The South Korean Model of Economic Development - parameters, problems and perspectives

Prof. Nako Stefanov, Dr. Habil.

Abstract

This report addresses an important and topical issue - the existence of a specific model of economic performance of South Korea, its key characteristics, stages of formation and functioning, problems and prospects.

The aim of the study is to confirm the existence of such a model, which demonstrated sustainable development in different periods of economic performance of the country:

- The period of catching up development from the 60's to the 80's of XX century;
- The economic performance during the Asia crisis in the 90's of XX century – the time of upgrading from an extensive to an intensive mode of functioning;
- The efforts for sustainable dynamic during the time of Global crisis in XXI century.

The study presents an attempt to understand the key mechanisms of this model which provide both the dynamics in the early stages and sustainability in recent periods of development.

Key terms:

South Korean model of economic development, stages of development, catching up development, extensive growth, intense dynamic, Global crisis, key mechanisms.

Content

Introduction

1. The creation of South Korean model of economic dynamics – the catching up stage - early 60’s - late 80’s of XX century;
2. The economic crisis of the 90’s in South Korea – adaptation to the globalization and upgrading from an extensive to an intensive mode of functioning;
3. The specific model of economic performance of South Korea – mechanisms, problems and prospects.

Conclusion

Sources
Introduction

South Korea over the past five decades has demonstrated incredible growth and global integration to become a high-tech industrialized economy. In the 1960s, GDP per capita was comparable with levels in the poorer countries of Africa and Asia. In 2004, South Korea joined the trillion dollar club of world economies, and currently is among the world's 20 largest economies.

The goal of the present report is to analyze is it possible to talk about the existence of a specific model of economic performance – the so called "South Korean model"? What are its basic parameters and mechanisms, its problems and prospects? Certainly it is relevant and important topic, particularly in light of the current financial-economic turbulent situation.

To achieve this goal the report is structured in two sections:

• Review of key stages in the development of South Korea since the 60s of the twentieth century to the beginning of the second decade of the twenty-first century;
• The specific model of economic performance of South Korea – mechanisms, problems and prospects.

As a methodological basis of the report are using such approaches as:

• Systemic approach whereby the model of economic dynamics under study is considered as a system composed of interconnected components acting as a one unit;
• Geopolitical and geo-economic approach - consider recent political and economic relations in terms of the specifics of the particular geo-formed natural environment, which creates unique interactions formats;
• Historical approach which starts from the assumption that the subject cannot be understood if you do not analyze it historically, i.e. how it has evolved over time and space.

The creation of South Korean model of economic dynamics – the catching up stage - early 60's - late 80-ies of XX century

When Korea launched its industrialization drive in the early 1960s, it was a typical developing country, with poor resource and production bases, a small domestic market. The economic situation was more than bleak: Korea's gross domestic product (GDP) in 1961 was only $2.3 billion or $82 dollars per capita. The science and technology (S & T) situation was even worse. There were only two public S & T institutions: the National Defense R & D Institute, created immediately after the end of the Korean War, and the Korea Atomic Energy Research Institute, founded in 1959.

In the early 60-ies of XX century, when political power passed into the hands of Park Chung-hee the primary purpose of economic development of South Korea was posed the
achievement of high rates of economic growth. A slogan "Miracle on the Han River" was raised. In this connection a specific management system of economic processes was created. This system borrows many elements from the Japanese model of economic development, which is characterized by fusion of state regulation and simulation and market elements – the so-called "Catching-up market economy". A particular characteristic of the system is the execution of Industrial policy by the state, which aim is stimulation of industrialization.

In this system a special role is played by the Economic Planning Board (EPB). EPB gets right to influence economic development through budgetary allocations of coordinating the use of foreign economic assistance and distribution of foreign investment. The chairman of BIP receives credentials of deputy prime minister. While the Prime Minister is focusing on political issues, this particular deputy curated economic problems.

Significant role in the ongoing Industrial policy played the Ministry of Finance and especially the Ministry of Trade and Industry. Since 1962 South Korea's economy is developing under the five-year plans. The first 5-year plan to boost the South Korea included the following tasks:

- The development of energy industries (such as coal production and electric power)
- The expansion of agricultural production and aimed at increasing farm income and correcting the structural imbalance of the national economy
- The development of basic industries and the economic infrastructure
- The utilization to the full extent of idle resource; increased employment; conservation and utilization of land
- The improvement the balance of payments through export promotion
- The promotion of science and technology.¹

The successful implementation of the first two five-year plans allows switching to growth rates that are among the most impressive in the world.

The economy grew rapidly with vast improvement in industrial structure, especially in the basic and heavy chemical industries. Capital was needed for such development, so the Park regime used the influx of foreign aid from Japan and the United States to provide loans to export businesses, with preferential treatment in obtaining low-interest bank loans and tax benefits. Cooperating with the government, these businesses would later become the chaebol, i.e. the big industrial-financial groups, which are till now the core of the economic

development of the country. The state facilitated the improvements of these groups for the benefit of Korean economic growth. Inside the operations of Chaebol groups the strong Korean family relationship is important because family members enter the market of business, not an individual. Every Korean chaebol business was started by a family group. It is considered that more than 2/3 of chaebol business is still managed by family members.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Late 1950’s</th>
<th>Mid-1960’s</th>
<th>1983</th>
<th>1995</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Samsung</td>
<td>Samsung</td>
<td>Hyundai</td>
<td>Hyundai</td>
<td>Hyundai</td>
</tr>
<tr>
<td>2</td>
<td>Samho</td>
<td>Samho</td>
<td>Samsung</td>
<td>Samsung</td>
<td>Samsung</td>
</tr>
<tr>
<td>3</td>
<td>Gaepung</td>
<td>LG</td>
<td>Daewoo</td>
<td>Daewoo</td>
<td>LG</td>
</tr>
<tr>
<td>4</td>
<td>Daehan</td>
<td>Daehan</td>
<td>LG</td>
<td>LG</td>
<td>SK</td>
</tr>
<tr>
<td>5</td>
<td>LG</td>
<td>Gaepung</td>
<td>Samsung</td>
<td>SK</td>
<td>Hanjin</td>
</tr>
<tr>
<td>6</td>
<td>Tongyang</td>
<td>Samyang</td>
<td>SK</td>
<td>Ssangyong</td>
<td>Lotte</td>
</tr>
<tr>
<td>7</td>
<td>Keukdong</td>
<td>Ssangyong</td>
<td>Hanhwa</td>
<td>Hanjin</td>
<td>Daewoo</td>
</tr>
<tr>
<td>8</td>
<td>Hankook Glass</td>
<td>Hwashin</td>
<td>Hanjin</td>
<td>Kia</td>
<td>Kumho</td>
</tr>
<tr>
<td>9</td>
<td>Donglip</td>
<td>Panbon</td>
<td>Kukje</td>
<td>Hanhwa</td>
<td>Hanhwa</td>
</tr>
<tr>
<td>10</td>
<td>Taechang</td>
<td>Tongyang</td>
<td>Daelim</td>
<td>Lotte</td>
<td>Ssangyong</td>
</tr>
</tbody>
</table>

Table 2. The economic growth in the Republic of Korea (1961-1970)

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate of economic growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>5,6</td>
</tr>
<tr>
<td>1962</td>
<td>8,2</td>
</tr>
<tr>
<td>1963</td>
<td>9,6</td>
</tr>
<tr>
<td>1964</td>
<td>5,8</td>
</tr>
<tr>
<td>1965</td>
<td>12,7</td>
</tr>
<tr>
<td>1966</td>
<td>6,6</td>
</tr>
<tr>
<td>1967</td>
<td>11,3</td>
</tr>
<tr>
<td>1968</td>
<td>13,8</td>
</tr>
<tr>
<td>1969</td>
<td>7,6</td>
</tr>
<tr>
<td>1970</td>
<td>9,4</td>
</tr>
</tbody>
</table>

http://countrystudies.us/south-korea/15.htm

It was under this setting that Korea started its drive for S & T development. Korea invested $5 million on R & D in 1964, which enabled the employment of fewer than 5,000 scientists and engineers. The economic and technological growth during this period improved the standard for living, which expanded opportunities for education. Workers with higher education were absorbed by the rapidly growing industrial and commercial sectors, and urban population surged.

The growth-oriented economic strategy emphasizing exports inevitably produced side effects. Although the government had been able to manage these side effects and effectively surmount various economic crises, the situation began to deteriorate in 90's. We have to stress that a motivating factor in the industrial sector were closely associated with negative interest rates. With the government backing the heavy industries, electronics and steel industries flourished. But the Asian financial crisis of 1997-98 exposed these weaknesses in South Korea's development model based on high debt/equity ratios and massive short-term foreign borrowing.

The economic crisis of the 90-s in South Korea – adaptation to the globalization and upgrading from an extensive to an intensive mode of functioning;

In 1997 South Korea encountered an economic disaster called the 1997 Asian Financial Crisis. Korea's reserves were severely limited with a total of only $6 billion remaining. International Monetary Fund (IMF) signed an agreement with the Republic of Korea on December 3, 1997 to grant 21 billion dollar loan. Agreeing with the IMF the government starts to take measures for economic restructuring. Structural reforms are made in the form of two main directions - (1) "Big Deal" and (2) "Work out".

The “Big Deal” concerned the Chaebols. Since one of the main objects of this restructuring are large industrial groups on 13 January 1998 a meeting of the President with the owners of the five largest groups, including "Hyundai", "Samsung", "Daewoo", "LG" was executed. In the center of the meeting were discussed five important points:

- Transparency of management;
- Cancel the practice of mutual loan guarantee;
- Restructuring of debts;
- Specialization of the groups within certain industries;
- Overall management responsibility system.

The "Work out" is the main means of restructuring companies through the banks, which hold the majority of the firms debt. This was a process aimed at improving the ability of companies to repay. Specifically this process involved a number of activities such as:
• Reduction or cessation of payment of dividends;
• Removal of mutual guarantees;
• Lending to start a new business;
• Separation of parts of the companies that had no prospects and selling these parts;
• Sale of share capital;
• Remission of debts;
• Conversion of debt into equity of the company;
• Other.

The "Work out" includes 11 major urban commercial banks of the Republic of Korea and 313 companies, which had obligations to them. The Republic of Korea succeeded for a short time to make a significant part of the needed restructuring. This actually stabilized the economy. The latter is evident from the development of the economy in 1999, which has been growing over the previous year.4

<table>
<thead>
<tr>
<th>Year</th>
<th>1996</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate of growth</td>
<td>6.8</td>
<td>5.0</td>
<td>-6.7</td>
<td>10.7</td>
</tr>
</tbody>
</table>

![GDP per Capita Index](1997 = 100)

Figure 1. South Korea’s Economic Recovery After 1997 5

Really the course – “Big Deal” and “Work out” means forming a new type of economic policy, significantly different from traditional industrial policy pursued so far. In the new conditions internationally - the process of globalization as domestically – the

---

necessity of overcoming the extensive and starting intensive way of development, the state is seen in the role of an active integrator. At the same time, it should take it as a one that will minimize the negative impacts of globalization in cooperation with local authorities and civil society groups. As one of the ways to reduce the negative impacts of globalization are considered regional cooperation. This approach seeks to maximize the benefits of globalization, while at the same time protect ourselves from segmentation and polarization of society.

Figure 2. South Korea’s GDP Growth from 1960 to 2007

The Global crisis and Republic of Korea

The launched in 2008 financial and economic crisis is an event with gigantic magnitude and influence on the socio-economic and political matters all over the world. There is a hierarchy of reasons causing its occurrence. The first type causes are concrete and visible, i.e. those are the immediate factors that create crisis situation. In the case of global crisis, these immediate causes are the followings:

Predecessor of the global financial and economic crisis of 2008 is the U.S. mortgage crisis, the first signs of which appeared in 2006 in the form of a decline in sales of new homes. As an essential factor for the credit crunch in the U.S., according the opinions of many experts is a "financial innovation" - the widespread use since the early 90s of the twentieth century of the derivative financial instrument and the aspiration to increase revenues by increasing the risks. It should not be overlooked that there are sets of views that behind every crisis of this magnitude there are reasons that could be called meta-reasons, i.e. fundamental
reasons related to the functioning of the system of global economic processes, or at least the dominant ones in key countries of the world economy.

In the conditions of the global crisis were started different mechanisms of actions, dominated by different ideologies of view of the economic reality. There are many varieties of ways of acting in the different countries. But it is possible to classify them into two types:

- The “Austerity model”, in which the orientation to overcome the imbalances created, is based on cuts in public spending, especially in their social part. The latter act creates increased social tension and a tendency to increase social conflicts with an unpredictable outcome. Put in another way, the emphasis in this model is the financial sector. Its alpha and omega can be expressed with the slogan "Reduce costs";

- The “Production model”, which is seeking balanced development at the expense of raising the technological level and the formation of an innovative platform of economic and social dynamics. Based on this innovative platform the efforts are reducing costs, offering new products, forming new stimulus for growth. The emphasis in this model is in production sphere. If expressed in one phrase it will be "Expanding the perspectives".

In the light of the abovementioned is it necessary to say that the proposed and pursued by Republic of Korea anti-crisis policies should be included in the mode of action, focused not so much to cut costs as to the expansion of perspective. The result of such a model is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012 (est.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth</td>
<td>0.3%</td>
<td>6.2%</td>
<td>3.6%</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

The specific model of economic performance of South Korea – mechanisms, problems and prospects

On the base of the abovementioned review is possible to say that between the years 1961-1997 and 1999-2008 in South Korea was formed and functioned, in spite of the certain transformation in the time, specific models of economic performance. The basic mechanisms of this model are possible to synthesize in the following manner:

1. Proactive Role of the State – in the various stages of its development the state played the following proactive roles:

---

In the catching up stage from the early 60's till the early 90's of XX century – the role of active initiator of catching up dynamic;

In the time of the crisis in the late 90's – the role of active integrator of restructuring policies;

In the time of Global crisis from 2008 till now – the role of active coordinator of various anti-crisis, based on production platform.

One key moment in this proactive role is the efforts to avoid social polarization.

2. Innovations as a key component of the economic dynamic of the country during these three stages:

- 60’s - early 90’s of XX century – creation national innovation system of imitation type and the gradual transformation of the system into multifunctional innovation complex;
- Late 90’s of XX century – efforts for creation of innovation generated development - National strategy for based on knowledge development;
- In the time of Global crisis – searching for technological leadership in important areas.

3. Flexible use of international factors and global circumstances for the goal of the economic development:

- In the catching up period of development – extensive use of the global geopolitical confrontation and seeking USA and Japan support for the realization of the catching up dynamic;
- In the time of the Asia economic crisis in the 90’s – adaptation to the globalization through regional cooperation especially with the fast growing China;
- During today Global crisis – establishment of an international cooperation network there are many questions, which are

Conclusion

The conclusion involves some prognosis concerning the prospect and perspectives of the South Korean model of economic development. Our opinion is that international factor plays key role for this model. From this point of view the perspectives are connected with the possible scenarios of the evolution of the global situation:
• In case of inertial scenario of the global situation the prospects of the further development of the model are low, which means that there have to be made changes in the model, but these changes is not expected to be done in rapid and drastic way;
• In case of improvement of the global situation the prospects of the further development of the model are high;
• In case the global turbulence will escalate more and more it is possible to witness drastic and rapid change of the model.

Sources


