

# **Lecture 4: Case Study – South Korea**

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# Policy is Risky

Truism:

- Good policy is good.
- Bad policy is bad.
- Good policy and bad policy are hard to tell apart.

Inherent risk to government policy

- Sometimes *decentralized* decision-making is better than *centralized* decision-making
- Always?

# South Korea

- South Korea is considered a “growth miracle”
  - From very poor to very rich in 50 years
- Common story:
  - “Embraced free markets and economy took off”
  - That’s “70% right, 30% wrong”
  - More complicated than that
- Go through details of South Korea’s experience
- Compare to Argentina (next class)

# The Case of South Korea



- 50 million people
- 38,000 sq miles (a little larger than Indiana)
- 2014 per capita GDP (nominal): \$25,970 (about half of the US)
- 2014 per capita GDP (G-K \$): \$35,700 (about 2/3 of the US)
- Currency: Won (KRW)
- Democratic government
- Major industries: electronics (Samsung, LG), automotives (Hyundai), shipbuilding
- Major cities: Seoul, Busan

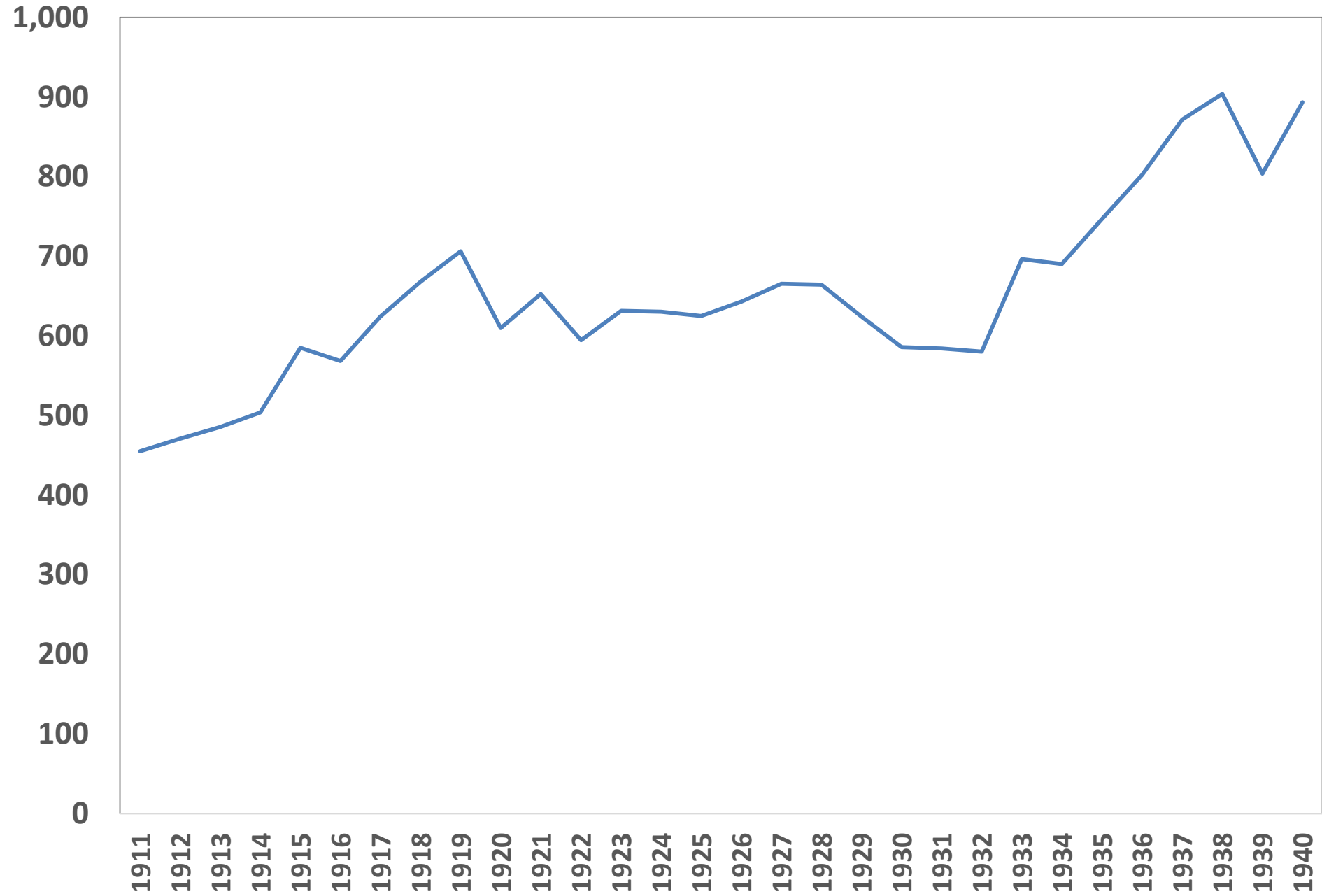
# Korea up to the 20<sup>th</sup> Century

- Korea was united until end of WW2
- Called the “Hermit Kingdom” because of isolation
- Relationship with China defined its history
- Solidly within Chinese sphere of influence until the late 19<sup>th</sup> century
- Relatively poor (compared to China)
- Invaded by Japan and ruled as a colony from 1910-1945

# Japanese Colonial Rule

- Japan used Korea as a rice and agriculture producing region
- Korean independence movements met with violent suppression
- Suppression of Korean cultural identity
- Japan introduced industrialization in Korea
- Production increased substantially
- Partly from war build-up

# Korean GDP per capita: 1910-1940



# World War II and aftermath

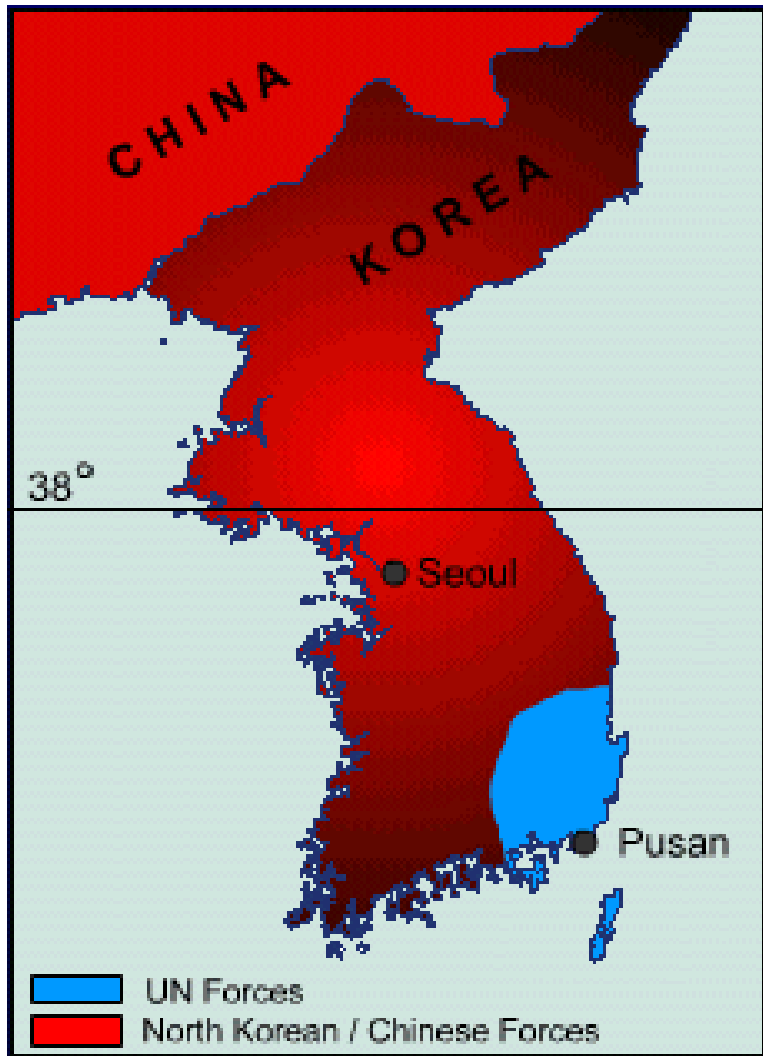
- During World War II, Korea was used to produce for the Japanese war effort
- Large number of Korean workers moved to Japan to work in Japanese factories
- With the surrender of Japan, Korea became independent
- Korea separated at the 38<sup>th</sup> parallel, the north administered by USSR and the south by USA



# Korean War

- USSR withdrew troops in 1948 and the USA in 1949
- North Korean army invaded South Korea on June 25<sup>th</sup>, 1950
  - Ideological conflict between socialism (north) and capitalism (south)
- South Korean army was unprepared and was badly beaten
- By August 1950, South Korean government only controlled the “Pusan Perimeter”

# Effects of North Korean Invasion



Big economic effects of invasion:

- Infrastructure destroyed
- Massacre of intellectuals
- Population displacement
- High civilian casualties

Note that all of these are permanent effects

# Korean War with US Involvement

- US received UN resolution to support South Korean government on July 7<sup>th</sup>, 1950
- Quickly pushed North Korean army to Chinese border



- China entered war supporting N. Korea
- Pushed back to around 38<sup>th</sup> parallel

# Post-War South Korea

- Korean War ended in a ceasefire (not a peace treaty)
- Country devastated by war, following decades of harsh colonialism
- At the end of the Korean War, South Korea's GDP per capita was \$835
  - Sub-Saharan Africa: \$927
  - USA: \$10,316
  - Japan: \$2,336
  - The Philippines: \$1,186

# Post-War Politics and Economy

- Syngman Rhee ruled South Korea through the war until 1960
- Economic mismanagement and stagnation
- Increasingly autocratic
- Election rigging and centralization of power
- After extremely fraudulent 1960 election, overthrown by popular student-led movement

# Military Dictatorship

- After the Rhee government fell, popularly elected leftist government came into power
- Anti-military, anti-police policies
- Military leaders under General Park Chung-hee took over the government
  - Stated reason was to protect the state from communism
  - Also, obvious self-interest

# Summary up to 1961

South Korea in 1961 had:

- Long history of exploitative colonial rule
- Series of recent, devastating wars
- Used by large foreign powers to fight proxy wars
- Unstable and ineffective governments
- Military control of state

In 1961, had 1/10<sup>th</sup> US GDP per capita

- Sound familiar?

# Economic Policy under Gen. Park

- Big inflows of aid from Japan and USA
- Export-oriented growth:
  - Provided zero interest loans for exports
  - Promoted imports of raw materials and exports of foreign goods
- Normalized relations with Japan
- Industrial policy: textiles, then heavy industry, then heavy chemicals
- Heavy government borrowing

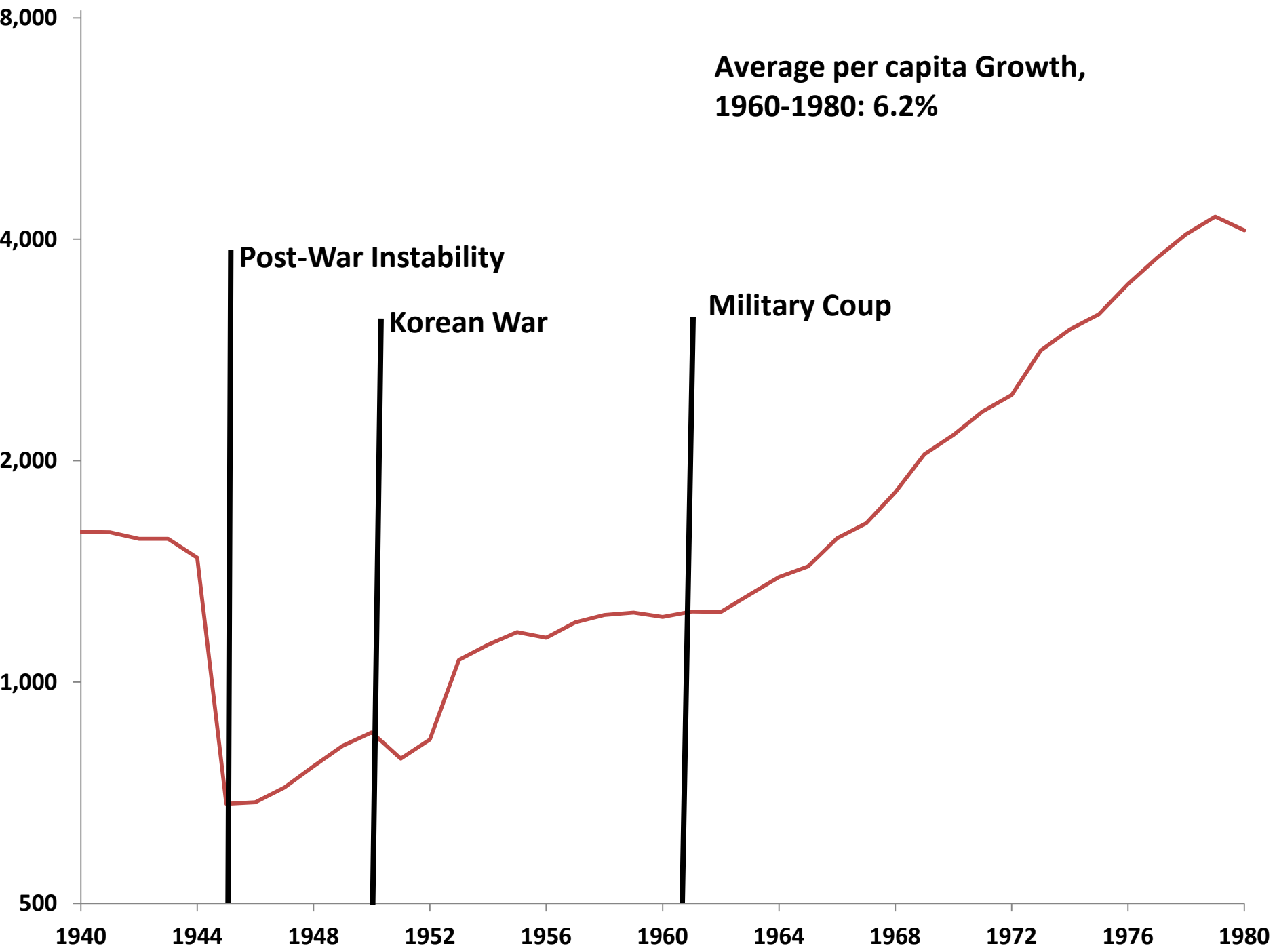


**Average per capita Growth,  
1960-1980: 6.2%**

**Post-War Instability**

**Korean War**

**Military Coup**



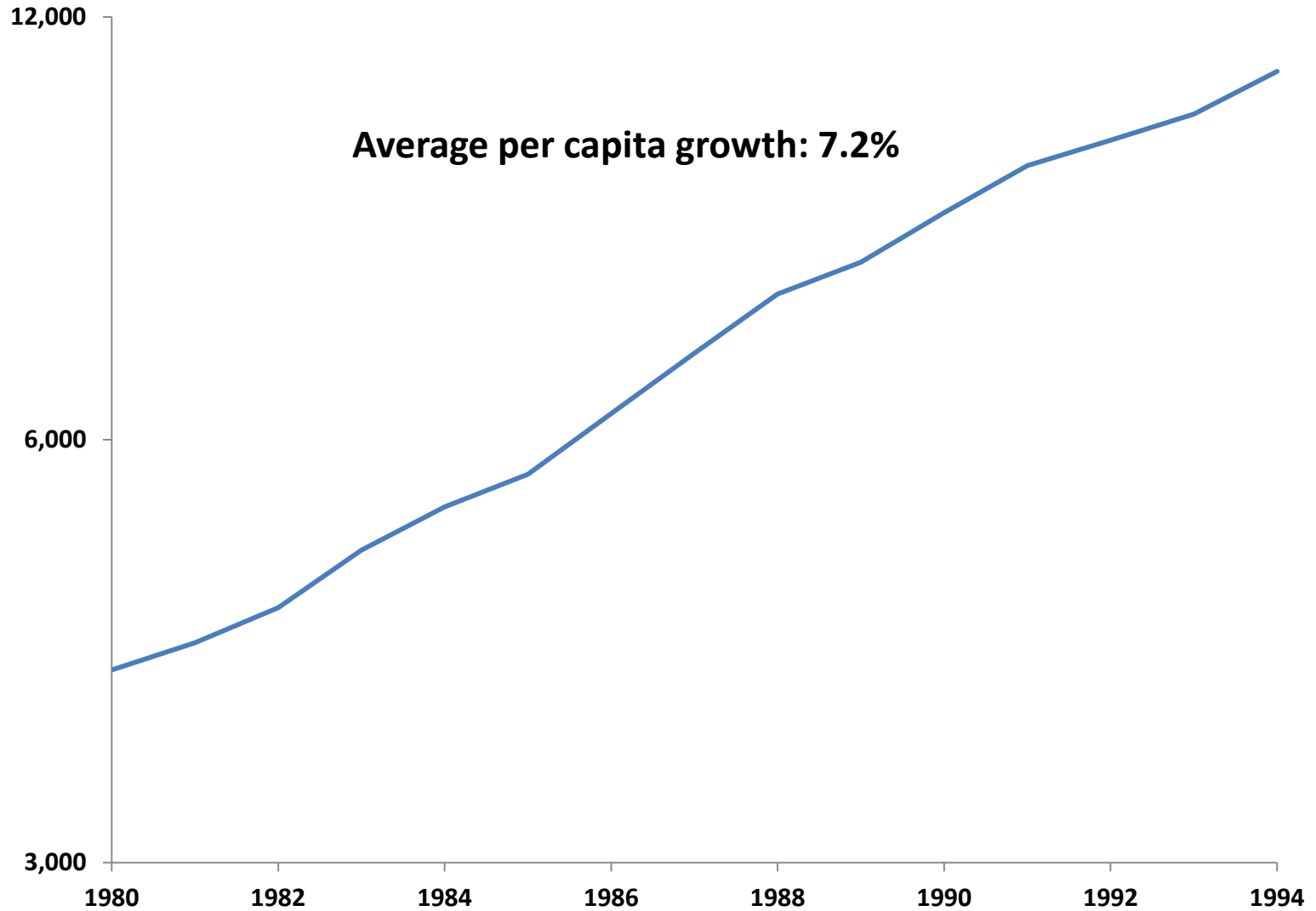
# Transition to Democracy

- In 1979, General Park was assassinated
- Followed two months later by another coup, leading to another military government
- Spring/Summer 1987:
  - May 18<sup>th</sup>: Catholic Priests for Justice Association reveals student tortured to death
  - June 10<sup>th</sup>: Government announces choice as next military-backed president
  - June 10-29<sup>th</sup>: Nation-wide pro-democracy protests
  - June 29<sup>th</sup>: Government accedes to pro-democracy demands

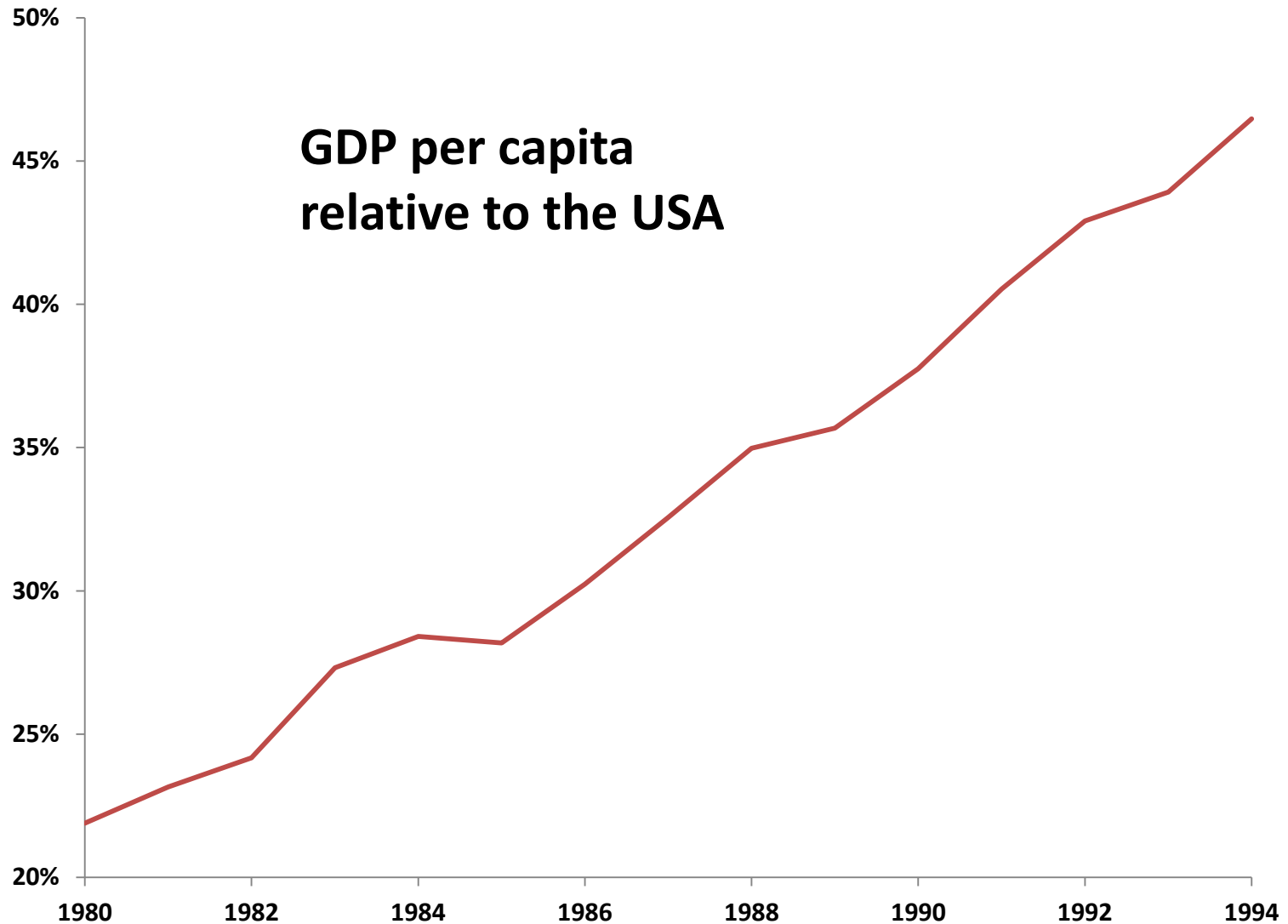
# Economic Policy: 1980-1996

- Tightly controlled monetary policy:
  - Very stable inflation
  - Very stable interest rates
- Removed barriers to foreign investment
- Removed restrictions on foreign travel
- Normalized relations with China
- Electronics and semiconductor industry boomed
- Government direction of major conglomerates
- Fast increases in trade

# Korean Growth: 1980-1994



# Korean Growth: 1980-1994

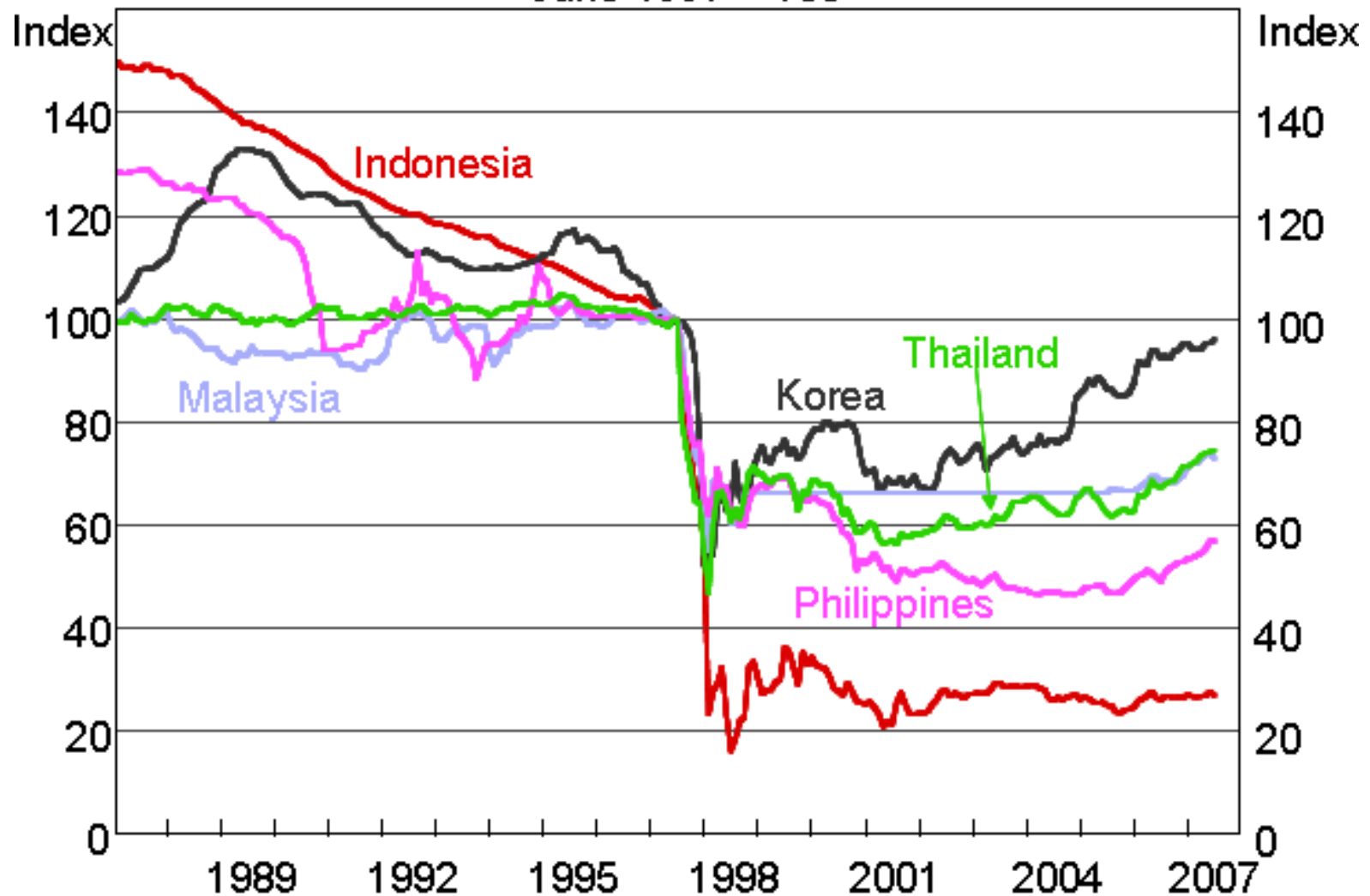


# Asian Financial Crisis

- South Korea very dependent on trade and foreign financing
- Small changes in exchange rates had a big effect on the economy
- Several east Asian economies started to have problems (Thailand, Indonesian, Malaysia)
- Investors worried about South Korea and stopped lending, leading to big swings in exchange rates

# Selected Asian Exchange Rates Against US\$

June 1997 = 100



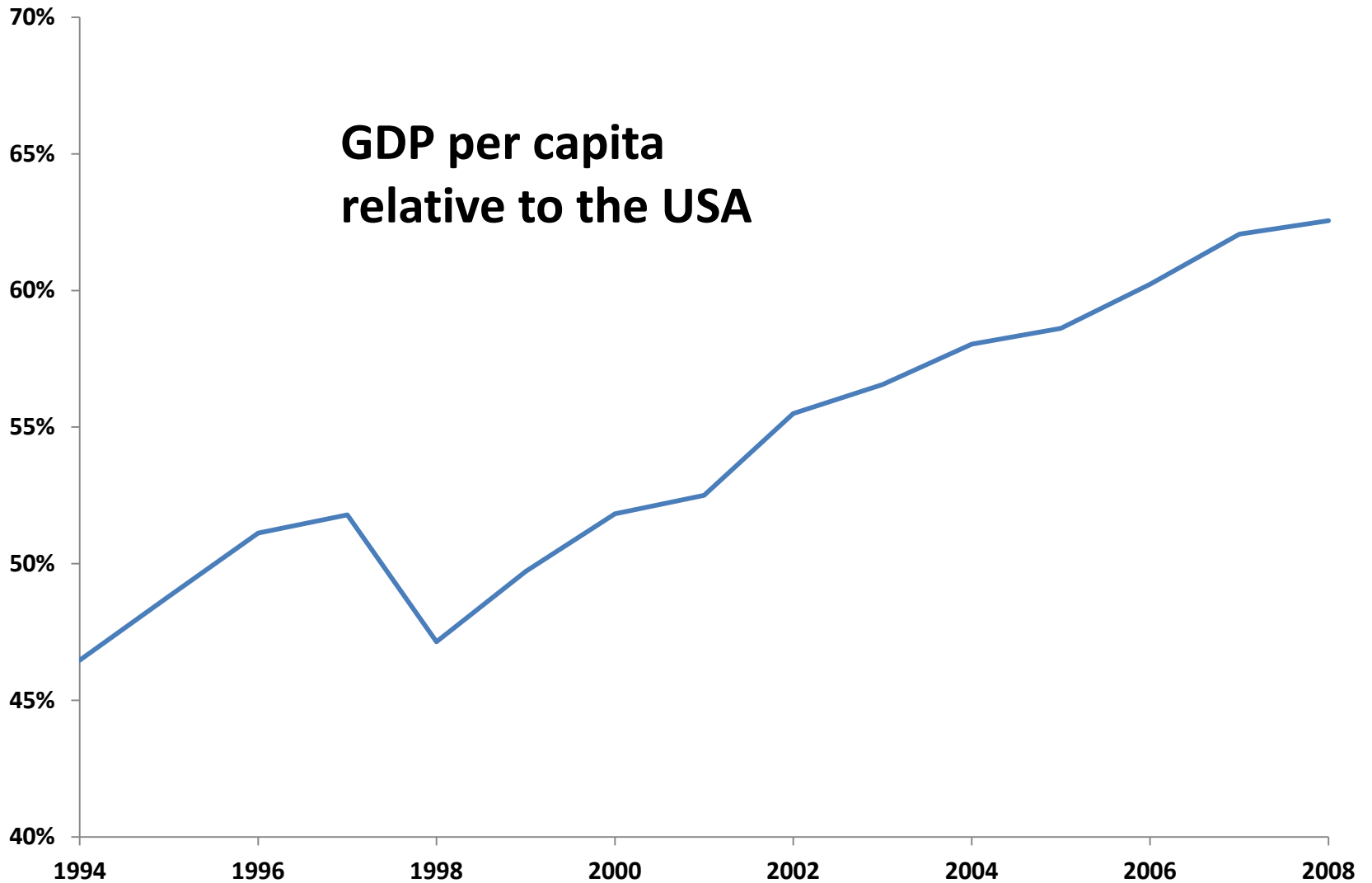
Source: Bloomberg; IMF

# Asian Financial Crisis, conclusion

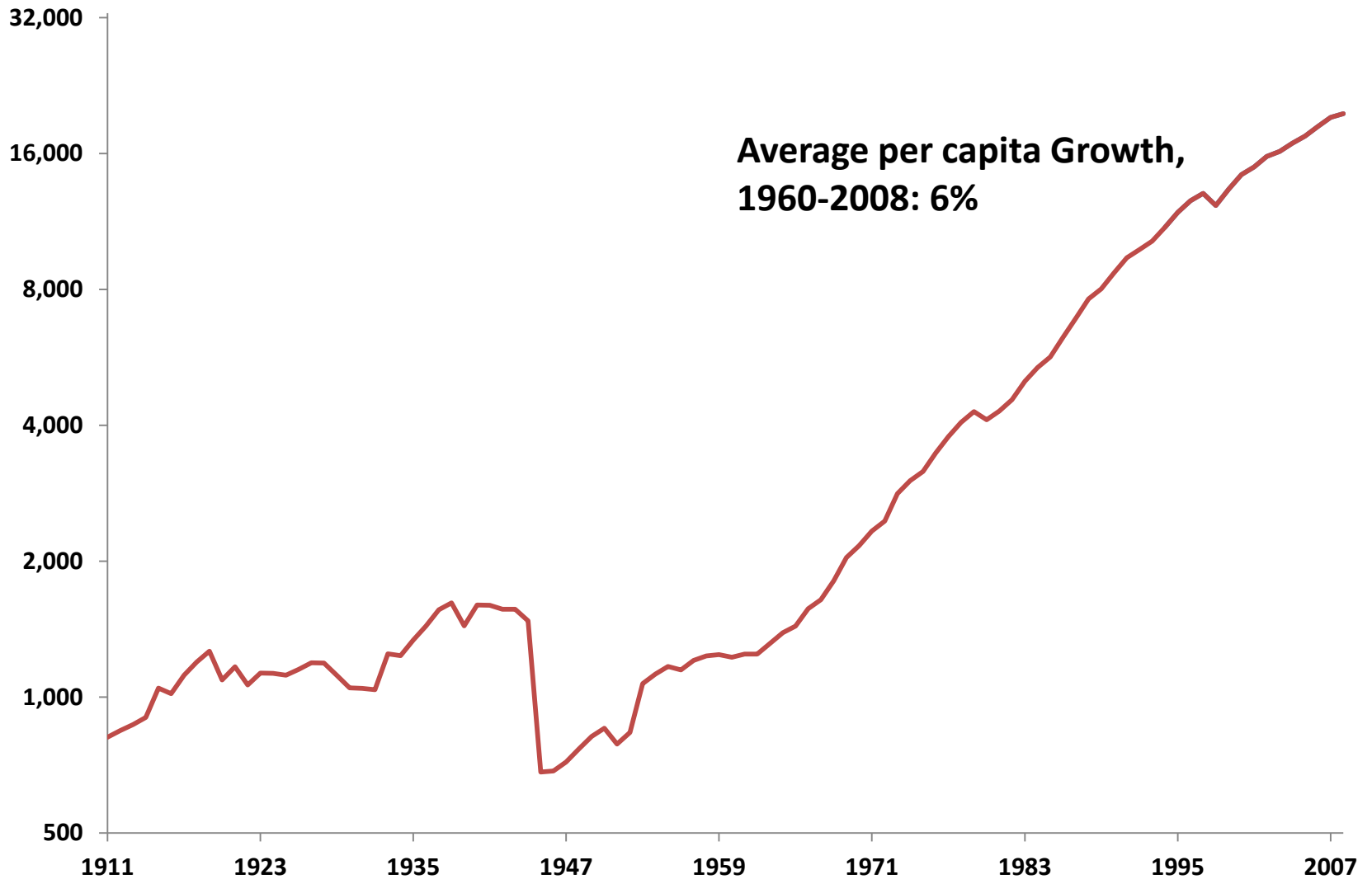
- The International Monetary Fund (IMF) gave South Korea a \$30.2 billion emergency loan
  - IMF is designed to help stabilize currencies
- Required country to pursue austerity measures
  - Less spending by government
  - More taxes
- Losses in growth were temporary



# Korean Growth: 1995-2008



# Korean Growth: 1911-2008



# Korean Growth: 1911-2008



# What did we learn?

- Thought experiment: If you were the leader of a country that is currently poor, what can you learn from South Korea?