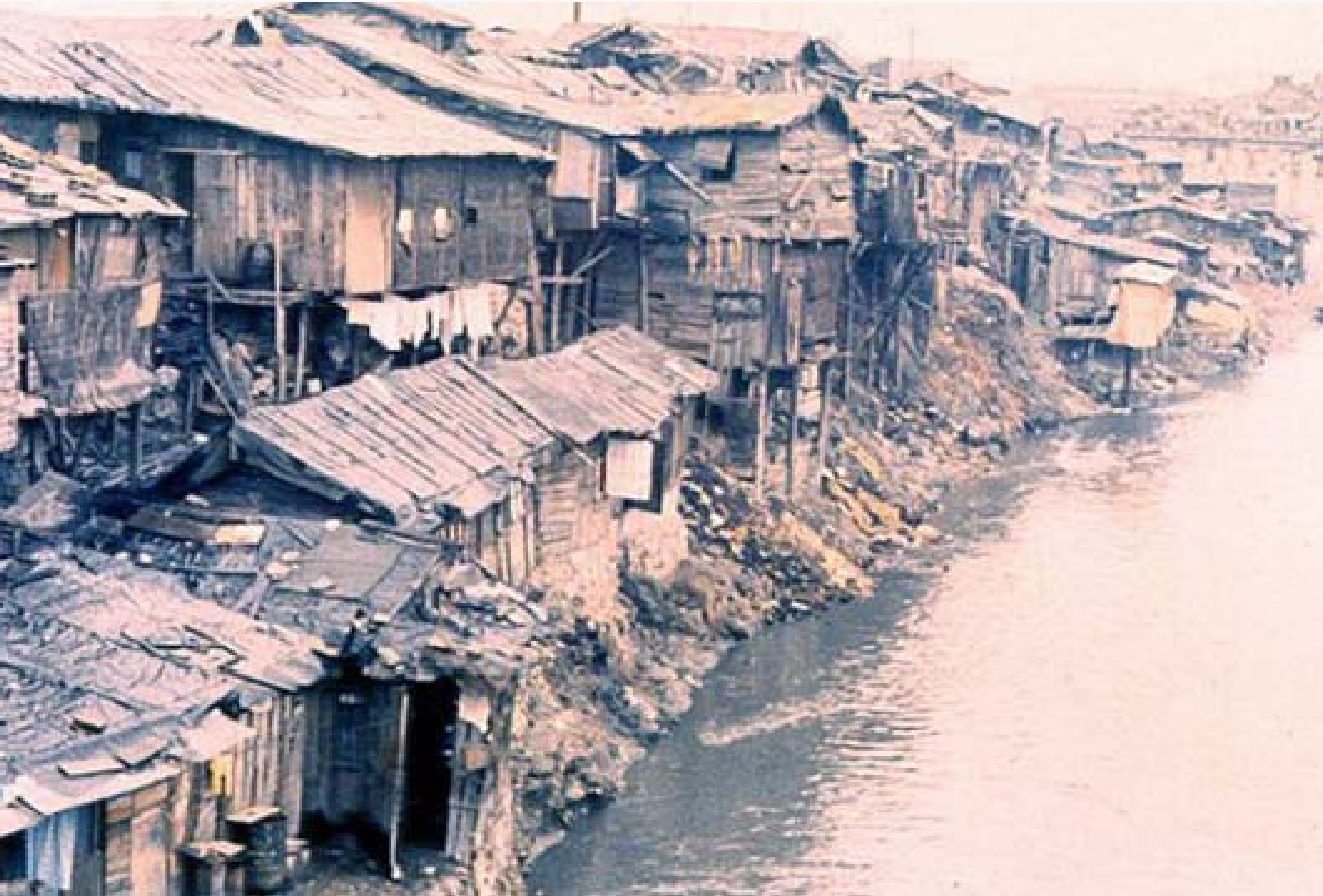
Absolute poverty declined steeply from 48% in 1961 to less than 10% entering 1980s.

<Absolute Poverty (%) : 1965-1993>





<Cheong-Gye-Cheon Stream in the 1950s>



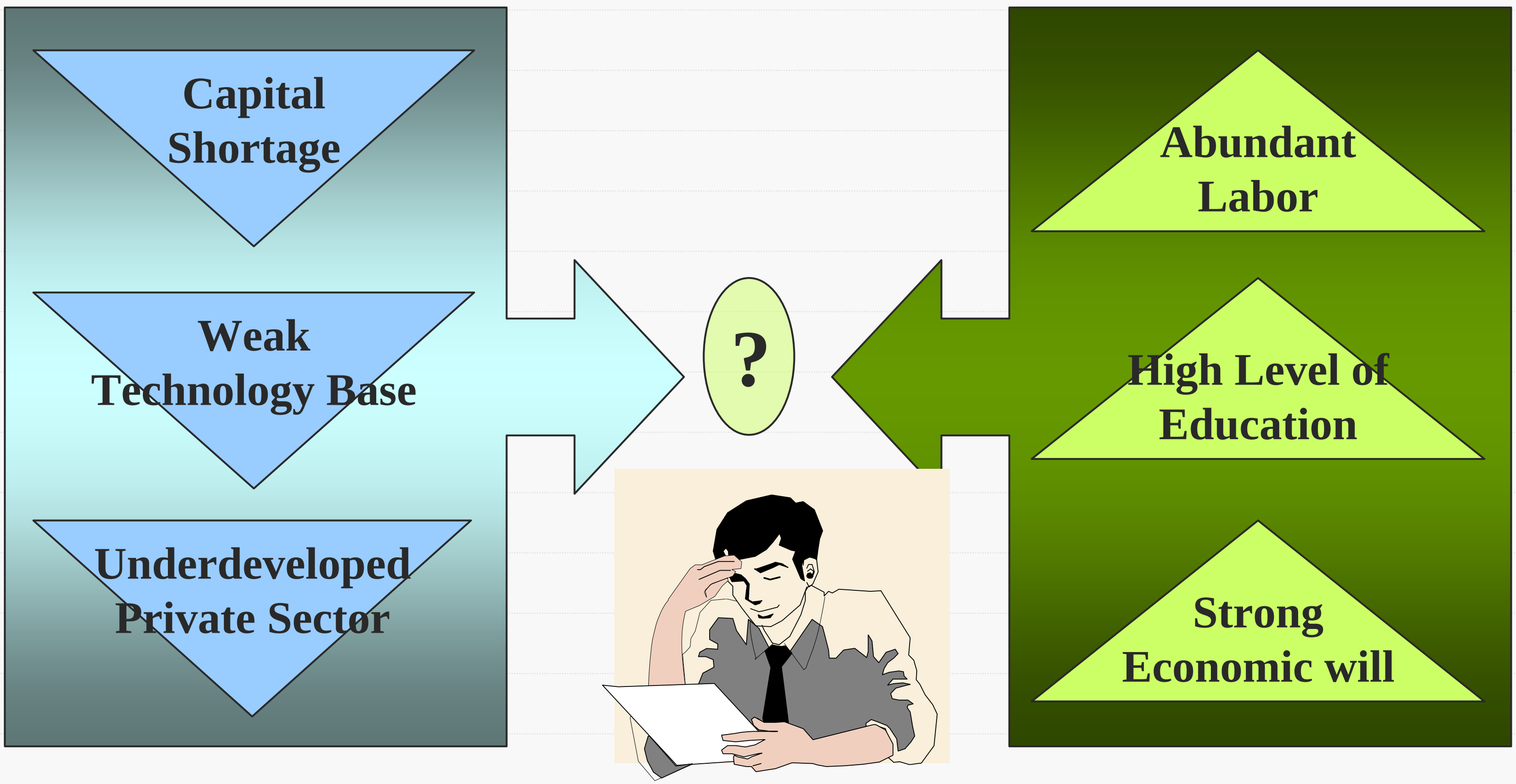
<Cheong-Gye-Cheon Stream, today>

☐ Bird-Eye View of Korean Economy (1962-2005)

	1962	1992	1997	2005
Economic Development				
Per Capita GDP	$87 (101st)	$7,527	$11,176	$16,291 (29th)
Investment (% of GDP)	13.8	37.3	36.0	30.1
Exports (% of GDP)	5.1	26.6	32.4	42.5
Imports (% of GDP)	16.8	27.7	33.0	40.0
Social Development				
Life expectancy at birth	55	72	74	77
Infant mortality rate (per 1000 births)	90	8	5.8	-
	1970	1980	1990	2000
Years School	5.7	7.6	9.5	10.6
Middle school enrollment ratio (%)	51.2	95.1	98.2	99.1
High school enrollment ratio (%)	28.1	63.5	88.0	96.4
Tertiary school enrollment ratio (%)	8.4	15.9	37.7	80.5

2. Economic Take-off with Outward-looking Development Strategy(1960~80)

- **A. Economic Conditions of the early 1960s:**
  War-torn & divided with $89 in1961(101st out of 125 countries)
  Vicious Cycle of low savings and low growth



Note 1:Basic philosophy of the 5-year plan:
five principles!

① Korean economic development should be achieved through industrialization

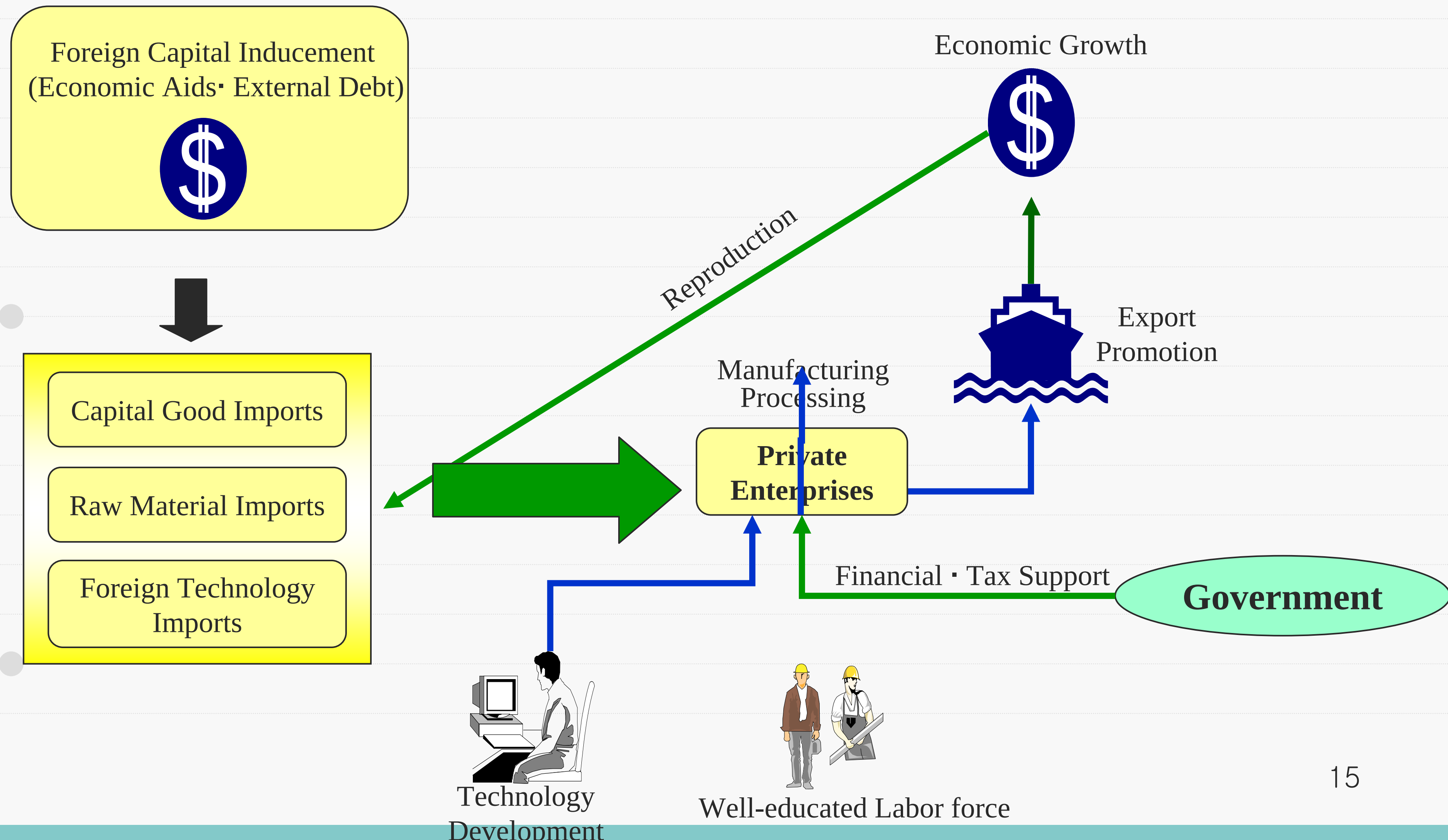
② Economic development should be achieved under government control and leadership

③ Although firms should be owned and managed privately, the government could implement private decisions in the case of major investments *("a variant of authoritarian capitalism", Cho Soon)*

④ To finance investments, foreign capital inflows should be induced

⑤ Growth should have a higher priority than redressing imbalances in income distribution and unevenness in industrial development across geographical regions

B. Working Mechanism of Outward-looking Development Strategy



C. Educating Manpower

Broad access to education raised level of manpower

Promoting engineers and skilled workers

- Technical and vocational schools were established
  * Kum-Oh Technical High School (1972)
    - State-of-the-art equipments for practical training were imported from Japan and Japanese teachers with technical know-how were recruited between 1972-76.
    - In 1976, among 400 new students, more than half were top graduates from middle schools in Korea
- Technical licensing and certification system were introduced

Korea excelled in International Vocational Training Competition (the Vocational Olympics), wining nine times in a row during 1977-1991.

[Reference 1] Education & HRD in Korea : Attainments

- **Quantitative profile** now: impressive; well above the OECD average

  - Education up to college level almost universalized

    * College Advancement > 80 %; (College Entry/ HS graduate near 100 %)

    * Net Enrollment for the aged 18~21 = 41%, (No. 5 in the World)

- Superb **academic performances**: global leader position (TIMSS, PISA etc.)

Size and Composition of Educational Investment (2000)

(Unit: %)

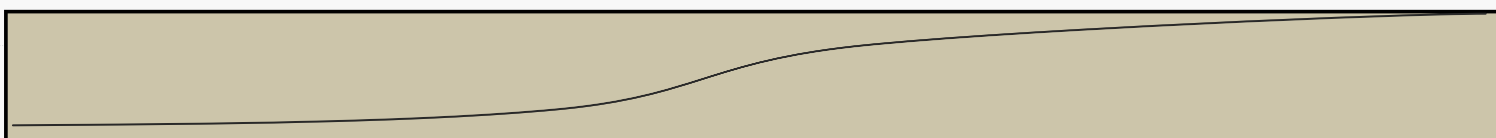
	OECD AVG	**Korea**	U.S.	JPN	UK	Germany
GDP share	**5.5**	**7.7**	7.0	4.6	5.3	5.3
(Public-financed)	**4.8**	**4.9**	4.8	3.5	4.5	4.3
(Private-financed)	**0.6**	**2.8**	2.2	1.2	0.7	1.0

OECD, *Education at a Glance 2003* *(Korean figures are for 2003)*

[Reference 2] S&T Policy

	1960s	1970s	1980s	1990s	2000s
Development Stage	Factor-Driven Stage (1960s–1970s)	Investment-Driven Stage (1970s–1990s)		Innovation-Driven Stage (1990s–2000s)	
Sources of Competition	cheap labor	manufacturing capability		innovative capability	
Major Direction of Industrial Policy	**Expand export-orient light industries**	**Expand heavy and chemical industries**	**Expand technology-intensive industries**	**Promote high-technology innovation**	**Transition to knowledge-based economy**
S&T Role of Government	**Scientific Institution Building** - MOST/KIST - S&T promotion act - 5-year economic plan includes S&T	**Scientific Infrastructure Setting** -GRI -Daeduck sci. town -R&D promotion act -KAIST:highly qualified personnel	**R&D and Private Research Lab Promotion** - NRDP - Promoting private research labs - Promotion of industrial R&D	**Leading Role in Strategic Area** - Enhancing Univ. reseach capability - Promoting co-op research - Policy coordination - GRI restructuring	**New Challenges**

Innovative Capability of Private Sector



Note 2: Korean economic miracle: OECD Economic Surveys

Three distinctive characteristics

ⓐ an outward-oriented development policy based on the expansion of exports

- to overcome lack of natural resources and small domestic market
- the reform of its exchange rate policies was a key
  - devaluation by 50% in 1964
  - the complicated multiple exchange rate system was replaced with a single rate
- tax exemptions and preferential access to credit
- export-promotion policies did not distinguish between industries except during HCI (Heavy & Chemical Industry) Drive

ⓑ macroeconomic stability

- sound fiscal and monetary policies

- a high level of government saving to finance public infrastructure and to provide credit to targeted sectors ⇒ made the government a net creditor

ⓒ investment in physical and human capital

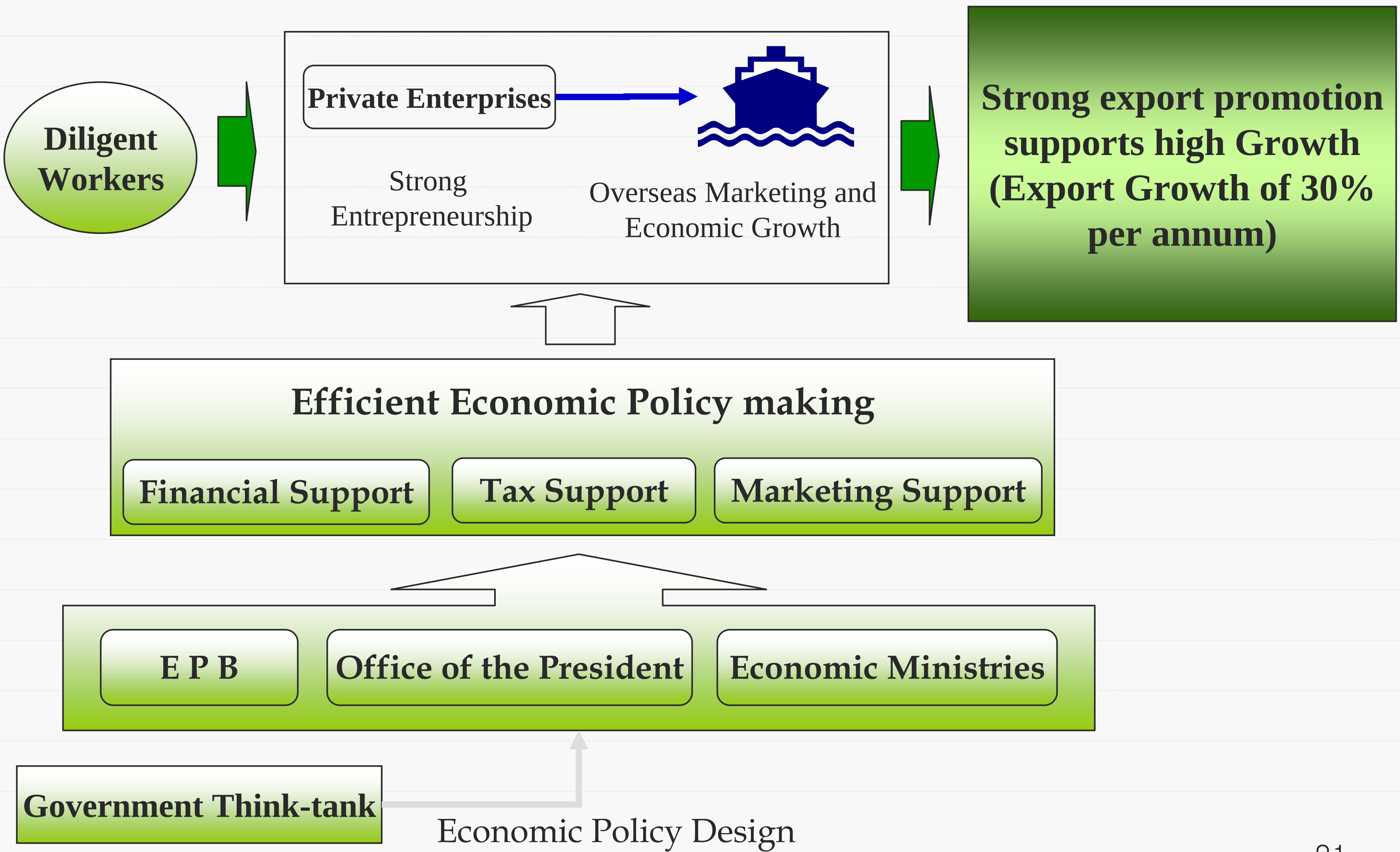
- well-educated, the literacy rate was 71% in 1960, compared with an average of 29% in other low income countries
- the high level of education in Korea has enabled it to take advantage of technology transfers
- the combination of well-educated labor force and a small stock of physical capital made the return on investment high!

 - this boosted fixed capital formation from less than 10% of GDP in 1961 to 30% in 1980

- the socialization of risk: an implicit guarantee

-**Social capital: trust, stable legal system, ownership, etc**

D. Continued High Growth Based on Strong Entrepreneurship and Government Support



Note 3: Institutional arrangements

- **EPB (Economic Planning Board)** was established in 1963 by absorbing the budget bureau from MOF and statistics bureau from the Ministry of Home Affairs

  ⦿ BOK (Bank of Korea) under its control
- Commercial banks were brought under gov't control by confiscating the stocks of the banks
- Three major administrative instruments to support EOI (export-oriented industrialization):

  ① the government export targeting system

  ② the support of the government-owned Korea Trade Promotion Corporation (KOTRA) for overseas marketing activities

  ③ Monthly Export Promotion Conference presided by the President
- Ignited **the people's "will to economize"**

Policy coordination and close consultation between the government and private sectors

- **Monthly Export Promotion Meeting led by the President to monitor export performance, and to reward best performers**
- **Relevant ministers, representatives from business, and banks participated in these meetings to review export trends and to resolve problems encountered by exporters.**

  - If some projects were found to be lagging behind schedule, the causes of the delay were analyzed and a decision on corrective action was taken, often on the spot.

  - One result was that every official had to be alert to ensure that a project on his authority did not become an object of negative attention at the meeting and in the presence of the President.

- **By doing so, this led to vision sharing among government and private sector that allowed better policy coordination**
- ***Monthly Export Promotion Meeting* helped review both bureaucratic and firm performance (Pragmatic and Flexible).**

E. Dynamism of Agricultural Sector

Green Revolution of the Agricultural Sector

- Government support in agricultural research and investment irrigation and forestry sectors.

  * Developed new variety of crops, built dams on major rivers

Saemaul (New Village) *Movement* (rural community development program) to improve income as well as living conditions

- Diligence, self-help, and cooperation were three pillars of the Movement

Rising productivity in agricultural sector

- Between 1970 and 1977 the rice yield per hectare rose from 3.5 tons to 4.9 tons
- Income distribution between farmers and urban workers had improved from the mid 1970s.

Note 4: Agricultural Policy and "Saemaul" Movement

- Between 1960 and 1979, Employment (60%→36%) and GDP (39%→19%) share of **agriculture declined** thus for a **more balanced growth:**

(1) a shift from low grain-price policy to **high grain-price policy:**

① to increase grain production

② to alleviate income disparity — a two-tier grain price system

(2) the **Saemaul (new community) movement** in 1972 (a massive investment in rural infrastructure): a social movement to reform the farmers' way of thinking and living,

① rural enlightenment,

- the spirit of self-help and cooperation, voluntary participation

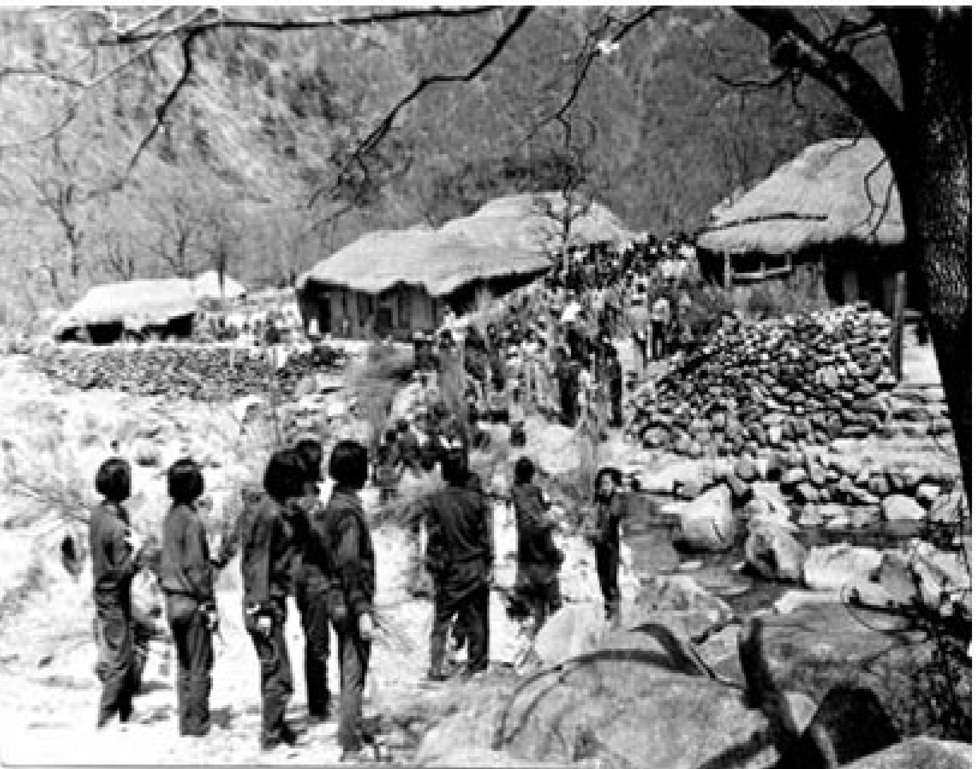
②social development

- environmental improvements, housing improvements, public utility expansion

③ economic development

- buildup of the production infrastructure, income augmentation program







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F. Heavy and Chemical Industry Development during 1970s

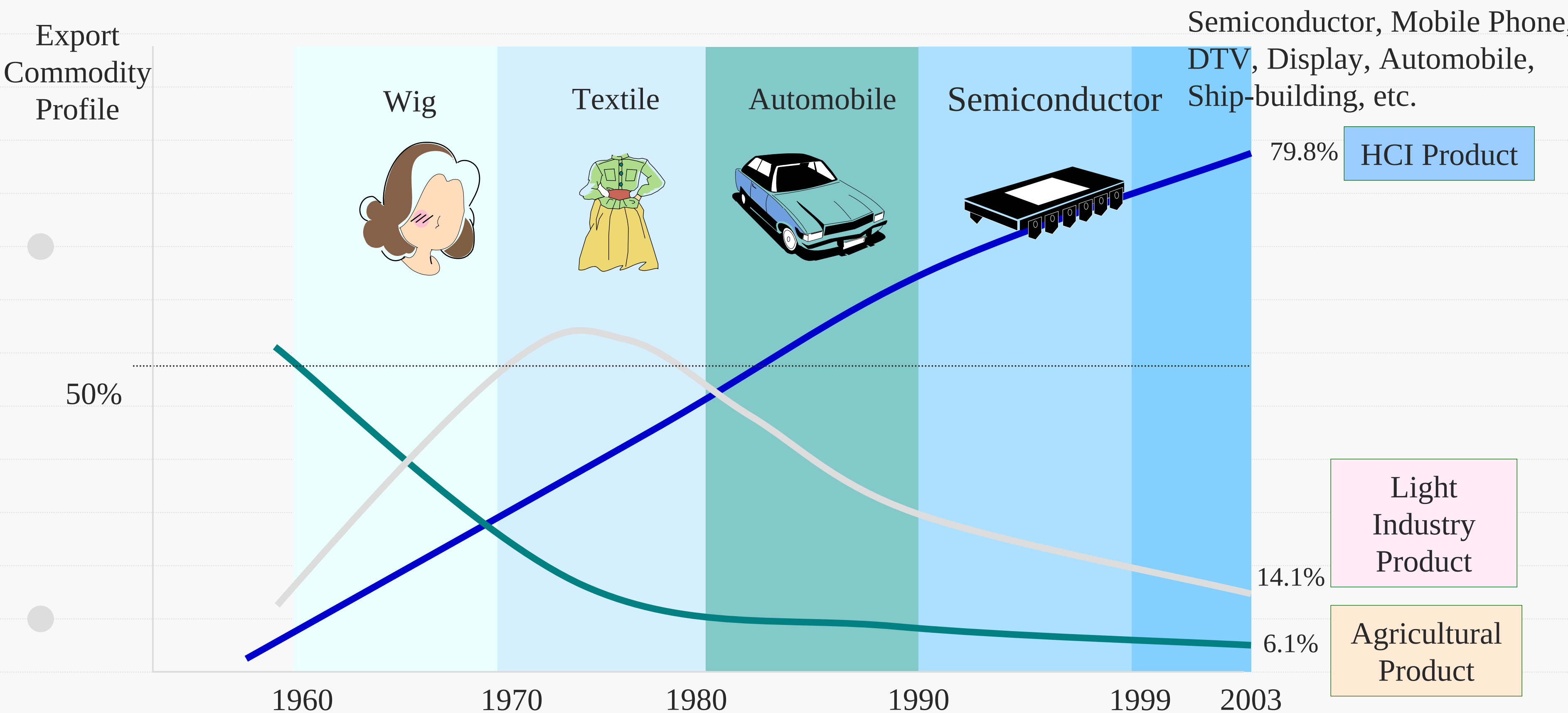
Policy Change Toward Heavy and Chemical Industry Development

- **Iron and Steel**
- **Electronics**
- **Petro-Chemical Products**
- **Automobile**
- **Ship-building**
- **Machinery**

- Mobilizing Financial Resources
- Selecting National Champions ("Chaebol")
- Accelerating Competition

From Agriculture to Manufacturing/ From Light Industry to Heavy Industry

Changes in Export Commodity Profile



G. Participation in the Global Economy

1. **Globalization provides immense opportunities and significant risks**
   - Outward-oriented strategy
   - Integrated approach of multiple tasks
   - Optimal level of Openness (geographic condition, policy factors, institutional factors)

2. Korea is an example of **economic dynamism and successful globalization (entrepreneur & GATTs)**

3. **Institutional preconditions & institutional reforms**
   (formal & informal rules of games)
   - Committed and credible government
   - Merit based bureaucratic system without corruption
   - Interaction between the public and private sectors
   - Secure property and contract rights

Lessons from Korea's Experience

Korea's performance of the growth with equity.

Major contributing factors for shared growth were:

- Export promotion policy : Growth with job-creation, initially led by **labor intensive export promotion**
- Broad access to education and raising technical know-how
- Leadership – **vision sharing** between government and private sector, and **political stability**
- Promoting spirit of **self-help:** ***Saemaul movement*** and workfare
- **Pragmatic and flexible policy approach**

3. Pitfalls of Government-led Development and Changes in Development Strategy(1980~2000)

A. Pitfalls of Government-led Economic Development

Financial Suppression Due to Prolonged Government Intervention

Over-investment in HCI

Inefficient Resource Allocation

- Increased Production Cost
- Efficiency Loss
- Weakened Export Competitiveness

• 1979 : Negative Export Growth for the first time since 1960

•1980 : Negative Economic Growth(-3.9%)

B. Recovering Growth Potential with Economic Stability

Stabilization Policy in the early 1980s

- Budget Freeze/Cut Zero-Base-Budgeting
- Phasing-out of Policy Loans and Interest Rate Deregulation
- Investment Adjustment in HCI

Results

Disinflation	Inflation at around 3%
Strong Exports	Current Account Surpluses
High Economic Growth	GDP Growth of 8% per annum

Note 5: Economic Liberalization Policy

① Import Liberalization

- was proceeded on a stop-and-go basis but gained momentum in 1984: import liberalization ratio (=automatic approval items / total tradable items) was raised from 0.80 in 1983 to 0.99 in 1994.
- The average legal tariff rate was lowered from 24% in 1983 to 18% in 1988 and 8% by 1994.
- The nominal rate of protection (=the percentage difference between domestic and world market prices) was lowered from 21% in 1982 to 14% in 1990 for manufactured goods.
- In contrast, the rate for agricultural products rose from 72% in 1982 to 101% (note that this figure is 6 times the legal tariff rate) by 1990.
- Only after 1989, liberalization of agricultural products were made: from 76% in 1989 to 92% by 1994.

②Financial Liberalization

- the government attempted to reduce the intervention in the allocation of financial resources,

  From 1981-83,

- (1) commercial banks underwent privatization,

  (2) interest gap between policy loans and ordinary bank loans were almost eliminated in 1982,

  (3) entry barriers into the financial industry were lowered

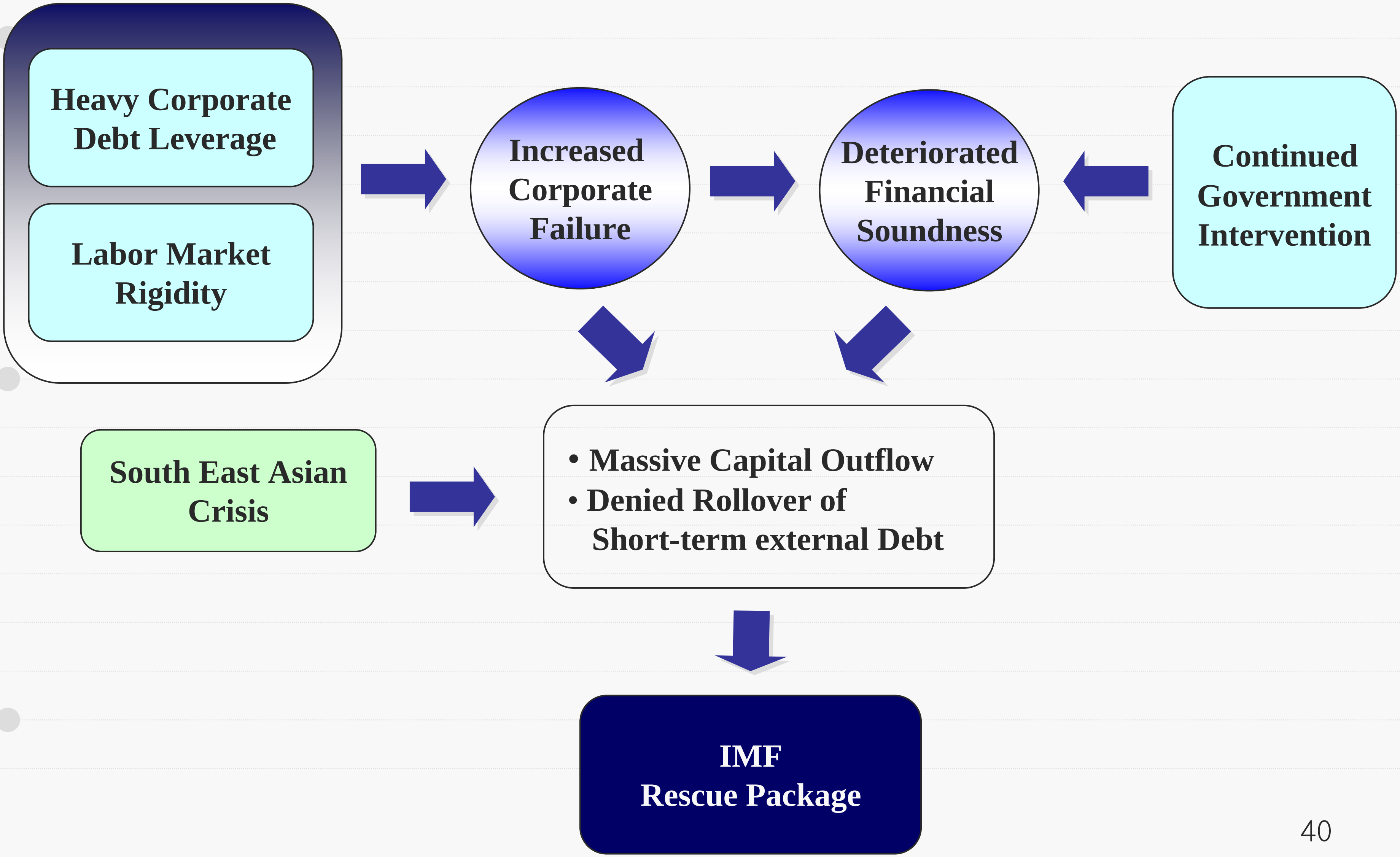
- Financial interrelation ratio (=total financial assets/GNP) rose from 2.4 in 1980 to 4.0 in 1990 and to 4.7 in 1994.

  (cf: 7.1 for Japan in 1993, 6.2 for USA in 1993, 5.7 for Taiwan in 1992)

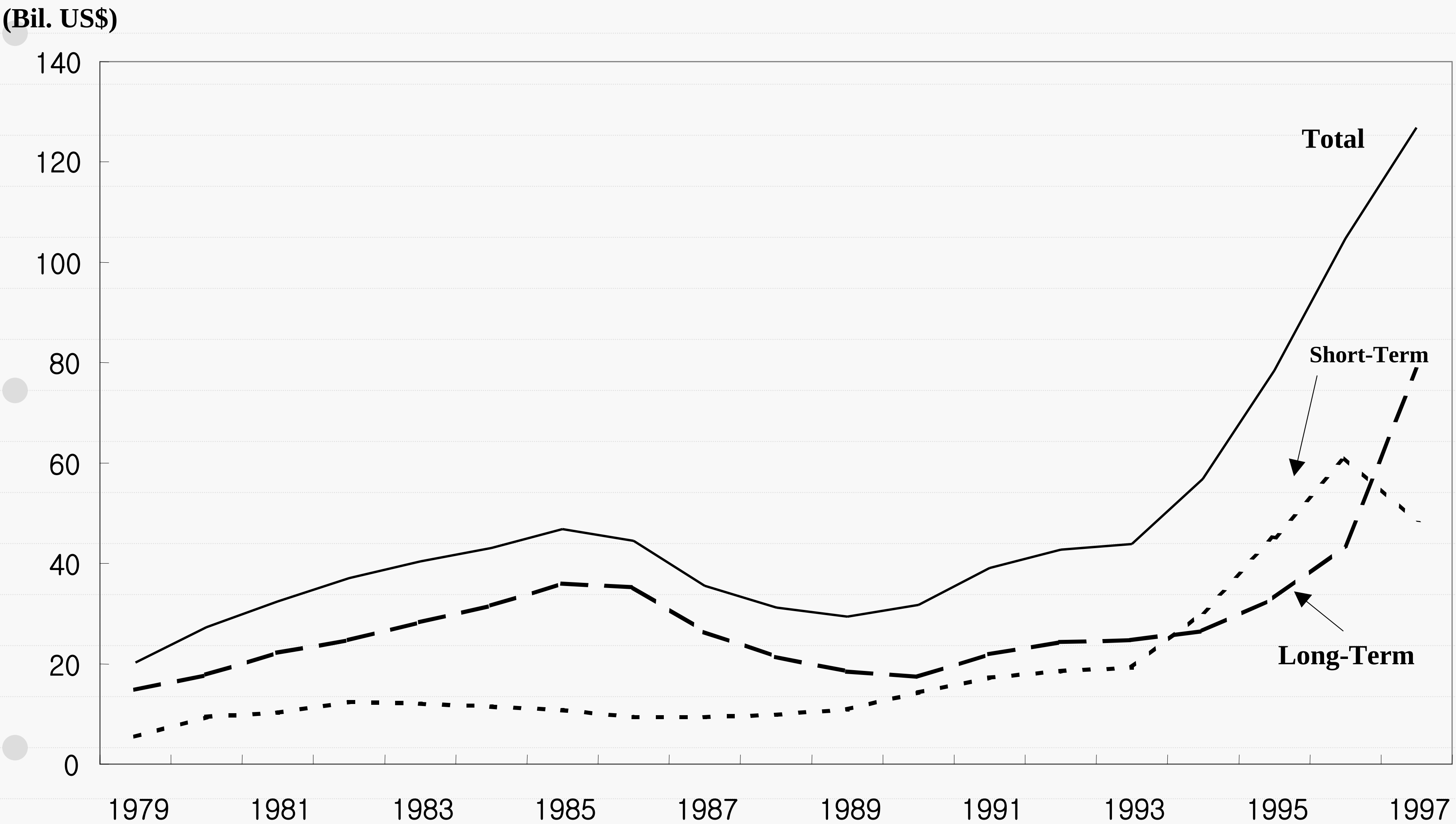
③ Opening of Capital Account

- Korea has always been a net capital importer, relied on foreign borrowing rather than on foreign direct investment as its financing strategy.
- Entering 1980s, government restrictions on FDI were relaxed: thus annual average of FDI increased from $130million in 1980-83 to $920million in 1988.
- Despite the liberalization on the inflow of FDI, its share in total fixed investments was a mere 0.3% on average in 1981-91, much smaller than 1.9% in the 1960s and 2.0% in the 1970s
- The fear of massive capital inflows: **relatively high interest rates and anticipated won appreciation**

4. Delayed Economic Reform and Financial Crisis in 1997



[Reference 3] Trend and Composition on External Debt



Part II: Economic Crisis Management

1. Government's Reform Efforts
2. Post-Crisis Economic Management
3. Sectoral Economic Reform Efforts

I. Government's Reform Efforts

(1) Korea's Reform Strategy: Full integration with the Global Economy

① Swift and Prudent Reforms
② A Coordinated, Multi-Faceted Approach
③ Preventing Moral Hazard
④ Maintaining Social Stability

(2) Korea's Financial crisis: key factors

① Shortage of foreign reserves
② Structural weakness
③ Failure to keep up with globalization trend
④ Moral Hazard Problems

(3) IMF Programs in Action

- Quarterly Review of Economic Policies, with room of flexibility
  ~ fiscal deficit / interest rate
- **IMF-Plus Package**
  ~ Elimination of trading band in the foreign exchange market
  ~ Allowance of hostile foreign M&As

(4) Result of Reform Efforts

- Financial and Foreign Exchange Market Stability
- Closure of Ailing Commercial Banks
- Elimination of Cross-Debt Guarantees
- Big Deals to Eliminate Excessive Corporate Capacity
- Abolishing of a Half of Government Regulation

II. Post-Crisis Economic Management

(1) The First Phase: Dec. '97 - Apr. '98

- Focus on securing foreign currency liquidity

~ IMF, IBRD, ADB / rolling over / sovereign bonds / current account surplus

- Nation-wide movement of "***gather-gold-for-export-and-repayment-of-national-debt***"

- Legal foundations for structural reforms

~ legislating reform bills / agreement bet. President and five ***chaebols*** / legal framework for layoffs

(2) The Second Phase: May - June '99

- Full liberalization of foreign hostile M&As
- Abolishing ceiling on foreign acquisition of real estate / limits on foreign stock investment
- Closing 55 non-viable corporations / 5 commercial banks

  * 64 trillion won program for NPL problem and recapitalization
- 8.5 trillion won for unemployment program

(3) The Third Phase: July '98 –

- BIS ratio satisfied after injection of 38 trillion for NPL
- Top five *chaebols*: to improve financial status
- Four mutual funds were established
- Economic stimulus package: fiscal deficit (GDP 5%)
- 10 trillion won program for social safety net
- FIPA: investor-friendly environment

III. Sectoral Economic Reform Efforts

(1) Financial Sector Reform: Bank and non-bank financial institutions

- Of the 25 commercial banks: 13 satisfied BIS ratios
- 12 unsound banks: 5 non-viable to be liquidated,

5 to take corrective actions

★Two remaining banks to be auctioned off:

♦ Korea First Bank to Newbridge Capital Consortium

♦ Seoul Bank to HSBC group (negotiation failed)

- Same method applied for non-bank financial inst.:

→ licenses revoked for 36, suspended for 55

<Fiscal support for financial restructuring>

- Unsound credit: 136 trillion Won (NPLs: 63.5 Won)
- **KAMCO** purchased banks' NPL at market value, by paying in kind (KAMCO bonds):
  ※ in '98, issued bonds (19.9 tril. Won) to purchase banks' NPLs (44 tril. Won)
- **KDIC:** issued bond (21 tril. Won) for recapitalization and depositor protection
- Additional bond issuance (23.1 tril. Won) by KAMCO and KDIC in '99 to make a total of 64 tril. Won
- Fiscal resources through **government-guaranteed public bonds**

<Capital Market Liberalization and FDI Promotion>

- Eliminating foreign equity ownership ceilings
- Full liberalization of foreign exchange transactions
- Hostile M&As by foreigners were allowed
- Legal basis for FDI: FIPA
- One-stop service at KOTRA
- Industries further liberalized: only 31 out of 1,148 industries partially or fully closed to FDI
- Tax exemptions and reductions

[Reference 5] Changes in the Number of Korea's Financial Institutions, 1997-2001

	Banks	Merchant Banking Corps.	Securities Cos.	Invest. Trust Cos.	Life Insurance Cos.	Damage Insurance Cos.	Mutual Saving Banks	Credit Unions	Total
End-1997	33	30	36	31	31	14	231	1,666	2,072
Exits (-)	5	22	6	6	7	1	95	305	447
Mergers (-)	8	6	1	1	5	0	26	102	149
Entries (+)	0	1	17	6	0	1	12	9	46
End - 2001	20	3	46	30	19	14	122	1,268	1,522
Net Changes (1997-2001)	-13	-27	+10	-1	-12	0	-109	-398	-550

Source: Financial Supervisory Service

(2) Corporate Sector Reform

- *Chaebols*: required **to eliminate existing cross-debt guarantees**
- Exit of 55 non-viable firms: denying new credit and cross-subsidy bailout for effective exits
- Corporate workout programs: IBRD to provide expertise
- Big deals: core competencies, reducing excessive capacity, creating efficient management structures
- **Fair Trade Commission**: concentration of economic power / preventing moral hazard

<Reform Agenda: agreed between top five chaebols and creditors>

- Adoption of combined financial statements
- Compliance with inter'l standards of accounting
- Reinforcing minority shareholders' voting rights
- Mandatory appointment of outside directors
- Establishment of external auditors committee
- Prohibition of cross-subsidiary debt guarantees
- Resolution of all existing cross-debt guarantees

(3) Labor Sector Reform

- Establishment of Tripartite Commission
- Enforcement of **New Labor Standards**

~ Layoffs due to managerial difficulties are allowed

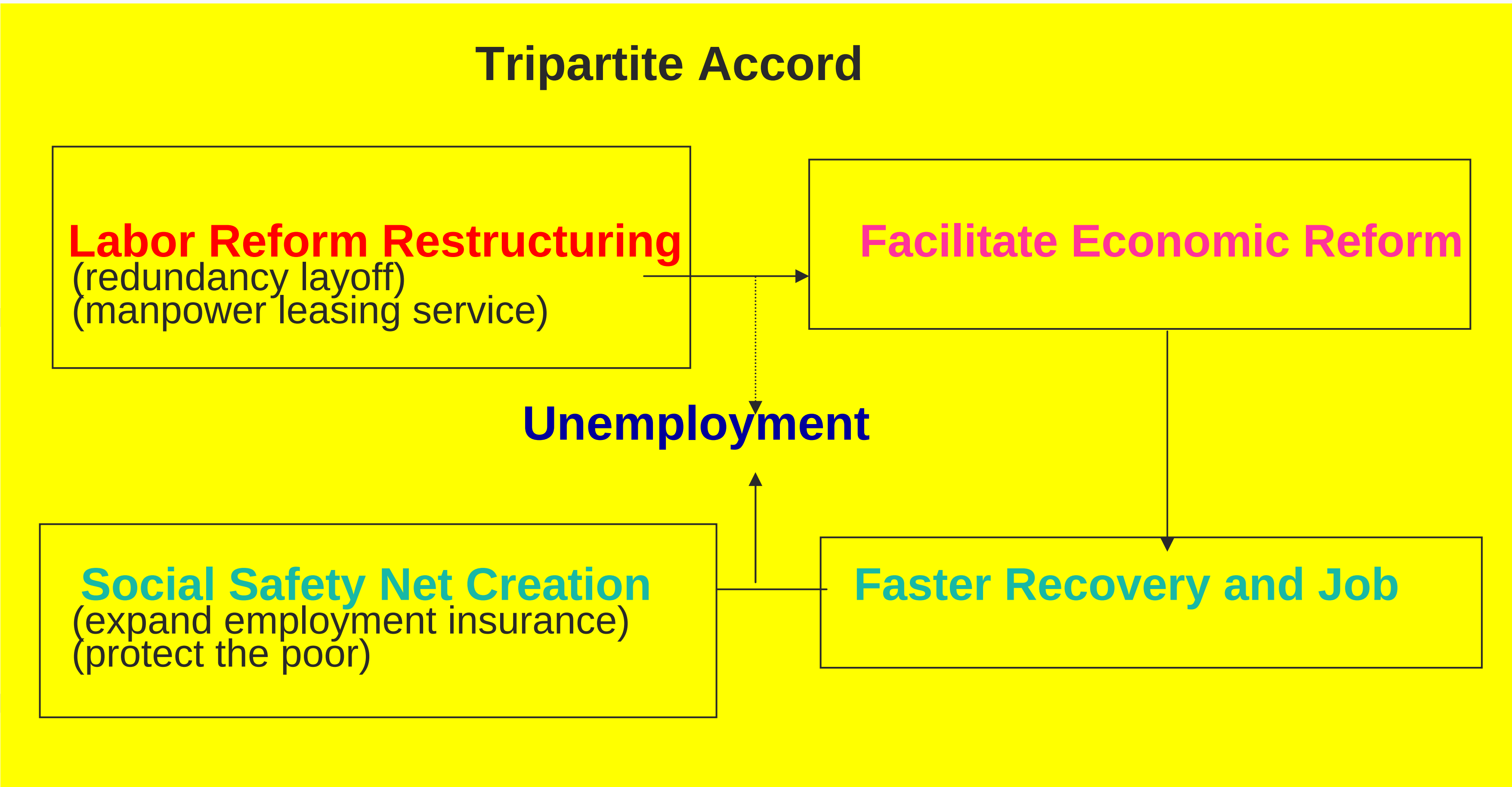
(32% employment cut at 9 banks)

- Introduction of a **Manpower Leasing System**

~ Employment outsourcing services for 26 occupations

(390 companies were established)

Reform Efforts: toward a more flexible labor market



Note 6: Tripartite Commission

⇒ Labor leaders, business leaders and public officials

⇒ Corporate governance, unemployment benefits, labor market flexibility

⇒ The Tripartite Accord contains 90 detailed measures for economic restructuring process

⇒ Market-oriented economy with cooperative industrial relations

(4) Public Sector Reform

- **Government reform: smaller but more efficient**
  ~ Central gov't: emp. reduction by 11%
  ~ Local gov't: jobs to be cut by 12%
- **Reform of state-owned enterprises**
  ~ 20 out of 109 were privatized in 1998
  ~ 89 subsidiaries subject to privatization and management reform
- Regulatory reform: Regulation Reform Committee abolished 4465 out of 11,125 total gov't regulations
  ~ abolished 23 and revised 248 laws

(5) Summary: Swift Crisis Resolution and Economic Recovery

Crisis Resolution Measures

- **Cleaning up Nonperforming Loans**
- **Expanding Social Safety Net**
- **Reducing Moral Hazard**
- **Improving Corporate Governance**
- **Accelerating Liberalization**

Results

1
- **Early Graduation from the IMF Program**
  - Foreign Reserves of more than US$100bn

2
- **Rapid Economic Recovery**
  - GDP Growth: 1998 -.67% → 1999 10.7%

3
- **Social Stability with Productive Welfare System**

6) Policy Issues of Korea

- *To overcome* **xenophobic attitudinal aspect** *and* **lack of global perspective of economic agents**

<Public sector reform>

- reforming quasi-government sector
- strengthening regulatory reform (OECD guideline)
- changing administrative practices of public servants

<Financial sector restructuring>

- making bank governance and capitalization stronger through foreign competition
- securing qualified human resources for financial supervision

<Corporate sector reform>

- changing role of gov't: regulations to be imposed not on the outcome but on the mode of activities
- big deal versus market economic functioning

<Labor market reform>

- layoffs and manpower dispatching to be in practice
- dialogue between Management and Labor Union to be promoted
- creating employment opportunities: mismatching to be reduced

- ***Drive for economic reform will continue.***

Part III. Implications for Africa

1. Duplicability of Korean Experience
2. Issues for Economic Management
3. Recommendations & Action Plan

Context of Korea & Africa:

Korean experience can be only good references.

Korea in 1960s

- GATT system
- Expand exports while protecting domestic market
- No China Factor
- Easy access to Tech
- Low Capital Cost
- Fixed Exchange Rate

Africa in 2000s

- WTO system
- No free lunch
- China : factory of labor intensive manufacturing
- Tech protectionism
- Global capital market
- Volatile Foreign Exchange Rate

Global context in 2008

- The Sub-prime Mortgage Market crisis made Investment Bankers to record losses and to pull back their portfolio from the third world countries (Eastern Europe, Asia, etc).
  (ex) BearStern, BNP Paribas, Societe General
- Difficult to attract FDI
- High commodity price implies stagflation or global recession.

Domestic Context

- Weak education system, Low human capital
- Low domestic saving ratio
- Weak Financial System
- Concentration on a few sectors/commodities
- Lack of Infrastructure

- Weak entrepreneur
- Unstable macro economy
- Social instability (inter-racial & class conflict

2. Issues of Economic Management

- Priority among Economic Goals
  :External Balance (FX), Inflation, employment, growth, equity

- Speed of Resource Mobilization & Adjustment

Market Driven (US)	Government Driven (Korea)
Slow	Fast
Low cost, fair	High cost, effective
Loss burdened by Entrepreneur	Loss burdened by government

- Formal vs Informal Adjustment
  -Formal : law & regulations or court decision
  -Informal :private restructuring, government guideline

2. Issues of Economic Management

- Tools
  : FX rate vs Interest rate
  : Tight vs Loose Monetary policy
  : Domestic saving vs Foreign saving
  : Loss sharing rules (Risk partner?)

- Public enterprise or Private firm
- Bail-out vs Restructuring
  :efficiency criteria

- Internal vs External Stability
  :Appreciation vs depreciation of FX rate

3.Recommendation & Action Plan

- **Build Infrastructure project** (highway, power plant, dam, etc) :can be financed by FDI or government bond.
- **Stable Macro Economics**: Make FX rate more flexible
- **Investment on Human Capital and Entrepreneur**
- **Encourage FDI & Domestic Savings**
- **Institutional Building** (formal & informal rules of game)
  - Committed and credible government
  - Merit based bureaucratic system without corruption
  - Interaction between the public and private sectors
  - Secure property and contract rights