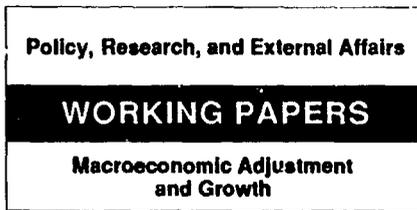


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# The Transition to Export-Led Growth in South Korea, 1954-66

Stephan Haggard  
Byung-Kook Kim  
and  
Chung-in Moon

South Korea's transition to export-led growth was a product of the interplay of four factors: pressure from the United States, strong executive power, bureaucratic reform, and a restructuring of the relations between the state and business.

This paper — a product of the Macroeconomic Adjustment and Growth Division, Country Economics Department — is part of a larger effort in PRE to analyze the way that political and institutional factors interact with economic policy reform. Copies are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Emily Khine, room N11-061, extension 39361 (43 pages).

In analyzing the turning point in Korea's transition in the early 1960s from a strategy of import substitution to one of export-oriented industrial growth, Haggard, Kim, and Moon examine not just the economics of change but the politics of economic policy and reform — the incentives facing state and business elites and the institutional context in which they operated.

Their analysis shows that the transition to export-led growth in South Korea was a product of the interplay of four factors: pressure from the United States, the dominance of the executive branch, institutional reform within the bureaucracy, and a restructuring of relations between the state and business.

Their findings help reconcile the debate between neoclassical and "statist" positions on Korea's economic transformation. They also provide an example of an institutional approach to economic development that is relevant for other developing countries.

They also draw some conclusions about the role of outside pressure in policy reform, about the importance to reform of administrative capability and organization, and about the politics of policy change. Among those conclusions:

- Economic development strategies are not simply packages of discrete policies — but involve the development of administrative capabilities.
- The timing of political cycles affects economic reform.
- Economic policies are more likely to be effective if the private sector has channels of access to government but does not dominate the policy process. Some mechanisms of insulation are required to shield business from its own instinctive tendency to exploit rent-seeking opportunities.

The PRE Working Paper Series disseminates the findings of work under way in the Bank's Policy, Research, and External Affairs Complex. An objective of the series is to get these findings out quickly, even if presentations are less than fully polished. The findings, interpretations, and conclusions in these papers do not necessarily represent official Bank policy.

# **The Transition to Export-Led Growth in South Korea: 1954-1966**

by  
**Stephan Haggard\***  
**Byung-Kook Kim\*\***  
and  
**Chung-In Moon\*\*\***

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- \*** Associate Professor, Department of Government, Harvard University  
**\*\*** Visiting Assistant Professor, Department of Political Science, Korea University  
**\*\*\*** Associate Professor, Department of Political Science, University of Kentucky

Two basic positions have framed recent debates about South Korea's remarkable economic growth. The neoclassical position traces South Korea's take off to a set of policy reforms in 1964 and 1965 that launched the country on the path toward export-led growth (Frank, Kim and Westphal, 1975; Kuznets 1977; Krueger, 1979). Policy was far from laissez-faire, but on the whole, the reforms moved Korea in a more market-oriented direction that sought to exploit Korea's comparative advantage. The "statists," by contrast, have detailed the pervasive intervention of the Korean government in the economy, even after the shift toward an outward-oriented strategy. Moreover, they have argued that such intervention promoted rapid economic growth (Leudde-Neurath, 1985; Jones and Sakong, 1980; Amsden, 1989).

This study addresses this debate by examining the transition from a strategy of import-substitution that characterized Korea's growth in the 1950s to a strategy of export-oriented industrialization. An analysis of policy change demands closer attention to factors ignored in the economic debate, particularly the incentives facing political and economic actors and the institutional context within which they operate. We make three sets of arguments, the first concerning the political system as a whole. In the 1950s, the financial weakness of the ruling Liberal Party and its declining political fortunes made it rational for Syngman Rhee to maximize his dependence on aid, limit the domain of coherent planning and maintain discretionary control over a variety of policy instruments in order to build political support. This contributed to incoherent economic policy.

Park Chung Hee also used economic instruments for political ends. Three conditions had changed by the early 1960s, however, one external, two internal. First, American pressure intensified under the Kennedy administration, and aid was used more effectively to press for policy reform. Second, Park was more susceptible to American pressure because of the very emphasis he had given to economic development in legitimating military intervention. Finally, Park had the capacity to

act decisively. With the concentration of power in the hands of the executive during the period of military rule, the old networks that constituted the political foundations of ISI were broken.

A second set of arguments concerns the relationship between political elites and technocrats. During the 1950s, the economic bureaucracy was "dualistic" (Haggard, 1990). A small cadre of technocrats advanced a reform agenda, but they occupied a peripheral role in the policy system. The military launched a series of institutional reforms aimed at enhancing the government's ability to plan and implement economic policy: a purge and reform of the civil service; the seizure of new policy instruments; and the centralization of economic decision-making. These institutional changes outlasted the military interregnum, and contributed to the coherence of subsequent policy.

Third, we seek to address the debate between the neoclassical and statist positions more directly by examining the nature of the government intervention that accompanied South Korea's turn to an export-oriented strategy. Two sets of mutually supportive reforms can be distinguished. The first was the macroeconomic and incentive reforms that have received wide attention from economists. The second set of reforms, however, drew on a more activist conception of the state's role and probably from an awareness of Japanese industrial policy. This side of the export-promotion program included heavily subsidized credit protection and a variety of institutional supports to exporters.

Why should these interventions be important if South Korea managed, on balance, to "get the prices right"? The answer lies, first, in the costs for firms in moving to an export-oriented strategy. Under an import-substituting regime, firms are unaware of their potential competitiveness. Where price signals have been distorted by import-substituting policies, providing subsidies to export can be effi-

cient in inducing firms to recognize their advantages.

A second reason for intervention centers on the credibility of government policy. If firms perceive that a new policy orientation is not likely to receive sustained governmental support, then they are unlikely to reorient production even if incentives favor it in the short-run (Rodrik, 1990). A number of government actions can be interpreted as institutional investments designed to signal governmental commitment. These two objectives--easing the transition to world markets for local firms and signaling government intentions--help account for the interventionist style of Korea's export drive.

The remainder of the study is divided into five sections. In the first section, we examine the politics of development under the Syngman Rhee government. The second section examines the short-lived Second Republic. Though Korea's take-off is generally traced to the early 1960s, this history is important since it provides telling evidence for the importance of political institutions in launching and sustaining growth-oriented policies. In the third section, we examine the period of military rule from the "revolution" of May 16, 1961 through the return to nominally civilian rule under Park in 1964, a period of dramatic political and institutional change. In the fourth section, we examine the economic reforms of the first three years of Park's first presidency. The conclusion extracts several lessons of broader comparative relevance.

## I. THE POLITICAL ECONOMY OF IMPORT-SUBSTITUTION: 1954-1960

The significance of U.S. support for the Rhee government can hardly be overstated. Aid financed nearly 70% of total imports between 1953 and 1961 and 75% of total fixed capital formation (Cole, 1980; Pu, 1961). From South Korea's independence in 1948, the United States sought to link its foreign assistance to close monitoring of foreign exchange, sound fiscal and monetary policies and the

privatization of Japanese properties.

Aid conflicts also reflected more basic differences over reconstruction and development strategy, not only between the Koreans and Americans, but among foreign advisors as well. Two emphases coexisted in the U.S. aid program: one that priority be given to stabilization, the other more developmentalist. The American-dominated U.N. Command was highly skeptical of Korea's economic potential and was primarily concerned with buttressing Korea's military position, rather than its economic self-sufficiency (Lyons, 1961). The American military placed particular emphasis on stabilization, arguing strenuously about the dangers of credit expansion and new investment. An economic advisory team to United Nations Korean Reconstruction Agency (UNKRA) represented a more developmentalist approach that was critical of the emphasis given to stabilization (Lewis, 1955). This group argued for a rationalized program of infrastructural development and import-substitution that would make Korea "self-sufficient" in five years, financed by large infusions of development assistance and greatly expanded mineral and agricultural exports.

Rhee's economic thinking was far from coherent, but he certainly cared less about inflation than the Americans (Park, 1967:11-13). The U.S. strategy seemed to neglect investment in new plant and equipment and offer a return to the export-oriented economy of the Japanese occupation (Chu, 1962; Lim, 1967:168-9). This fear was compounded by sustained American pressure to normalize economic relations with Tokyo, pressure that Rhee successfully resisted.

The United States took over the responsibility for Korea's reconstruction from the multilateral agencies in 1953. Eisenhower's call for an additional \$200 million for Korean reconstruction was tied to the effort to overcome Rhee's vehement opposition to the signing of an armistice (Chu, 1962:82-90; Eisenhower, 1953). The new U.S. aid commitment did not mark the end of political conflict between dono

and client. Rhee complained publicly about the slowness of aid deliveries, the lack of attention to new investment and the emphasis given to commodity imports, which accounted for about three-quarters of all aid between 1953 and 1960. One half of this was agricultural commodities, with the rest going primarily to fertilizer and petroleum products. Of the remaining project-related aid, only 16.5% went directly to manufacturing. Nonetheless, the significance of U.S. aid to industrial development is greater than the figures suggest, since imported commodities, including foodstuffs, were distributed to local industry for processing and became the basis for the development of a number of important Korean firms (McNamara, 1990). Despite the common picture of sluggish growth under the import-substitution regime, industry did quite well, albeit from a low base. GDP growth averaged 3.9% from 1953-55 to 1960-62, but this can be traced largely to the poor performance of agriculture and services. Industry grew at 11.2% a year (Cole and Lyman, 1971:192-193).

During the war, exchange rate policies continued to be the central point of contention. Between 1953 and 1960, Korea saw a bewildering succession of exchange rate regimes. None lasted for two full years; all undervalued the dollar (Frank, Kim and Westphal, 1975). Following acrimonious negotiations, the U.S. succeeded in getting the Korean government to devalue in December 1953 and to commit itself to a broader reform effort. When Rhee visited Washington in July 1954, the U.S. outlined the economic and political quid-pro-quo for assistance. Rhee would agree to:

1. Recognize the authority of the United Nations Command over the Korean armed forces, a move deemed necessary to hold Rhee in check;
2. Accept ceilings on the size of the Korean armed forces, which were seen as a drain on both the U.S. and Korean budgets;
3. Privatize state-owned properties and encourage private investment;
4. Utilize aid funds in compliance with U.S. laws and regulations and notify the U.S. of how foreign exchange was being used;

5. Maintain a realistic exchange rate;

6. Import aid commodities from those non-Communist areas where the lowest prices were offered, in effect, a demand that economic relations with Japan be normalized;

7. Establish a system that would raise the money for won advances to U.N. forces through public auction, rather than through loans that would be repaid at set exchange rates (FRUS, 1954).

Despite the agreement, U.S. aid coordinator E. Tyler Wood was subjected to a tirade from Rhee in September 1954 on the need to maintain a fixed rate in order to avoid inflation and restore confidence (Wood, 1953). Rhee threatened that if the U.S. did not agree, he would revert to an even more overvalued rate. As Wood recognized, the issue was whether the U.S. would rely on good faith from Rhee concerning reform measures, or stand firm by demanding compliance on a strict quid-pro-quo basis.

An agreement was reached in 1955 on the conditions under which devaluation would be required, but U.S. policy gradually shifted beginning in 1956 from a focus on the exchange rate to the root cause of the imbalance in domestic inflation. In 1956, Rhee ordered that a Financial Stabilization Program be elaborated (Lim, 1965:168-169). The Ministry of Finance worked closely with advisors to the U.S. aid mission in developing the program, and others followed each year. The stabilization programs were successful at slowing inflation, but the positive effects on investment and development were not forthcoming. GNP growth peaked at 7.7% in 1957, declined to 5.2% in 1958, 3.9% in 1959 and 1.9% in 1960.

The standard interpretation of this slowdown was that it reflected the growing inefficiency and exhaustion of import-substitution. This is no doubt true, but as a World Bank assessment noted, the stabilization programs contributed to the slowdown in growth, particularly as they corresponded with a decline in American aid

(World Bank, 1964:4-5). But even more importantly, the stabilization program could not address the underlying political structure that was distorting the allocation of resources and hampering a more rational planning process. Policies that appeared a complex and confusing patchwork from an economic perspective can be explained by Rhee's use of the instruments of economic policy--allocation of foreign exchange, bank credit, import licenses, and the distribution of state-owned enterprises--to sustain and build a base of support.

As soon as the war ended, Rhee began to face more intense political competition. New opposition parties formed. Rhee ran unopposed in 1956 because of the sudden death of his major opponent. Nonetheless, he managed to capture only 55% of the popular vote, down from 72% in 1952, and his vice presidential candidate was defeated. Most observers of Korean politics note a shift in the style of leadership in a more autocratic and defensive direction during the late fifties (Palais, 1973; Henderson, 1968). "Hardliners" within the party and the administration gained at the expense of those favoring technocratic solutions and greater emphasis on economic development. One obvious way of mobilizing funds to finance elections and other party activities was to forge a closer alliance with portions of the private sector. A new group of businessmen arose in the post-World War II period through commerce or the acquisition of state-owned enterprises. As these firms diversified beyond their commercial activities into manufacturing they sought government support. The grant of various privileges generated rents that could be recycled back to government officials, to the party and to individual legislators (Kim, 1964; Park, 1982; McNamara, 1990).

It is impossible to get an aggregate estimate of the size or composition of what might be called the rent-seeking sector. Evidence from a variety of sources, including evaluations of the aid program by the U.S., those scandals and incidents that became political issues during the 1950s and those that were later exposed during investigations launched by the military government suggest that

corruption was widespread (GAO, 1962; Hakminsa, 1985; Meade, 1951:203-212; Lee, 301-2 1985; Park, 1982; U.S. Embassy [Seoul], 1954; McNamara, 1990).

The greatest opportunities were provided by the overvalued exchange rate, which was linked to a complex licensing system for imports. U.S. criticism of the exchange rate and trade regimes was usually couched in terms of the need to encourage the productive and efficient use of resources, but clearly reflected a concern with corruption. A GAO report noted that "laxity" by the Bank of Korea in the allocation of aid dollars to importers encouraged speculation and led to collusion between supplier and importer, shipment of defective merchandise, kickbacks and overpricing (GAO, 1962:98-143).

Trade policy was closely tied with access to foreign exchange. As the U.S. sought greater "self-sufficiency," doubts were raised about the policy of financing consumer goods imports. In 1957, an amendment to the tariff law paved the way for a somewhat more systematic pursuit of ISI (KOMF, 1978:78-81). Tariffs were lowered on capital goods and raw materials and higher tariffs were imposed on locally manufactured goods and on finished and semi-finished goods. This provided new opportunities for profit in a range of processing industries, including the famous "three whites," sugar, cotton yarn, and wheat flour, which had liberal access to PL480 shipments. For example, wheat was provided virtually free of duty to millers through PL480. The cost of producing a sack of wheat flour was estimated at 350 hwan, but domestic manufacturers were able to charge 1,200 hwan per sack, and shortages sometimes drove price to 5,000 hwan (Kim, 1965:27-30).

Another controversial element of economic management under the Rhee regime was the allocation of bank loans. In the 1950s, capital was scarce and inflation relatively high, but interest rates reflected a policy of financial repression. Government ceilings on loan rates meant windfalls for those firms gaining access to finance, who then paid "commissions" for their privilege. Privatization of

state-owned enterprises and banks and government contracting provided additional opportunities for the ruling party. Not limiting itself to kickbacks, the Liberal Party was estimated to have interests in twenty-nine projects and the party was believed to have had a substantial interest in at least 50 percent of all of the private projects receiving American aid in 1960 (Kim, 1975:152).

These examples of the political use of economic instruments suggest why bureaucrats had an extremely low level of autonomy from outside pressures. Bruce Cumings (1981:151-158) has shown how the bureaucracy and the former colonial bureaucrats who staffed it were an important base of Rhee's political power in the early period of independence. Wider evidence confirms that higher civil servants were recruited on a political basis with only perfunctory screening (Pak, 1961; Song, 1960; Yi, 1966). In 1960, only 1.3% of bureau directors (Grade 2) and 4.6% of administrators (Grade 3B) were recruited by examination. A detailed study of U.S. efforts to export meritocratic norms concludes that it "was difficult to find any effect of the American effort on the personnel system in Korea" (Bark, 1967:221-222).

The aggregate picture demands some modification, however, since portions of the bureaucracy were open to foreign models, innovation and planning. The bureaucracy might be described as "dualistic," with competing centers of political and technocratic rationality coexisting in one administrative structure. The innovations that did occur provided the bureaucratic raw material from which later institutional developments were forged (Lee, 1968:ch. 8). In 1955, Rhee established the Ministry of Reconstruction (MOR). The MOR was involved in the coordination of the annual stabilization plans with the American aid mission through the revived Combined Economic Board. An Economic Development Council (EDC) was formed in March 1958 as a consulting and research agency for the Ministry of Reconstruction, financed partly by counterpart funds. As a new ministry with no set constituency, the MOR developed a significant cadre of trained administrators who were relative-

ly insulated from Liberal Party pressures. The Bureau of the Budget within the Ministry of Finance was also an island of innovation, urging reforms of the budgetary process.

In April 1959, the EDC economists drafted a Three Year Plan which was to be the foundation for later planning efforts. The plan spurred reforms in the government's statistical capabilities and became an important educational device for all those immediately concerned. The fate of these reform efforts, and particularly the Three Year Plan, was decided by politics both within and outside the bureaucracy. The semi-independent status of the EDC, the growth of MOR and the plans of the reformers encountered stiff bureaucratic resistance. More importantly, the economic bureaucracy as a whole had little autonomy from pressures emanating from the Party, the private sector and the executive itself. The Liberal Party had a powerful say in personnel administration, leading to frequent changes at the ministerial level (Table 1).

Table 1  
Turnover Among Economic Cabinet Ministers, 1948-1960

Ministry	Number of Ministers	Average Term
Agriculture	16	9 months
Commerce	11	13 months
Finance	9	14 months
Reconstruction	4	13 months

(Source: Calculated from Frank M. Landers, Technical Assistance in Public Administration: USOM/Korea, 1955-1967 [Seoul: USOM/Korea, 1967], p. 60).

Conditions only worsened as the political situation deteriorated in the late 1950s. Preoccupied with political problems, Rhee reviewed the Three Year Plan only twice during the two year period of its formulation. The Liberal Party shelved the final draft of the plan for a year in 1959, approving it only a few days before the student revolution that ended Liberal Party rule.

In sum, Korea in the 1950s exhibited political characteristics which were clearly inimical to development planning. The government was poorly insulated from the demands of the private sector and was penetrated by patron-client networks, while the economic bureaucracy was subject to political interference from both the executive and the ruling party. The last years of the Rhee administration were a period of some innovation within the economic bureaucracy, but these innovations took place in a larger political context that blocked reform.

## II. THE SECOND REPUBLIC: APRIL 1960-MAY 1961

The short-lived Second Republic suggests the critical importance of the larger political context for development planning efforts. The Second Republic was launched following a series of demonstrations against the Rhee government that culminated in the "student revolution" in April and Rhee's resignation (Han, 1974; Kim, 1983). The opposition Democratic Party came to power in July, replacing an interim government. Economic development and the elimination of corruption were the top political priorities of the new administration. The new government continued to seek aid, but took a number of initiatives including a devaluation of the exchange rate in February 1961, the rationalization of public enterprises and in general, the move toward a more market-oriented economy (Eisenhower, 1960). High-level support was also given to new planning efforts. In November, the Ministry of Reconstruction was instructed to draft a new five year development plan that would improve upon and supersede previous efforts.

Most importantly, work was begun on restructuring the economic bureaucracy itself. Reformers were given new opportunities to advance their ideas on institutional reform. Through a Working-Level Interministerial Council for Reorganizing Government, the reformers pieced together an intra-bureaucratic coalition in favor of centralization of key planning and policy functions. In early May 1961, they proposed the creation of a "super ministry," later to become the Economic Planning

Board. The key innovation, taken from the Indian Planning Commission, was to combine planning powers with control over the budget and inflows of foreign capital. The new ministry was to be built around the planning offices of MOR and EDC, but was also to absorb the Bureau of the Budget and control over the allocation of aid funds that had been with the Ministry of Finance. The plan was unveiled days before the military government took power.

If public statements by Chang Myon and internal bureaucratic alignments seemed to be moving toward reform, the larger political context was much less favorable. Part of the political problem lay with short-term economic policies and conditions, including devaluation, an increase in rates for government-subsidized services and food shortages. Economic problems were not the only difficulties facing the new regime, however. The Democratic Party was a loose coalition of anti-Rhee politicians (Han, 1974). Many saw the ascent to power as the opportunity to exploit the patronage benefits of office so long denied them. Members of the ruling party quickly moved into positions in public enterprises and the bureaucracy. Chang Myon also suffered broader political weaknesses. He had been selected as prime minister only after a factional struggle that ultimately split the party. Reform of the military, purge of corrupt officials, confiscation of illicitly accumulated wealth and unification with the North gained the attention of intellectuals and students and became highly divisive issues. Labor, including teachers and bank employees, also took advantage of the political opening to organize and press their demands. Lacking any independence, even from its own supporters, the government was unable to reconcile the conflicting demands placed on it from left and right, and finally proved incapable of maintaining order.

### III. MILITARY INTERREGNUM: MAY 1961-DECEMBER 1964

The differences between the Rhee and Chang Myon governments on the one hand and the military and post-military governments on the other provide crucial

insights into the institutional foundations of Korea's rapid economic growth. The military coup of May 16, 1961 had three consequences for the Korean political system. First, the military broke the political networks of the Rhee period by centralizing power in the executive. Even after the transition to a nominally democratic system in 1964, the new political structure resulted in a high degree of independence from the demands of interest groups. This is visible in a second major change; the restructuring of business-state relations. A new alliance with the private sector was forged over the early sixties, but one in which the opportunities for rent-seeking were reduced. Finally, the centralization of political authority was matched by a centralization of economic decision-making in the Economic Planning Board. These reforms increased the power of reformist technocrats by elevating their stature within the bureaucracy and by expanding the range of policy instruments at their disposal.

### Restructuring Politics

The military justified its intervention in politics by reference to the tasks of economic development; as Park wrote in 1962, "the key factor of the May 16 Military Revolution was to effect an industrial revolution in Korea" (Park, 1970:175). The economic policies of the junta were initially driven by short-term political concerns rather than a coherent strategy, however. The early actions of the military government had a strong puritanical and anti-urban tone that reflected the rural origins of the coup leaders (Cole and Lyman, 1971:274). The younger colonels of the 8th class of the Korean Military Academy saw themselves as progressives, advancing the same reformist causes as the April student revolution (Kim, 1971). With weak ties to the dominant elite, the military had few reservations about restructuring politics. Following the coup on May 16th and the declaration of martial law, all political parties and organizations and unions were banned and the press subjected to censorship. A Revolutionary Court and Prosecution was established in

July to try those accused of various crimes, including the illicit accumulation of wealth and corruption. In the spring of 1962, 4,369 politicians and government officials were forbidden to participate in politics unless undergoing a screening by the military, a process that cleared all but 74 politicians. The 74 included, however, top leaders of the Democratic Party and other progressives. The bureaucracy and military were not immune from the drive for "purification." In July, 2,000 officers were retired, including 40 generals. One of the first tasks of the newly formed Korean Central Intelligence Agency (KCIA) was the screening of 41,000 government employees, 1,863 of which were found to have been involved in corruption and "anti-revolutionary" activities (Gunsa Hyuckmyung Pyunchanwiwonhoi, 1963).

The actual consolidation of political authority proved circuitous because of deep splits within the military itself. In August 1961, Park promised a return to civilian government in May 1963. Hoping to capitalize on the opposition's disarray, the junta announced an early election. Park accepted the nomination of the Democratic Republican Party (DRP), which had been organized by Kim Jong-pil, a key member of the coup group, head of the KCIA and Park Chung Hee's nephew-in-law. The decision to return to a formally democratic political structure brought the factional splits within the Supreme Council for National Reconstruction (SCNR), the body of coup leaders, into the open. The younger officers, some influenced by socialist ideas, wanted an extension of military rule to carry out a wide-ranging transformation of society and economy. When Park sought to heal the split within the military by announcing he would postpone the elections and hold a referendum on continued military rule, he precipitated a broader political crisis and strong protests from Washington. Park relented on the referendum. Even with a fragmented and politically tainted opposition, Park won only a narrow victory amidst charges of election fraud

Despite the return to democratic forms in January 1964, the new constitution designed by the military and its advisers greatly strengthened the power of the executive (Oh, 1968:157-164). First, the constitution returned to the presidential system, with a weak, unicameral legislature (Kim and Pai, 1981:ch. 1). The President had complete say in the appointment of the Cabinet, including the Prime Minister, and great influence both formal and informal over the judiciary. The President also enjoyed a range of emergency powers that included the ability to constitutionally restrict freedom of the press, assembly and speech. This structure, and a stringent Political Party Law that placed various restrictions on political activity, tended to weaken not only the legislature but all political parties, including even the ruling party (Kihl and Kim, 1976). Once ensconced, Park skillfully used the powers of incumbency for building new networks of political support around the presidency.

It should be added that Park himself drew a close link between a centralized political system and the tasks of economic development. The following is but one example of a theme that Park sounded throughout his political career:

In order to ensure efforts to improve the living conditions of the people in Asia even undemocratic measures may be necessary...It is also an undeniable fact that the people of Asia today fear starvation and poverty more than the oppressive duties thrust on them by totalitarianism...In other words, the Asian peoples want to obtain economic equality first and build a more equitable political machinery afterward (Park, 1971:39-40).

### Restructuring Business-State Relations

The link between state power and development strategy is most visible in the restructuring of state-business relations (Lee, 1985; Park, 1982; Kim, 1967). Two weeks after the coup, thirteen major businessmen were arrested. Though eight of these were induced to make large "contributions" to the government and were released, the investigation was broadened to include another hundred and twenty businessmen. The definition of "illicit" wealth covered the entire range of rent-seeking and rent-granting activities that had been pervasive, if not unavoidable,

under Rhee: illegal contributions to political funds; illicit purchase of vested properties; profiteering from preferential access to government contracts and loans; misallocating foreign funds.

Though the government seized all outstanding shares of commercial bank stocks, thus gaining control of a powerful policy instrument, they compromised with large manufacturing and construction firms. In August 1961, the final decision of the investigation committee demanded that thirty entrepreneurs refund an amount that was much lower than the initial estimates of illegally accumulated wealth. The reason for this shift in policy is summarized neatly by Kyong-dong Kim: "the only viable economic force happened to be the target group of leading entrepreneurial talents with their singular advantage of organization, personnel, facilities and capital resources" (Kim, 1967:470). In a recent interview, Kim Jong-pil, a leading figure in the junta, outlined his own thinking at the time:

Pardoning the illicit wealth accumulators was an obvious violation of the revolution's pledge to eliminate corruption and old evil practices. But it was necessary...If we punished businessmen under corruption charges, it was evident that our economy would be paralyzed. Of course, members of the revolutionary council insisted on prosecuting them, but I opposed it. It was essential to coopt them in order to carry out revolutionary tasks. I personally persuaded General Park to release those arrested and to give them new tasks. Moreover it was I who helped these businessmen form a new business organization, the Association of Korean Businessmen, the predecessor of the Federation of Korean Industries (Oh, 1986:339).

On their release, the members of the newly formed Association submitted a plan to the Supreme Council identifying fourteen key industrial plants, including cement, steel, and fertilizer in which they were interested in investing if the appropriate supportive policies were forthcoming. The penalties imposed for the illicit accumulation of wealth were to be invested in new plant, but these totalled less than one sixth of the cost of the Association's plan (Lim, 1968). One of the most important issues for the new business organization was easing access to domestic and foreign credit. Government guarantee of foreign loans became a

central feature of government credit policy over the 1960s and 1970s.

The interpretation of the illegal wealth accumulation episode is the subject of some controversy. Some accounts have stressed the continuity with past practice and the fact that the military was forced to make peace with the private sector. Politicians in the newly formed Democratic Republican Party were as dependent on business contributions as Liberal Party politicians had been and the practice of "political taxation" of the private sector by the executive was an open secret. The government's control of the banking system provided it a powerful tool with which it could reward followers, and the question of preferential loans became a major political controversy in 1964 and 1965, just as it had under Rhee (Dongah Ilbo, February 18, 1965; Shin Dong Ah, 1965; Park, 1982:198-213; Kim and Park, 1968).

The thesis of continuity overlooks important changes in the nature of business-government relations, however. First, as we argue below in more detail, the economic reforms launched by the military significantly reduced the opportunities for the directly unproductive profit-making activities that had existed under the Rhee government. Devaluation benefited a wide range of small firms who turned to export. While the government retained a high level of discretion over some policy instruments, others, such as loans to exporters and access to imported inputs, were extended to exporting firms on a non-discretionary basis. Second, even where discretionary favors were extended to larger firms, they were generally tied to some developmental purpose. Finally, the government had acquired greater control over the instruments of economic policy than it had during the fifties.

### Restructuring the Economic Bureaucracy

This expanded state capacity was the result, in turn, of changes in the economic bureaucracy. Given that the group of coup-makers was relatively small, the problem of how to administer the government rose immediately. The military's approach was to use the existing governmental apparatus, but to superimpose on top

of it the Supreme Council for National Reconstruction and to appoint military men to key positions throughout the administrative structure. The change of government provided an auspicious opening for reformers within the bureaucracy to push forward their ideas concerning administrative restructuring. Within a week after the coup, the reform group had submitted the plan that had already been developed under the Chang Myon government. The Working Group's plans for an Economic Planning Board fit with the centralizing tendencies that accompanied the period of military rule. As called for in the plan, the new ministry consisted of the budget bureau, transferred from the Ministry of Finance, the statistics and research bureau, moved from the Ministry of Home Affairs and the planning and coordination offices from MOR.

From its initiation, the EPB came to have a powerful say over other ministries through the budget. EPB's Bureau of Budget prepares the broad guidelines for the annual budget, collects annual proposals from the other ministries and evaluates their feasibility. EPB's power lies in its ability to designate specific projects for which other ministries prepare the budgetary implications, and above all, its power to adjust the budget estimates submitted by the ministries. A capital import bureau was also established in 1961, and EPB's power extended to the area of foreign borrowing. European investors refused to lend unless the government extended guarantees on loan repayment. Seeing an opportunity to further expand EPB's powers, the Bureau of International Cooperation, which oversaw aid relations and was the dominant bureau throughout the early sixties, persuaded Park to establish more extensive controls on the import of foreign capital. In July 1962, the ministry was given the power to extend government guarantees to loans and to audit and oversee the activities of the borrowing firms. Finally, EPB was given the power to select those capital goods imports and importers which qualified for government-aided deferred payment privileges. When coupled with new laws that transferred

the power to approve and extend incentives to foreign direct investment from the Ministry of Finance to the EPB, the new ministry effectively gained complete control over Korea's import of foreign capital. These laws naturally gave EPB a strong say over the money supply and industrial policy as well. In 1963, the special status of the EPB within the cabinet was further enhanced when its minister was also given the title of Deputy Prime Minister.

In addition to consolidating the economic planning structure, the military also launched a number of reforms designed to improve bureaucratic performance and implementation. Three can be mentioned briefly. First, the military forged much closer relations between the executive and the economic policy machinery. On coming to power, the military demanded weekly briefings on the state of the economy. The military had developed a standard briefing procedure, leading to the joke that the country was run by the "ABCs": Army, briefings and charts. These briefings provided an important channel of access for the technocrats, however, and a way of influencing and educating the top military leaders. Second, the military developed a system of "planning and control offices" (PCOs) as a way of monitoring and evaluating performance (Lee, 1968:144-145). A PCO was established within EPB in July 1961 and the model was gradually extended to other ministries. Placed under an Office of Planning Coordination in the Prime Minister's office, the PCOs were required to monitor and evaluate the status of implementation of its projects in quarterly reports, providing the Prime Minister, and ultimately the President, an independent channel of information. Finally, under the guidance of the Minister of Cabinet Administration, a series of reforms sought to rationalize the system of personnel administration. Reforms included centralizing recruitment and selection, improving examinations and installing a performance rating system.

### Toward Policy Reform

The changes in the Korean political system under the military proved important

for the adoption and implementation of a coherent economic strategy, but they did not in themselves constitute an economic program. Understanding the economic reform demands exploring in closer detail the interests of three sets of actors: the technocrats, the military and the United States.

Despite its formal powers, EPB initially faced problems similar to those of the MOR under Rhee. On coming to power, the junta assigned the newly-forming Economic Planning Board the task of drafting a new plan. The junta outlined a series of quantitative objectives, including annual growth rates and targets for the principal macroeconomic variables. These numbers were derived from the previous plan, but artificially inflated to distinguish the new plan from its predecessor. The overall philosophy of the plan was "a form of 'guided capitalism' in which the principle of free enterprise and respect for the freedom and initiative of private enterprise will be observed, but in which the government will either directly participate in or indirectly render guidance to the basic industries and other important fields" (Economic Planning Board, 1962:28). From the perspective of the planners, however, a primary goal was to eliminate the range of controls that had permitted the corruption and misallocation of resources of the Rhee period. The ambitious plan targets and projections, for which the plan has been criticized, were secondary to the effort to outline this more general policy thrust. The plan is replete with references linking state intervention not only to economic inefficiency and distortions, but to corruption (EPB, 1962:27). Interestingly, the plan was extremely cautious with reference to macroeconomic policy, despite the rather ambitious growth targets--7.1% a year from 1962-1966--which had been imposed by the military. Instead, the language at some points even seems to suggest some skepticism about the plan targets imposed by the military:

While the plan implementation calls for procurement and supply of enormous amounts of investment capital, pursuit of policies tending to undermine financial stability in favor of excessive investment is

bound to offset the beneficial effects of the Plan, and might even lead to its complete failure. Therefore, in determining financial

and banking policy for the period, it is essential that the volume of investment be maximized only within the framework of financial and monetary stability" (EPB, 1962:35).

Not surprisingly, this conservative, market-oriented approach did not fit with the immediate political interests of the military. While the SCNR pushed through the organizational reforms of the economic bureaucracy and delegated planning tasks to the new Economic Planning Board, they also set up an advisory board on economic questions that gave several populist economists access to the junta. These economists, and some of their sympathizers among the colonels of the 8th class, were critical not only of the corruption of the Rhee period, but of the dynamics of a market system under which "the rich get richer, the poor get poorer."

A series of policy actions reflected this populist thrust (Brown,1973 :50-51). The junta decreed the abolition of all "usurious" debts to farmers and fishermen, guaranteed government repayment of those debts that were within legal interest rate limits and moved to guarantee high and stable prices to farmers through subsidies. Efforts were made to assist small and medium firms through the creation of the Medium and Small Industry Bank. These policies were coupled with a highly expansionist monetary policy--a 60% increase in the money supply in the military's first year in office--and large budget deficits driven by the ambitious investment demands of the plan and pay increases to public servants.

### Pressure from the U.S.

The American attitude toward Korea during this period influenced both by changing events in the country itself and by a broader reassessment of U.S. interests that took place under the Kennedy administration. The debate over Korean policy began prior to the military coup, sparked by a long policy paper drafted in

March 1961 (Farley, 1961). Claiming that Korea was a "sick society," the paper argued that U.S. interests were being undermined by the weakness of the Chang Myon government, the continuation of widespread corruption, but also fundamental failures in the organization of the U.S. aid program. Arguing that "we cannot sit by and assume that Koreans must shape their own destiny" and that "the gradualist approach to reform will not satisfy the needs of the country," presidential aids pressed for a crash program that would be based on wide-ranging reforms (Rostow, 1961).

The U.S. signaled its displeasure at the intervention of the military. By June, however, a Presidential Task Force on Korea advised for a strategy that included establishing ties with the moderate elements of the regime and promoting self-sustaining growth by encouraging the development of a coherent planning effort (National Security Council, 1961). Particular attention would be given to policy reforms that would undercut the opportunities for corruption: credit allocation; budgeting; government contracting; taxes and interest rates were given as examples. Support would also be extended for private efforts to encourage foreign direct investment (Brubeck, 1962). The need to exert pressure to achieve reform was explicitly recognized: "experience has shown the effectiveness of sanctions, based upon withholding of inducements of economic aid, as a means of ensuring Korean performance" (National Security Council, 1961).

By August 1961, cables from Seoul and internal documents showed a grudging admiration of the ability of the military government to get things done (U.S. Embassy, 1961). In addition, there were reasons to avoid undue pressure on the government. Until Park's announcement of March 1963 that military rule might be extended, the U.S. was constrained by the fear that Kim Jong Pil and the younger colonels would gain in power. In January 1963, the embassy went so far as to argue that the military's, and Park's, complete withdrawal from politics was nei-

ther "feasible nor desirable" (U.S. Embassy, 1963a).

A badly bungled currency conversion plan in June 1962, revelations of corruption and KCIA malfeasance, and the inflationary consequences of the military's economic policies gradually moved the United States AID mission to adopt a tougher position on economic reform. In March 1963, AID officials overseeing the Far East in Washington noted that it had been almost a year since supporting assistance to Korea had been released. When this was investigated, it was found that the director of the AID mission had been withholding portions of U.S. aid, including PL480 assistance, with the purpose of forcing the Korean government to adopt a stabilization plan (U.S. Embassy, 1963b). This pressure came at a decisive moment of particularly poor harvests in the fall of 1962 and the spring of 1963. The expectation of devaluation and rumors of a U.S. aid cutoff encouraged hoarding and speculation, pushing grain prices up dramatically and worsening the usual "spring famine."

The need to generate foreign exchange pushed the military government to several innovations in support of exporters, including new financing schemes, tax exemptions and a system that linked the right to import to export proceeds (Hong, 1979:54-55). Park also attempted to get around AID and maintain the elements of his politically motivated economic policies by obtaining private foreign commercial credits, not only from the United States, but from Germany, Italy, France and Canada as well (Far Eastern Economic Review, August 8, 1965). Nonetheless, foreign exchange reserves dropped from \$193 million in June 1962 to under \$100 million in July 1963 as foreign exchange was used to import rice.

The pressures exerted on the economic front by the U.S. came to overlap with growing concern in Washington about the country's political direction. Park's announcement in March that military rule might be extended was met by an extremely tough American response. Kennedy sent a personal note of protest to the junta and the State Department announced that \$25 million in economic aid to assist the

Five Year Plan was being withheld.

The United States pressure appeared to work on both fronts. Park agreed to elections in the fall as well as to a stabilization plan. Four year-end targets were set: ceilings on the money supply, budget deficit, and commercial bank credit and a floor on foreign exchange reserves. The object of the stabilization plan was to get the Korean government to "adopt basically new fiscal and foreign exchange policies in order to meet program goals" (U.S. Embassy, 1963c). The embassy recognized that the two objectives of securing a return to democratic rule and achieving stabilization clashed, since the range of policy actions required by the stabilization program would be highly unpopular: cutting rice subsidies, insisting on repayment of loans to farmers, and cutting the budget. Some accommodation was made in the implementation of the plan, but the United States stood firm, fearing that the government would "react to their plight by putting pressure on the U.S. to provide more aid" (U.S. Embassy, 1963d).

#### IV. ECONOMIC POLICY UNDER PARK CHUNG HEE: 1964-1966

The election by no means marked the end of opposition to Park's rule. The country experienced political crises in 1964 and 1965 over the ratification of the treaty normalizing political and economic relations with Japan (Kim, 1971). The seriousness of the Treaty Crisis should not be downplayed. In using martial law to manage protest, the crisis demonstrated the veto that the military continued to hold over political life. Nonetheless, Park's victory in the 1963 election did free the government to concentrate its efforts more squarely on economic policy reforms; devaluation, tax and interest rate reforms, an opening to foreign capital and the drive to expand exports. While the ruling party was once again charged with electoral fraud, Park could run in the May 1967 elections on the basis of successful economic performance.

American influence was crucial in these reform efforts. Fearing that the government's efforts would relax, the AID mission gradually shifted the policy dialogue from the question of stabilization toward the issue of devaluation. Though some members of the AID team sought a rate of 300 won to the dollar, the U.S. position was that 285 would be appropriate; over 1963, the rate averaged 130 to the dollar. The Korean government returned with representatives from business who said that they could not live with 285 because of the anticipated rise in the cost of imported inputs. But the United States insisted on a large devaluation, and on May 3, 1964, the official rate was devalued to 255, a fairly revealing ex post indicator of the relative power positions of the two sides.

Prior to the summer of 1964, the policy dialogue between the United States and Korea centered largely on devaluation and stabilization. In the summer of 1964, there were important changes in the leadership of both AID and EPB that signaled a new and more collaborative course. In May, Chang Key Young took over as Deputy Prime Minister and head of EPB, where he was to stay until 1967. Prior to his assumption of the position, EPB had seen six changes of leadership in its short history. Despite its formal powers, its planning efforts had been sidetracked by larger political conflicts. Chang, while maintaining close contact with Park and the DRP, was also granted wide leeway in the development and implementation of economic policy. The new AID chief met on a regular basis with Chang to outline the details of various reforms, generally getting the support of Chang who would mobilize the bureaucracy for action.

The new AID team did not openly abandon the money supply targets of the 1964 stabilization program on the grounds that to do so would lessen U.S. bargaining power (Bernstein, 1966). In 1964, however, AID signaled that they would take a more lenient view of plan targets than the previous team had. The new team, and particularly advisor David Cole, believed that it was counterproductive to push strict monetary targets while simultaneously undertaking difficult reforms of the fiscal

and financial systems. The issue was not getting the prices "right," but providing additional incentives that give the economy a push: the exchange rate low, credit to productive activities and exports cheap, and interest rates to savers high. The inflationary consequences of such a policy course would be partly offset by the mobilization of new resources, but some inflation was seen as tolerable.

The reforms not directly related to the push to expand exports can be reviewed here only briefly. The improvement in tax collection is a clear example of the link between administrative reform and the extractive capability of the state. Since the early fifties, the AID mission had financed a succession of advisers on all aspects of the tax system, but tax collection remained poor. In March 1966, under the direction of a close military associate of Park Chung Hee's, a sweeping reorganization of the Taxation Bureau was launched. Tax collections increase 18.6% in 1964, 44.5% in 1965 and 68.7% in 1966 with little change in the tax structure or rates (Landers, 1967:133).

A concern with domestic resource mobilization was also behind the interest rate reform of late 1965 (Cole and Park, 1983; McKinnon, 1973). Studies commissioned by the U.S. pointed to the negative effects of low interest rate ceilings on domestic savings, but a particular concern of the government was the rapid growth of the financial power of the curb market, which accounted for between 56 and 63 percent of total domestic credit at the end of 1964. A major incentive to reform was to move savings into the state-owned banking system. Park pushed a doubling of interest rate ceilings through the National Assembly in September 1965 with U.S. prodding (Cole and Park, 1983:163-165).

The defining aspect of the new course was the single-minded emphasis placed on exports. The neoclassical interpretation of the success of this effort was that it hinged on devaluation and the selective liberalization of imports. The organizational context of Korea's export promotion efforts receives much less attention, but

was important in three ways. First, institutional design cut across normal bureaucratic lines by engaging the power of the president and AID. This gave the export drive its comprehensive character. Second, the new institutions linked the public and private sectors and provided channels for the exchange of information between them. This structure enhanced the credibility of policy by engaging the private sector in its formulation. At the same time, however, the development of extensive informational capabilities and expertise within the bureaucracy allowed the government to monitor the private sector and to use discretionary policy instruments, such as tax audits, to guarantee compliance, in some cases, down to the level of the firm. Finally, the new institutions disseminated technical and market information that was critical for establishing effective market links between Korea and the rest of the world.

In late 1964, while AID was absorbed with developing a new stabilization program for 1965, a program for export expansion was being formulated within the Ministry of Commerce and Industry with the assistance of Amicus Most, an American businessman who had been hired as an adviser to AID (Most, 1969). In March 1965, an Export Promotion Subcommittee (EPSC) was formed, which while not a government agency, became a central organizational locus for mobilizing support for expanded exports. The EPSC consisted of the vice-ministers of the economic ministries and relevant agencies, governors and officials of the Bank of Korea and the commercial banks and representatives from private sector peak associations: the Korean Chambers of Commerce, the Korean Businessmen's Association, the Korean Traders Association, and the Small and Medium Business Cooperatives Association. At the working level, the EPSC consisted of a series of private-public task forces assigned to examine problems of finance and taxation, agriculture, fishing, mining, heavy industry, light industry, marketing, information, quality improvement and technical assistance. Through the task forces, the EPSC influenced the annual export promotion policy proposals emanating from the Ministry of

## Commerce and Industry.

Despite the fact that the most important price incentives--the exchange rate, export credit and access to imports--were extended on a non-discretionary basis, an interesting feature of the export promotion effort was its sectoral emphasis. Through the Ministries of Commerce and Industry and Agriculture and Forestry, 35 "commodity chiefs" were assigned to develop programs for specific commodities and to coordinate with representatives of the appropriate industry. Organized under the Korean Traders Association, sectoral export organizations provided services such as marketing, advertising, inspection and arbitration assistance, and were provided various special favors, such as the right to allocate quotas (as in the textile industry) among member firms. Priority sectors were not rigidly set; the export promotion structure was flexible and responsive to business requests for priority status. Nonetheless, there were various criteria that were established for inclusion, such as a preference for new export activities over existing ones and the avoidance of those low-cost, mass-produced items amenable to automated production in the advanced industrial states.

The sectoral focus of the program is clear in the setting of export targets, by region, industry and in some cases, by individual firms. At the beginning of the export drive, targets were command in nature with sanctions used to gain compliance. Gradually, the target setting exercise became a way to identify policy barriers to expanded exports and the firms began to set their own targets. The government role included aggregating and processing information supplied through the export associations. But the targets were more than just projections. A survey of firms by Rhee, Ross-Larson and Pursell (1984) reveals that the firms felt that the target-setting process had resulted in a more rapid expansion of production than they would have otherwise undertaken. Half of the firms surveyed for 1974 and 1975 claimed this, and three-fifths of the firms in 1976. The surveys also reveal

that the government maintained mechanisms for guaranteeing compliance. Only one firm claimed that it had been penalized for failing to meet an export target. Of 85 firms polled, however, 58 mentioned that the rigor of tax collection was linked to export performance while another 38 mentioned that export performance was tied to greater facility and speed in their dealings with government. Sixty-one of 85 ranked "assurance of continued government support for the firm's efforts" as an advantage of good export performance.

The formation of the EPSC and the setting of annual targets provided institutional mechanisms through which the public and private sector were brought together and mutual influence was exercised. What is particularly interesting about the Korean case is that such efforts extended up to the president himself. In 1965, the first National Export Promotion Meeting was held, chaired by the president. The president could act directly on problems that individual industries were facing, often by simply issuing directives on the spot that had the force of law. The meetings provided a way of smoothing difficulties they had in dealing with government ministries (21 firms out of 51 listed this as a primary benefit of the meetings) and permitting decisions of principle that facilitated exporting (16 of 51 listed this).

A second set of institutions that evolved during the early sixties were those concerned with disseminating information and the transfer of what might be called "managerial technology." Given that Korea did not have an advantage in heavily automated machine production that would act to ensure quality, quality control became a crucial issue in establishing a competitive position and a longer-term reputation (Most, 1969:82-90). The improvement of quality poses a collective action dilemma. Any given firm benefits from the efforts of other national firms, but has an incentive to sacrifice quality for price in markets that are price sensitive. The government acted in two ways to overcome this dilemma. The first was the effort to prevent the export of items that did not meet certain standards or con-

tract specifications; the second was to disseminate internal standards and promote the sampling techniques that would allow rigorous testing. Over the early sixties, a network of public quality control organizations were developed.

A greater problem was to meet the design requirements for standardized mass-marketed products typical of advanced country markets. The most obvious channel for marketing Korea's exports were those large retail chains (in the U.S.) and trading companies (in Japan) willing to take a developmental approach to their relations with Korean firms. The problem, however, was in generating the initial interest, since information is scarce on a potential producer entering world markets for the first time, and reputation is non-existent. Korean firms with historical ties with Japan were important in the opening of economic relations with that country, but the government played a large role in making new markets where such connections did not exist. A key recommendation of the EPSC was that an effort be made to induce the executives of leading U.S. chains to come to Korea. In Most's (1969:118) words, "through the U.S. government agencies, the door was opened to meet the top executives of the buying chains." In October 1965, representatives of ten of the largest American buying chains doing a total of \$15 billion of retail business annually were invited to Seoul.

Establishing the marketing nexus worked both ways. Not only did foreign firms have to discover Korea, it was imperative for Korea to establish permanent presence in foreign capitals. In part, this was a foreign policy problem, and new efforts were made to broaden the scope of Korea's foreign relations. The Korean Trade Promotion Corporation (KOTRA), modeled on Japan's JETRO, was founded as a public entity in 1962. KOTRA was the overseas arm of the Ministry of Commerce and Industry and functioned as commercial attaches of embassies normally do. KOTRA assisted manufacturers in locating markets, advised on market requirements and served as a conduit for information between Korean producers,

traders and foreign buyers.

The various economic incentives extended to exporters--fiscal incentives, wastage allowances, etc.--have been listed elsewhere, and need not be discussed here in detail (Hong, 1979). Two policies are worth reviewing, however, because they suggest the curious mix of mercantalism and liberalism in the Korean export program. Probably the most important way in which the government enhanced the profitability of exporting was through its control of credit (Cole and Park, 1983:ch. 6; Hong and Park, 1986). Short-term, low-interest loans were extended without limit against any letter of credit (L/C). L/C loans were made at 6 1/2%, compared with discounts on commercial bills that were 24% following the interest rate reform. The cost of the interest rate subsidy was born by the Central Bank, which discounted the loans by the commercial banks. Since this was a source of guaranteed profit, the commercial banks had an interest in seeking export business. The rediscounting was covered partially out of other profits of the Central Bank and partly by direct subsidies from the government. Such a program, devised by the industry-oriented Ministry of Commerce and Industry, naturally cut against the emphasis on stabilization that had characterized American aid policy in 1963 and 1964. Nonetheless, it was sold by the AID mission, even over reservations of the conservative Ministry of Finance!

The role of trade liberalization in Korea's export growth is a matter of substantial debate. Frank, Kim and Westphal (1975) and Krueger (1979) argue that the sixties was a decade of liberalization, basing their judgement on the 1964-66 period on an increase in the number of items eligible for import and a decline in the number of prohibited items. They also note, however, that after the 1964 devaluation, a temporary special tariff law was enacted to capture windfalls on restricted import items, with tariffs up to 90% being applied, and that an import prepayment deposit was frequently required of 100% of import value. Even after 1965, a number of policies continued to affect the ability to import, including the

obligation to surrender foreign exchange in exchange for certificates, advance deposit requirements, the licensing of traders and minimum export requirements for importers.

Import quotas on individual items were abolished only at the end of 1966. Though this is taken as evidence of the abandonment of discretionary quantitative restrictions and greater reliance on tariffs, the QRs were replaced by a system under which items could only be imported by manufacturers of related products a policy with obvious protectionist implications. The policy of linking importation of some items to the export of similar products created a kind of industry-specific 'barter' system whereby privileges on the domestic market were granted in relation to export performance.

Perhaps the most important change in trade policy is held to be the switch from a positive to a negative list system, a change in policy, which, as with the unlimited discounting of loans against confirmed letters of credit, reduced the degree of government discretion over the behavior of importers. This reform did not come until July 1967, however, and even then, the new system restricted 42.9% of all import categories. Gilbert Brown, a champion of the neoclassical interpretation of Korea's takeoff, states bluntly that "no major industries were left without either quantitative restrictions or tariff protection adequate to maintain strong domestic market positions" (Brown,1973:167; Hong, 1979:107).

In sum, the development of Korea's export capacity followed the following policy sequence. First, stabilization allowed a significant devaluation. Shortly thereafter, a wide-ranging program of subsidies and supports to exporters was also launched designed to enhance the profitability of the export sector. This effort went beyond price incentives, however, to the development of political and administrative structures that allowed private sector input and enhanced the state's capacity to monitor performance. Additional government efforts centered on establishing

market connections between Korea and the outside world by providing information. Liberalization, however, was extremely selective, leaving the domestic market for consumer goods in the hands of local firms.

## V. CONCLUSION

In the late 1970s, Korea's economic policy turned in an even more interventionist direction in an effort to develop heavy and chemical industries (Haggard and Moon 1983; Haggard, 1990:ch. 6). The level of industrial concentration increased dramatically, and an even closer relationship developed between the government and the largest chaebol. It is a telling commentary on the neoclassical interpretation of Korea's growth that not until the government of Chun Doo Hwan in the 1980s were a number of important reforms even contemplated: comprehensive import liberalization, privatization, liberalization and internationalization of the financial sector and a gradual retreat from the subsidization of exports and the industrial targeting that characterized Korea's growth (Moon 1988; Haggard and Moon 1990).

Does Korea offer other developing countries a "model," or are historical peculiarities of the case barriers to drawing any policy inferences or broader generalizations? Some conclusions can be drawn concerning the role of outside pressure in policy reform, the importance of administrative capacity and organization and finally, on the politics of policy change.

The Korean case suggests strongly that the power of outside actors is limited by the internal political situation. Even with Korea's overwhelming dependence on the United States, Rhee was successfully able to resist unwanted reforms. Park, on the other hand, was more politically vulnerable to U.S. pressure. But the success of U.S. influence did not simply rest on the manipulation of aid to achieve desired ends. Two additional ingredients were required. First, the reforms promised to address political problems that Park faced. Economic reforms promised to mobilize foreign exchange and savings and had tangible benefits for the

party in power. Second, the sustainability of the reforms rested not simply on pressure, but on the development of a longer-term cooperative relationship between American aid advisers and Korean technocrats. These transnational ties not only served to communicate ideas from the outside, but also sensitized AID advisers to domestic political constraints.

Second, our account suggests that economic development strategies are not simply packages of discrete policies, but involve the development of administrative capacities. Institutional reform had two crucial functions. First, it enhanced the position of the technocrats within the bureaucracy itself, elevating their status and increasing their control over the power of other ministries. This enhanced the capacity of the government to formulate coherent policy. Second, administrative reforms enhanced the quality of the civil service at lower levels, and thus increased the ability of the government to implement policies.

We have argued that the political networks that sustained Korean ISI were only broken through the intervention of the military and that the ability to implement policy swiftly and flexibly "benefited" from the relative weakness of the legislature and interest groups including business as well as labor. It is an instructive counterfactual to think of what Korea's economy would be like if governments similar to either the Rhee or even Chang Myon governments had stayed in power. Two generalizations might be offered. First, the timing of political cycles matters. The period of most active reform came after Park's political position had been temporarily secured by his election in October 1963. Second, policies are likely to be more effective if the private sector has channels of access to government, but does not dominate the policy process. Some mechanisms of insulation are required to shield business from its own instinctive tendency to exploit rent-seeking opportunities.

Our analysis of the Korean case has broader analytical implications for the

study of economic development in Asia and elsewhere in the developing world. To date, economists have worked in isolation from area and country specialists and political scientists. Economic models are elaborated with minimal attention to the institutional framework. Nor is an effort made to understand why policies are adopted; policy choice is treated as exogenous. On the other hand, regional and political studies have not explored historical and archival materials with an eye toward questions in economic theory, such as the effect of different growth strategies on economic performance. Focusing on the politics of economic policy reform and the role of institutions in economic growth constitutes an important bridge toward truly interdisciplinary work in political economy.

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