

Lecture I

**South Korean Economic Development:
from 1960s to today**

Lecture 1: South Korea's Economic Development from 1960s to 2000

South Korea's Economy in 1960s



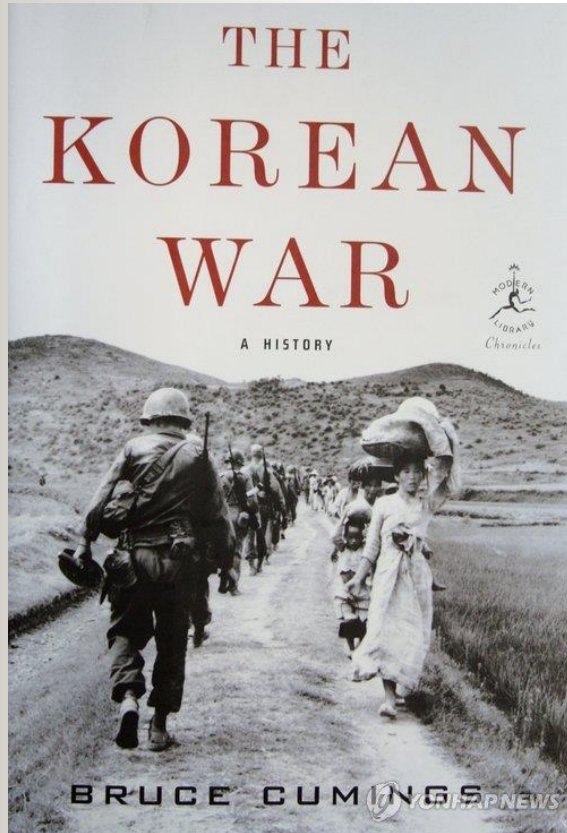


Korean Peninsula





The Korean War over 1950 to 1953





The Korean War over 1950 to 1953





The Korean War

Heungnam Retreat, 1953





The Korean War over 1950 to 1953





The Korean War over 1950 to 1953





Life after the Korean War





Life after the Korean War with Foreign Aid





Life after the Korean War with Foreign Aid





The Korean War over 1950 to 1953



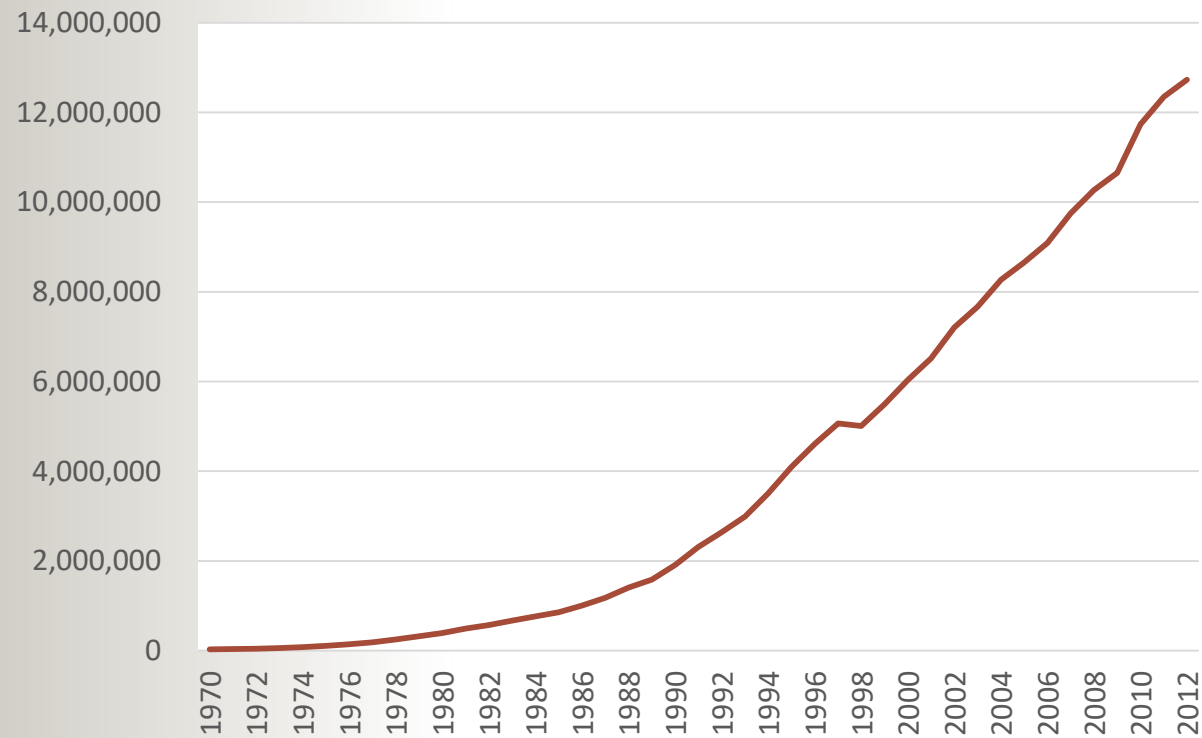


The Korean War over 1950 to 1953





South Korean GDP



Introduction

- Korean economy has achieved **unprecedented economic growth** in the last four decades.
- Over 1962 to 2014, the **average annual growth rate of RGDP** is nearly **8%** per capital **GDP** has increased from **\$87** to **\$35,400** (PPP based).
- The **manufacturing sector** has been grown from **14.4%** to **30.0% of GDP** and Korea is the **10th largest trading country** in the world today.

Introduction

- Main Factors of rapid growth
 - 1) iterate population
 - 2) strong leadership
 - 3) dynamic and forward looking **entrepreneurs** with **strong financial supports**
 - 4) **government's export oriented policies**
- Pressure from abroad to further open domestic market, democratic reform, substantial wage increases, deterioration of international competitiveness, and financial crisis of 1996 and 1997 and resulting restructuring

Export-led Take off in the 1960s

1

Establishment of Economic Development Plans

- Pop growth 3%, widespread unemployment, agricultural sector constituted 2/3 of labor, zero savings, and income/person \$80.
- **New political leadership** strongly committed to economic development and adopted outward-looking growth strategy which was appropriate for small economy with abundant labor and without natural resources.
- Five-year economic development plan
- Economic Planning Board

Export-led Take off in the 1960s

2

Increased Tax Revenues



- **Establishment of the Office of National Tax Administration:**
To increase tax revenues, taxes on luxury items, business income, high personal income, and inheritance were raised.
- **Tax revenue increased** 9.7% of GNP (1961) to 14.8% of GNP (1970).

Export-led Take off in the 1960s

3

Changes in the Financial Sector



- Allocation of real resources by intermediating financial resources between savers and investors
- Fin sector is the most heavily regulated industries in developing countries.
→ *Korea was no exception*
- Korean government induced private investment in strategic sectors.
- Commercial banks were nationalized in 1961.

Export-led Take off in the 1960s

3

Changes in the Financial Sector

- **Specialized banks** were established by the individual ad hoc acts rather than general banking act.
→ *Small & Medium Industrial B, Citizens National B, National Agricultural Cooperatives, Korean Exchange B, Korea Housing B, Export-Import B of Korea, Korea Trust B, and Korea Development B*
- In 1974, by the contribution of deposit money banks, government established **National Investment Fund** for heavy and chemical industry.
- **Local Bs system** was from Daegu B.
→ *amounts to 10 local banks.*



Govnt's Strong Initiative on Saving Increase in the 1960s



Export-led Take off in the 1960s

4

Inducement of Foreign Loans

- Promote and allocate **borrowings from abroad**
→ *Foreign Capital Investment Law 1960*.
- Bank of Korea provided **repayment guarantee** for foreign loans.

Export-led Take off in the 1960s

5

Interest Rate Reform for Savings Mobilization

- **Drastically increased interest rate** in 1965 for induce the money in the underground to public market. (15% to 26.4%)
- Total time deposit increased by 7 fold.
- **Domestic saving** doubled and **foreign inflows of capital** together increased investment.
- But the reform did not liberalize the financial market.
- For high investment, the average RGNP growth rate exceeded 10%.
- Export also increased by 5-fold over the period.

Export-led Take off in the 1960s

6

Export-Oriented Industrialization Policy

- Korea adopted and pursued **export-led industrialization policy** because the only source of foreign exchange was export.
- **Labor intensive light industries** like textiles, garments, footwear, plywood, and wigs

Export-led Take off in the 1960s

7

Export Incentives

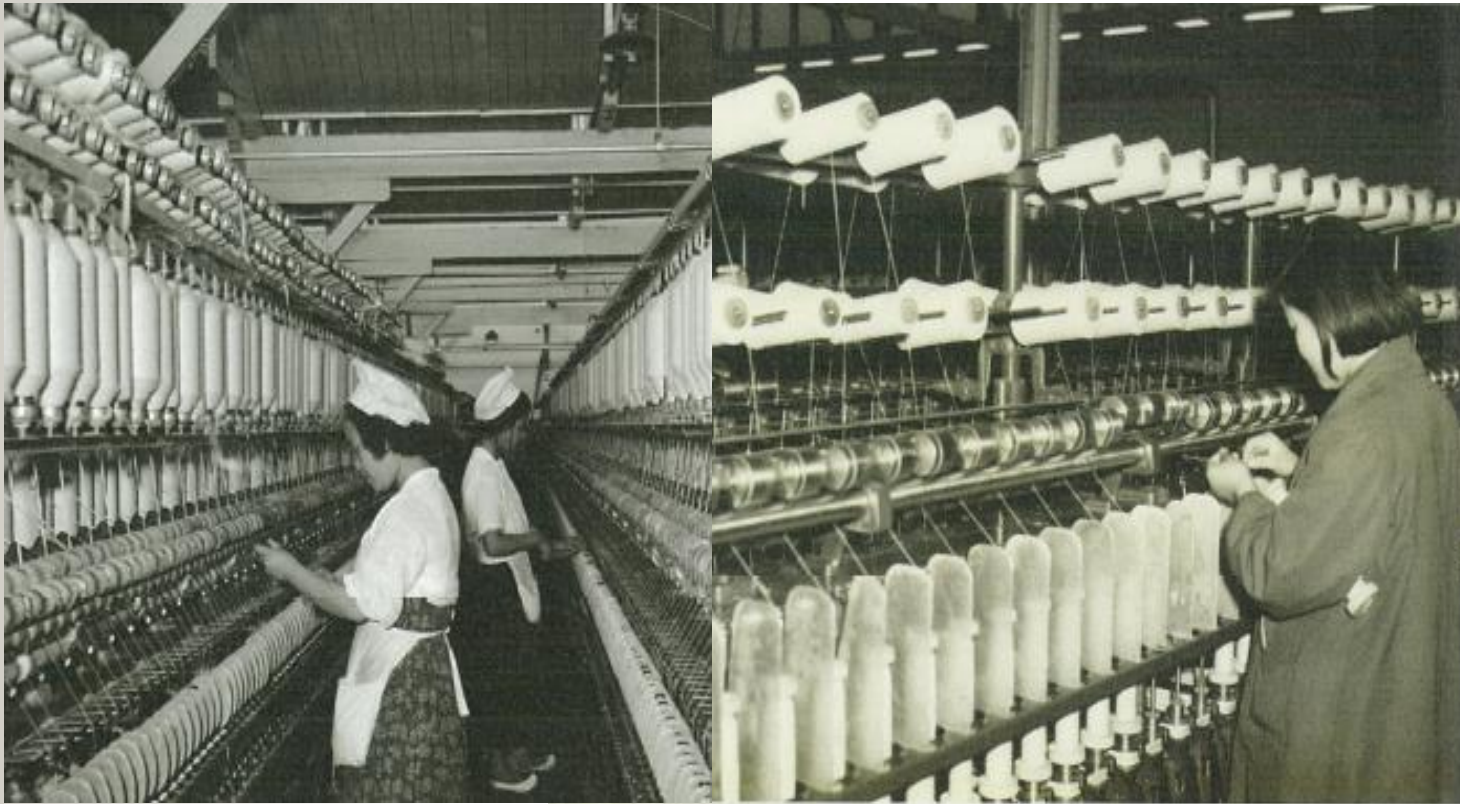
- Included **tax benefits** (reduction or exemption of income tax and depreciation allowances on invested capital) and **financial support** (direct subsidies for export and loan at preferential rates)
- **Exchange rate** was **devalued** from 130 won to 255 won in 1964.
- Korea Trade Promotion Corporation (KOTRA)
- Monthly Export Promotion Conference



Export increased by 40% per year between 1962 and 1971.
GNP grew over 9%.



The Light industry in 1960s





The Light industry in 1960s



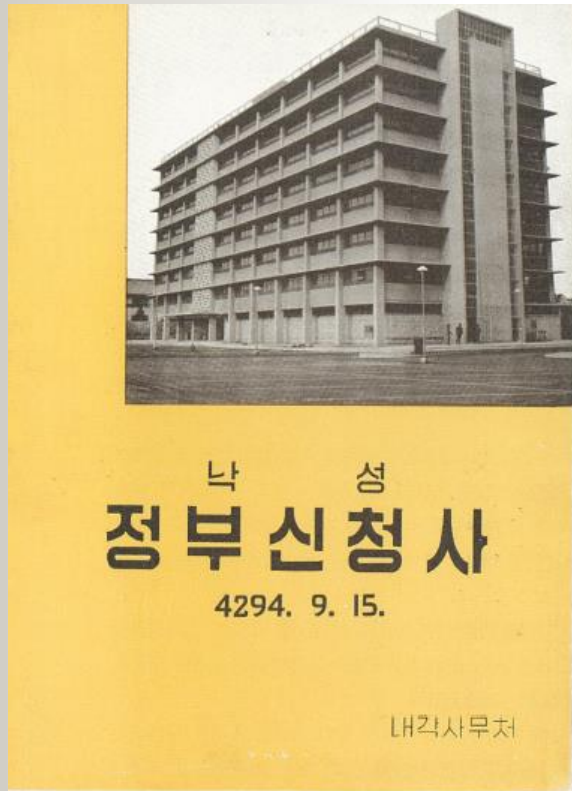


The first Korean produced automobile in 1960s



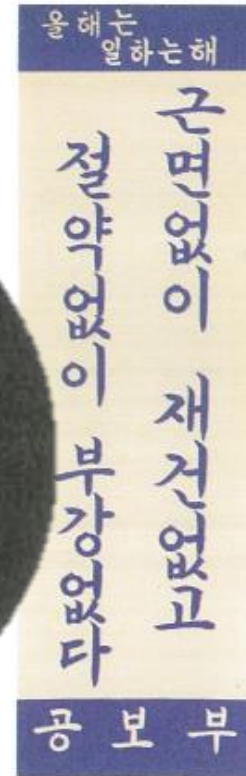


The new Government Office Building in 1961





Government's Strong Drive in 1960s



Lecture 1: South Korea's Economic Development from 1960s to 2000

South Korea's Economy in 1970s



HCI Promotion & Macro Imbalance in 1970s

1

HCI Policy and Policy Loans

- By the end of 1970s, Korean economy suffered from **serious internal and external macroeconomic imbalances**
→ *inflation, high oil price shocks, and balance of payments.*
- Government believed that promoting **heavy and chemical industries** (HCI) would **upgrade export structure**.
- Government operated **financial institutions** supplied credit to these industries.

HCI Promotion & Macro Imbalance in 1970s

1

HCI Policy and Policy Loans

- But over-optimistic views on Heavy and Chemical industries caused over **investment problem** in early 1980s.
→ Government *intervened the market and reduced capacity*.
- For more allocation of resources to H & C industries in 1970, policy loan increased to 70%.

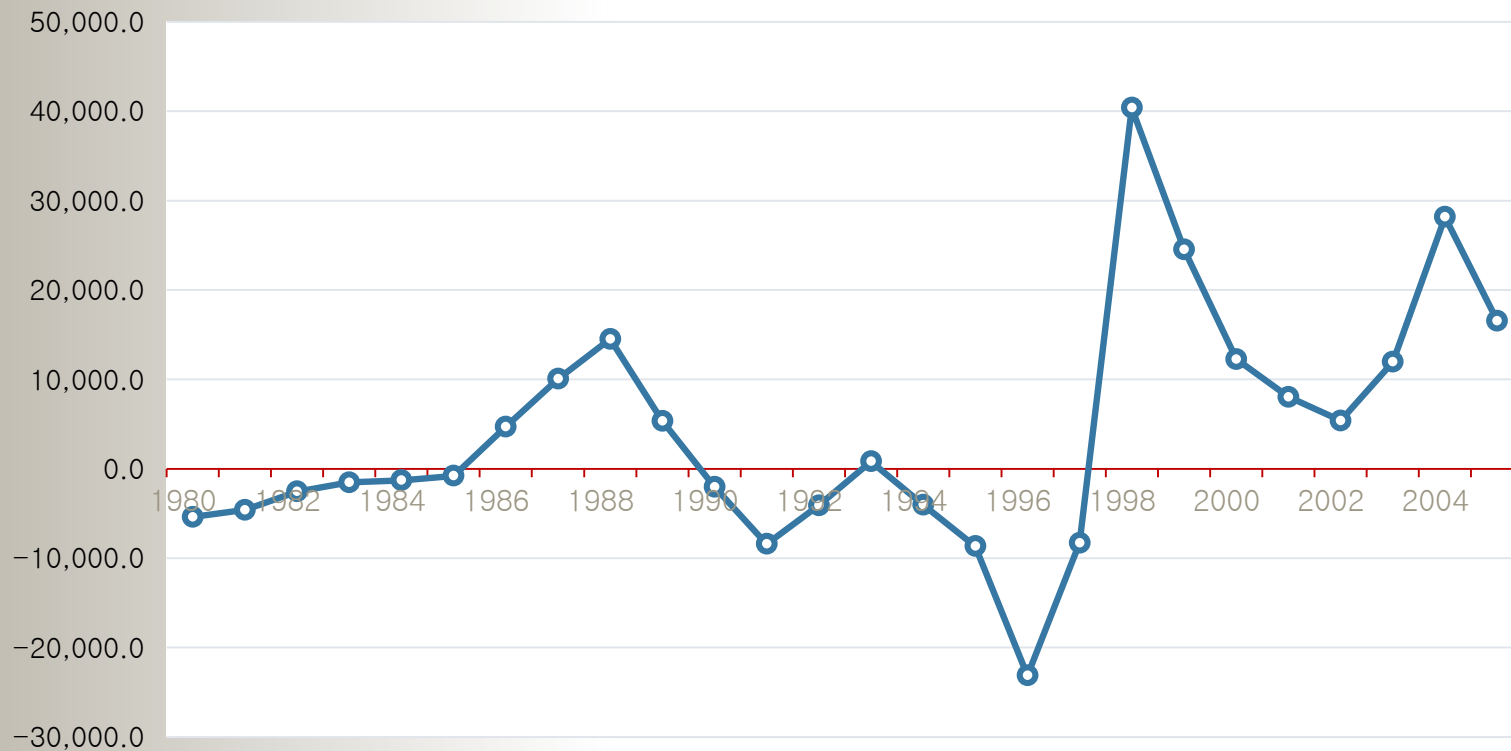


Inflation





Korean Trade Surplus





Government's Drive in 1970s

Establishment of POSCO



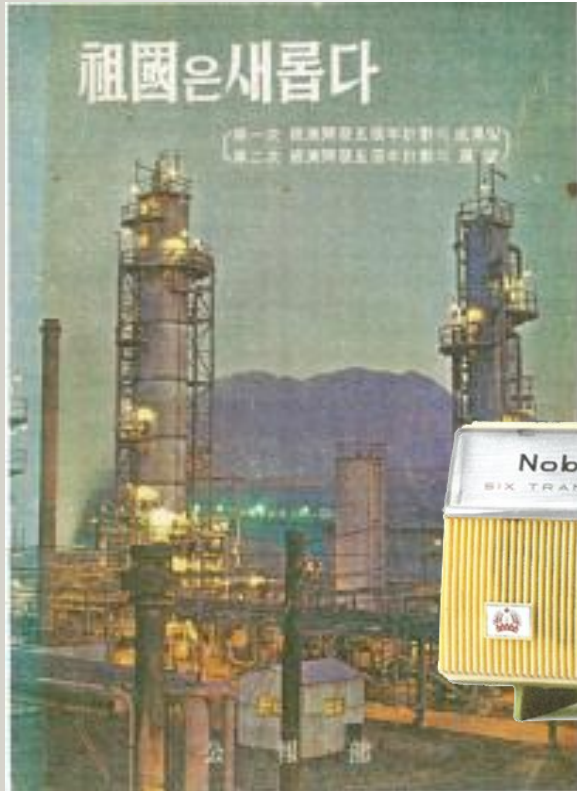


Government's Strong Drive in 1970s





Government's Drive in 1970s





Government's Drive in 1970s



HCI Promotion & Macro Imbalance in 1970s

1

HCI Policy and Policy Loans



- Bank loans interest to key industries were between 8% to 13% while the general B loan's rate was 17% and inflation rate was 16%.

HCI Promotion & Macro Imbalance in 1970s

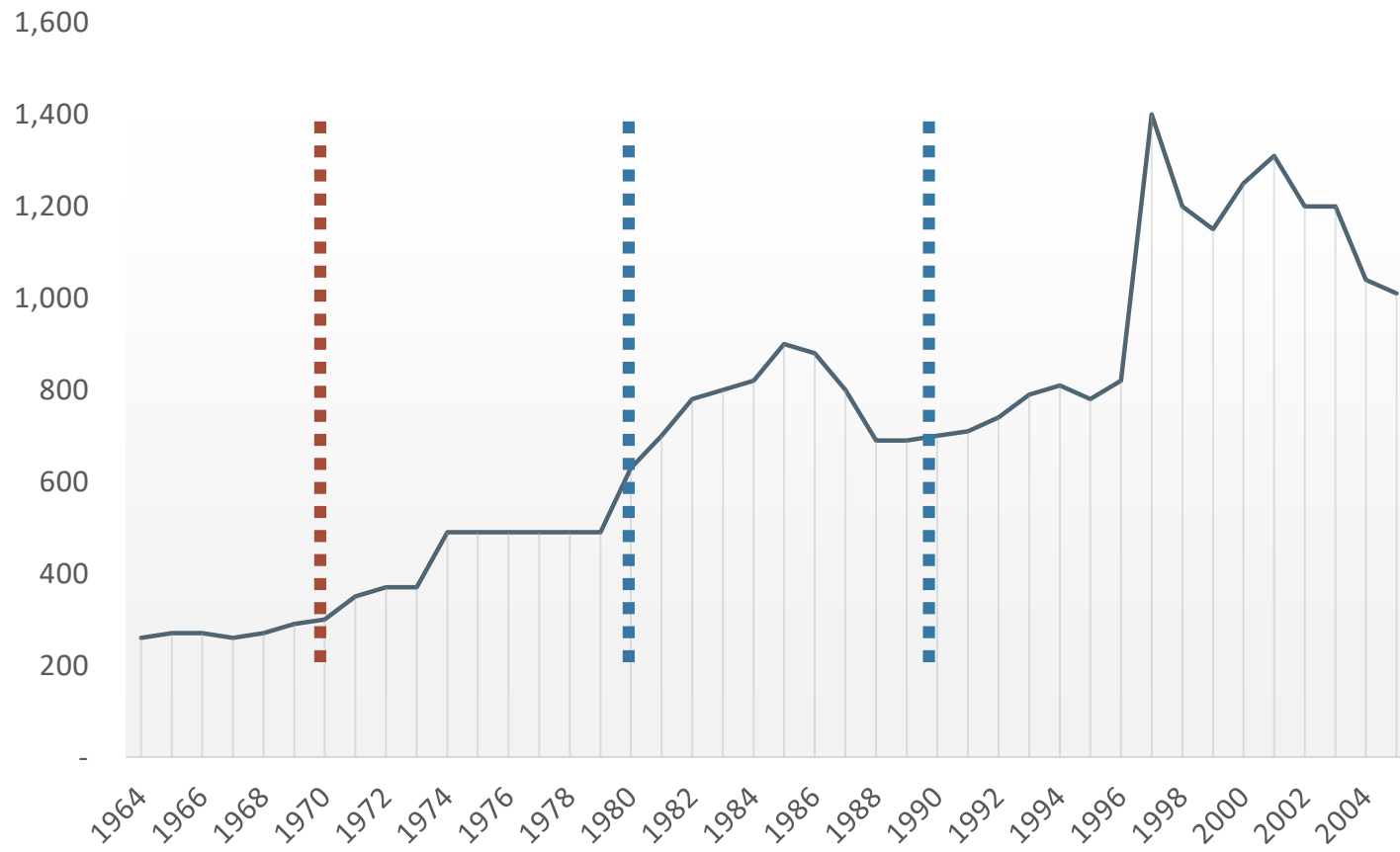
2

Exchange Rate Policy

- Won's value against US dollar was stable in 1970s.
- Except three periods' of devaluation: 14% in June 1971, 7% in the first half of 1972, and 21% in December 1974.
- But the **real exchange rate** appreciated for **higher domestic inflation**. (real exchange rate = nominal exchange rate * (p^d/p^f))



KRW/USD Chart



HCI Promotion & Macro Imbalance in 1970s

3

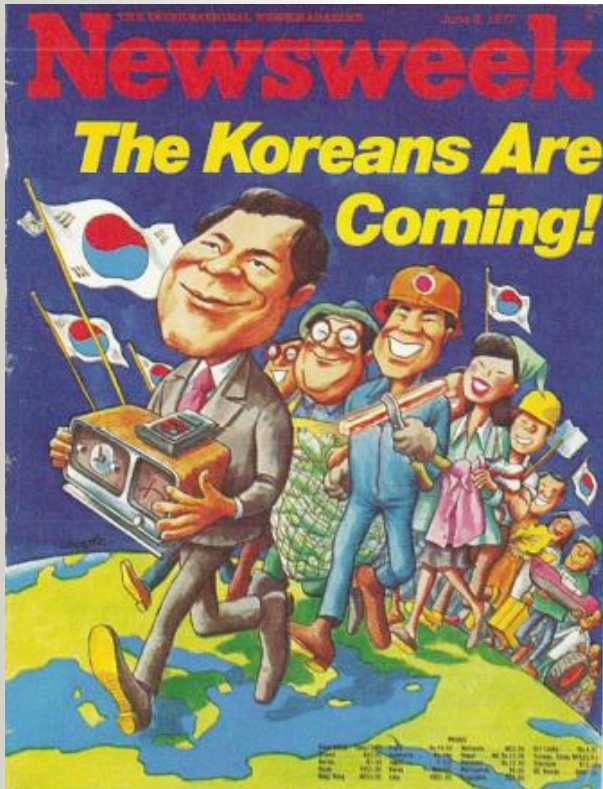
Growing Macroeconomic Imbalance



- **Increased fiscal expenditure** for reducing recessionary impact caused **large budget deficit**. → *defense tax and value added tax were introduced in 1975 and 1977.*
- Rapid monetary expansion for policy loans and foreign capital inflows
- **Current account deficit** reached 10% and 7.5% over **the two oil shock periods**.



After all, there was a rapid economic growth in 1960s and 1970s



Lecture 1: South Korea's Economic Development from 1960s to 2000

South Korea's Economy in 1980s



Economic Stabilization and Liberalization in the early 1980s

1

Price Stabilization Efforts



- 2nd oil shock hit Korean economy in 1979 and caused high inflation in early 1980s.
- To control the inflation, government pursued **contractional fiscal and monetary policies**.
→ *expanded to comprehensive stabilization program. In early 1980, fighting against inflation was given the top priority.*



Inflation



Economic Stabilization and Liberalization in the early 1980s

2 Monetary Policy

- Annual M2 growth rate decreased to 27% from 34%. Over 1982 to 1985 it was decreased by 17% more.
- Real interest rate increased and financial deepening accelerated.

Economic Stabilization and Liberalization in the early 1980s

3

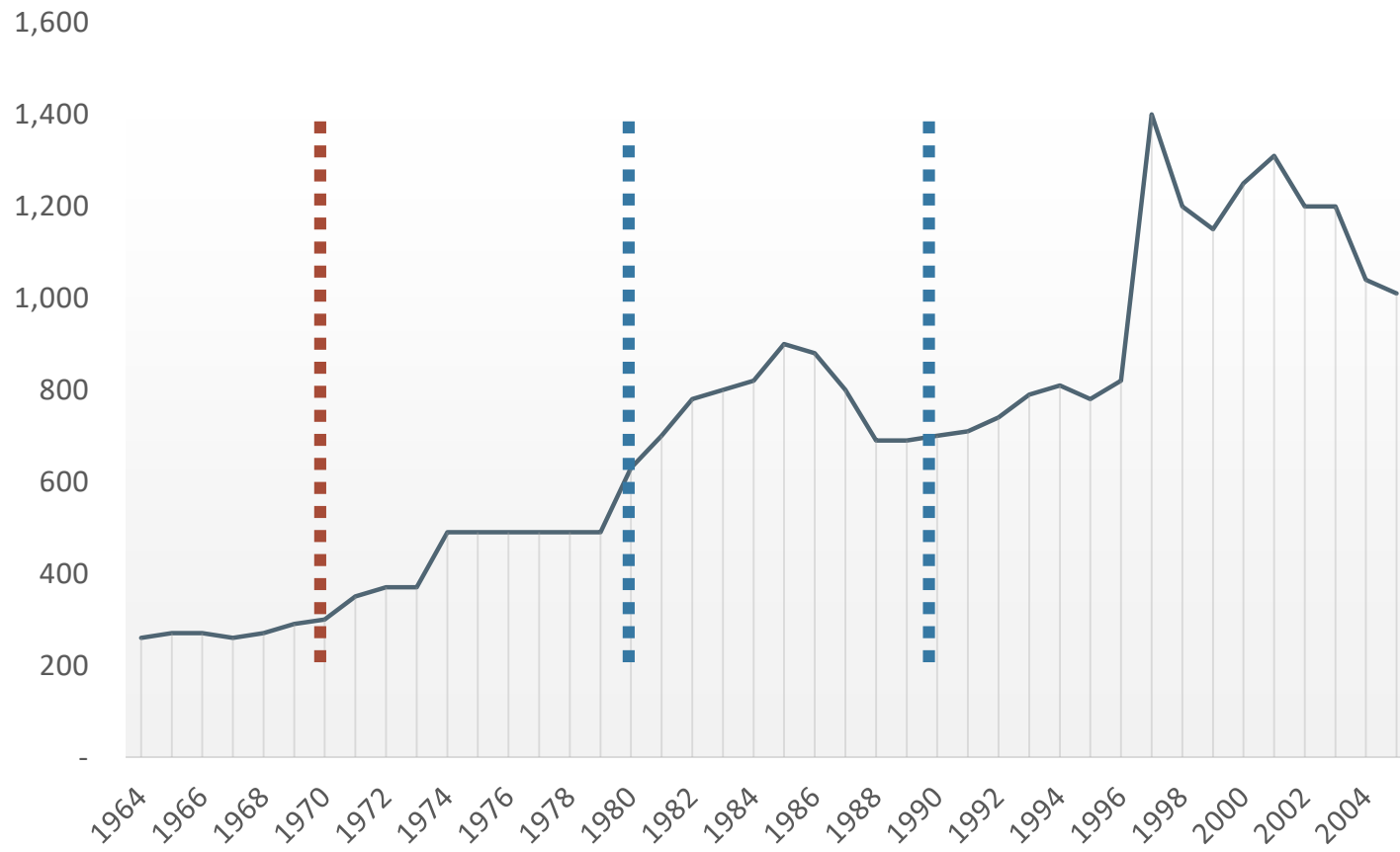
Foreign Exchange Policy



- In 1970s, the **exchanged rate** was almost fixed.
- Faced with high inflation and decreasing export, government depreciated Korean Won and adopted **flexible exchange rate** system in early 1980s.
- Won/Dollar exchange rate **increased by 20%** in Jan 1980.
→ *Current account deficit began to drop in 1982.*



KRW/USD Chart



Economic Stabilization and Liberalization in the early 1980s

4

Incomes Policy



- To support the contractional policy, government started 'income policy' from 1982.
- Wage increase schedule of public employees was applied as guide lines of private sector.
→ *stabilize wage of workers.*

Economic Stabilization and Liberalization in the early 1980s

5

Fiscal Policy



- Even though economic recovery was apparent in 1983, government pursued **restrictive policies**.
- Government Expenditure/GNP decreased to 23% (1987~1988) from 28% (1980~82).

Economic Stabilization and Liberalization in the early 1980s

6

Results

- Inflation decreased from 25% (1980~81) to 7% (1982). It stayed around 3% over 1983 to 1987.
- Steady financial deepening and inadequate infrastructure investment

7

Can we do this now?

Macro-Imbalances in the late 1980s

1

Impact of the 'Three-Lows'



- Korea achieved strong growth thanks to increase in export and the 'three-lows'.
 - 1) low Korean Won (depreciated by 35% between 1982 and 87)
 - 2) low international interest rate
 - 3) low petroleum price

Macro-Imbalances in the late 1980s

2 Monetary Policy (1986~91)



- M2 supply increased by 73% (1986~88) for current account surplus.
- BOK absorbed the liquidity through Monetary Stabilization Bond.



Seoul Olympic 1988



Macro-Imbalances in the late 1980s

3 External Pressure for Appreciation and Rapid Wage Increases (1989-91)

- For the increased pressure from US, **Korean government appreciated Won** by 24% between 1987 and 89. → *trade deficit*
- After 1987, an outbreak of labor disputes for **Democratization increased wages rapidly** almost by 18% between 1988 and 89.
→ *inflation*.

Macro-Imbalances in the late 1980s

3

External Pressure for Appreciation
and Rapid Wage Increases (1989-91)



- Consumption and construction increased in a large scale.

Macro-Imbalances in the late 1980s

4

Recession, Recovery, and Unfavorable External Environment

- Faced with external and internal imbalances, government started **stabilization policies in 1991**.
- Restrictions on construction activities
- Inflation pressure eased for slower growth over 5%. (1992~93)

Macro-Imbalances in the late 1980s

4

Recession, Recovery, and Unfavorable External Environment

- Growth gained the momentum again (8.5%) in 1994 for higher export and facility investment.
- In 1996, **current account deficit increased** to \$24B (5% of GNP) for unfavorable external shocks.

South Korea's Economy after 1990s



The 1997 Crisis and IMF Bailout

1

1997 Financial Crisis



- Amassed structural deficiencies weakened Korea's international competitiveness.
- **Terms of Trade** was deteriorated by 20% between 1996-97.
→ *extremely large pressure on thin profit margins of firms.*

The 1997 Crisis and IMF Bailout

1

1997 Financial Crisis

- Bankruptcies of Chebols like Hanbo, Sammi, Jinro, Haitai, and New-Core



It was mainly caused by **low profitability, excessive leverage ratio, and inadequate governance.**

The 1997 Crisis and IMF Bailout

1

1997 Financial Crisis



- Foreign investors were skeptical about govnt's willingness and ability to fix the structural problems.
- Financial crisis took place from Thailand to Indonesia and it came to Korea.

The 1997 Crisis and IMF Bailout

1

1997 Financial Crisis



- In December 1997, Korea experienced a **severe financial crisis** with its foreign reserve is exhausted.
- Government asked financial assistance to IMF.

The 1997 Crisis and IMF Bailout

2

Dealing with Liquidity Crisis



- Primary goal was to encourage the flow of foreign capital into Korea.
- Korean govnt and IMF agreed on **financial package** on December 1997 which IMF (\$21B), WB (\$10B), and ADB (\$4B) promised to provide.

The 1997 Crisis and IMF Bailout

2

Dealing with Liquidity Crisis



- It was effective measure to stop outflow of foreign capital and stabilize Won's value.
- Korea successfully **re-entered world financial mkt** by issuing **bonds** of \$4B in April 1998.

The 1997 Crisis and IMF Bailout

2

Dealing with Liquidity Crisis



- Current account improved quickly and the surplus amounted to \$40.6B in 1998.
- It helped portfolio capital inflow and expanded usable foreign exchange reserve.

The 1997 Crisis and IMF Bailout

2

Dealing with Liquidity Crisis



- As the end of July 2003, the reserve reached \$133B.
- Korean government repayed all foreign exchange borrowed to IMF.



Conflicts between the two economists over IMF crisis

Stanley Fischer

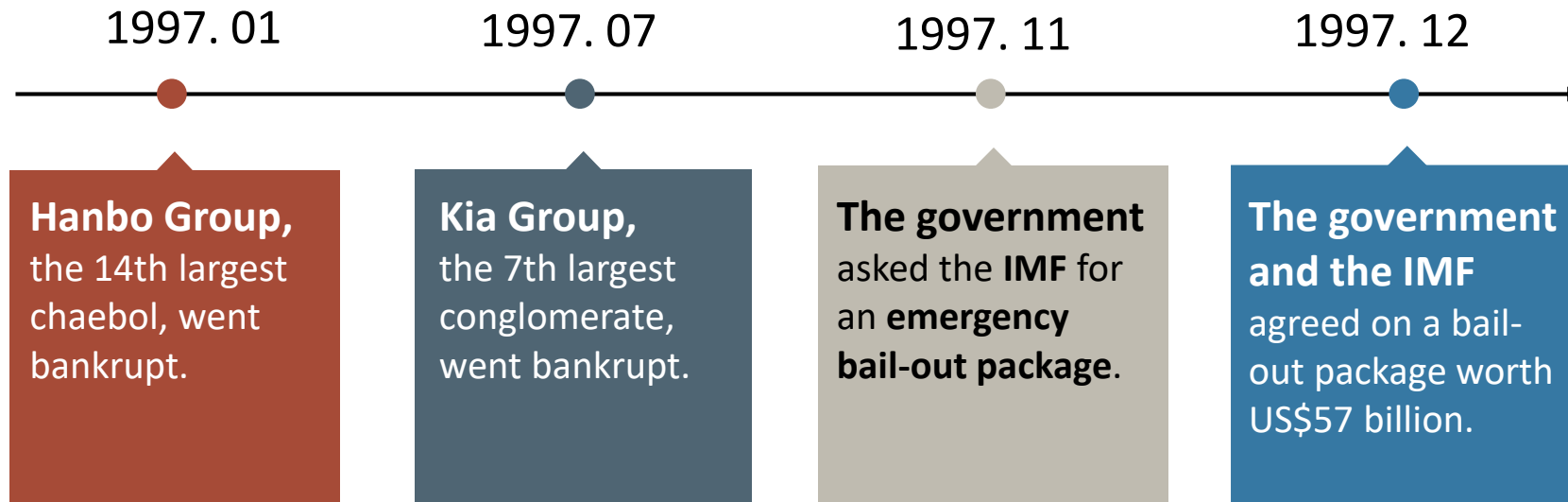


Joseph Stiglitz



The 1997 Crisis and IMF Bailout

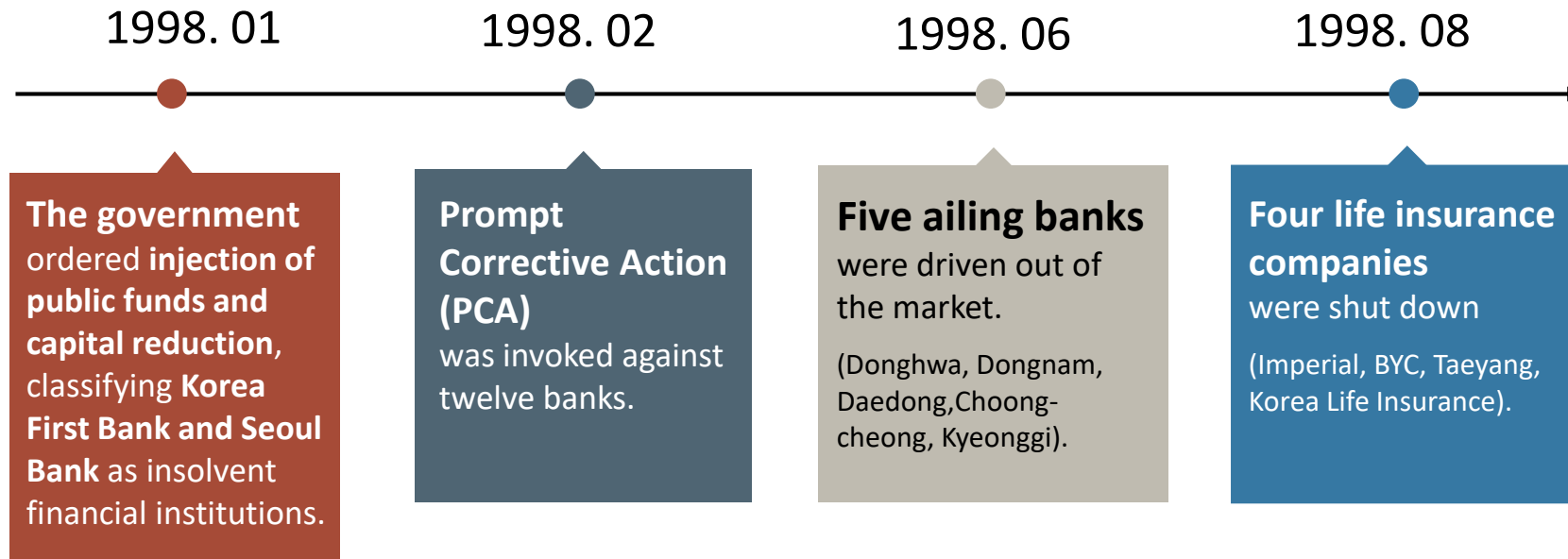
Restructuring Stage



Fourteen merchant banks, two securities companies and one investment trust company were shut down.

The 1997 Crisis and IMF Bailout

Restructuring Stage



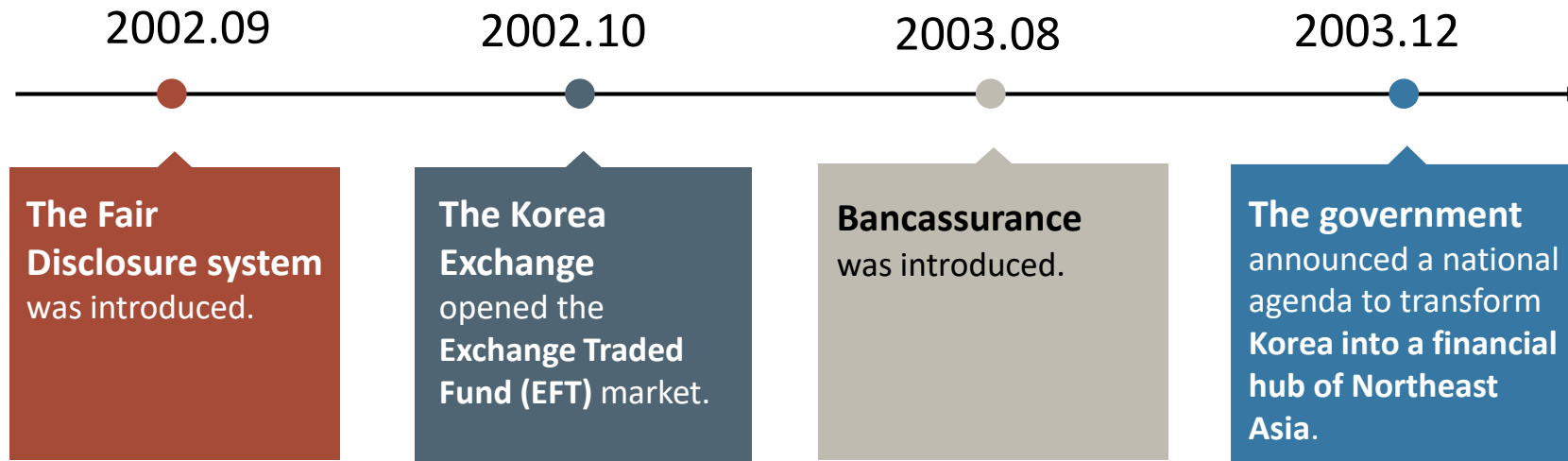
The 1997 Crisis and IMF Bailout

Restructuring Stage



The 1997 Crisis and IMF Bailout

Globalization Stage



The 1997 Crisis and IMF Bailout

Globalization Stage

