

Hyung-Koo Lee

The **KOREAN**  
**ECONOMY**

Perspectives for  
the **Twenty-First Century**

# The Korean Economy

*Perspectives for the Twenty-First Century*

Hyung-Koo Lee

*State University of New York Press*

Published by  
State University of New York Press, Albany

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Printed in the United States of America

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For information, address State University of New York Press,  
State University Plaza, Albany, NY 12246

Production by Dana Foote  
Marketing by Theresa Abad Swierzowski

### Library of Congress Cataloging-in-Publication Data

Yi, Hyŏng-gu, 1940—

The Korean economy : perspectives for the twenty-first century /  
Hyung-Koo Lee.

p. cm. — (SUNY series in Korean studies)

Includes bibliographical references and index.

ISBN 0-7914-2887-7 (alk. paper). — ISBN 0-7914-2888-5 (pbk. :  
alk. paper)

1. Korea (South)—Economic conditions. 2. Korea (South)—Economic  
policy. I. Title. II. Series.

HC467.Y51395 1996

330.95195—dc20

95-39691

CIP

10 9 8 7 6 5 4 3 2 1

# FOREWORD

by Patrick Yeoh

*The Korean Economy* is an ambitious and original attempt to provide a comprehensive diagnosis and a provocative prognosis of the unique path of South Korea's economic development. Hyung-Koo Lee is exceptionally qualified to address this complex and exciting subject. He has brought to bear his extensive public-service experience and strong intellect to the topic. Before his previous appointment as Minister of Labor, Lee served as governor of the Korea Development Bank, and Vice Minister at the Ministry of Construction, the Ministry of Finance, and the Economic Planning Board. As such, he has been deeply engaged in South Korea's economic miracle in recent decades.

After chronicling South Korea's economic development process and those public policies that have shaped this process, Lee proceeds to argue for a fundamental paradigm shift in economic policy if South Korea wants to fulfill its aspirations of joining the ranks of the world's major economic powers at the turn of this century. The government, instead of playing a commanding role as in the past, will, from now on, have to withdraw from the economic frontline. Its new task will be to encourage greater private-sector initiative by dismantling hitherto protectionist policies that no longer serve the long-term interests of the South Korea economy. Lowering import barriers, deregulating foreign exchange and interest-rate regimes, opening up the service sector (including banking) to foreign competition, and removing structural impediments to the internationalization of South Korean enterprises are some of Lee's prescriptions.

The author also gives a succinct analysis of the vast economic potential of a reunified Korea, a unification that must be proceeded with carefully and gradually as it will be a tortuous process fraught with problems.

In the final chapter, Lee outlines two alternative scenarios for the South Korean economy: one opts for temporary high growth at the expense of fundamental reforms, thus allowing many unresolved structural problems to plague the economy in the long run; the other

chooses, as a high priority, to address the structural problems in the economy by implementing fundamental reforms even at the risk of temporarily lower growth, thereby putting the economy on a more efficient and balanced footing for it to advance to the next stage of development. Lee's preference for the second scenario is stated in no uncertain terms.

Indeed, throughout the book, Lee blends strong convictions and insightful observations with objective analysis, articulating them not only passionately, but also cogently.

Readers of this book will find themselves enriched and indebted to Lee for his generosity in sharing his insights and vision with them.

Patrick Yeoh  
President, DBS Bank, Singapore

# FOREWORD

by Charles S. Sanford, Jr.

Torn apart by the Cold War and devastated by a civil war, the Korean economy was in disarray and its prospects for recovery were bleak indeed. Now, only forty years later, the world observes in wonder how this small nation has transformed itself into a potential global economic power and done so without a history of technology or plentiful natural resources.

South Korea's achievements make it a paradigm for other developing nations struggling to achieve economic viability in a global environment of increasing competition. Hyung-Koo Lee's book reviews the industrialization of Korea and analyzes in detail economic environments facing Korea today. It goes on to propose a strategy for further progress, based firmly on the nation's current problems and opportunities.

Previously Minister of Labor in the Korean government, Lee has spent the last thirty years helping to shape the economic strategies of Korea while serving in institutions such as the Economic Planning Board, the Ministry of Finance, and the Ministry of Construction. His observations of Korea's changing domestic and international environments are firsthand, making all the more compelling his call for implementation of economic reforms and the rethinking of the roles of government.

The Korean economy is in a transition. The adjustment is from a low-wage, assembly-type production to that of an industrialized nation with technologies and software as the basis for international competitive advantage. The pains of transition are amplified by the pace at which global economic leaders are developing new technologies, as well as by competition from emerging nations pursuing the strategies Korea once employed successfully.

As globalization of economic activity continues to accelerate, the strategic focus of the Korean economy should be, as Lee describes, to anticipate and benefit from change. At the dawn of the twenty-first century, we can expect an era of prosperity for individuals, corporations, and nations that welcome change and respond to it in constructive ways. Those who resist change will have difficulty finding protective shelters and will fall behind. Lee suggests a broad economic strategy for

the new century that is rich in insight and detail. He views as likely the reunification of the Korean peninsula, and his vision of the nation takes this into account.

Importantly, Lee's book is a prescription for changing the Korean government bureaucracy, which has been characterized by the hands-on management of economic development. Lee calls for the bureaucracy to allow market forces to influence specific economic activities, with the government's role being to provide a consistent and level playing ground for all potential economic agents. The government should no longer be the sole arbitrator on matters such as who gets preferred access to subsidized financing, which domestic markets are protected from international competition, and which businesses that have failed on their own merits are rescued.

Lee advocates competition among various types of financial institutions as well as internationalization of the financial markets, interest rate control, credit allocation, foreign exchange restrictions, entry barriers, and separation of roles among different types of financial institutions—all of these served Korea well in an earlier era, but continuation of such potentially market-distorting mechanisms will stifle further growth. The gradual erosion of the walls separating securities and banking businesses would be an especially productive change, not only for Korea but in many markets elsewhere, including the United States.

In addition to changing the role of the government, Lee calls for implementation of programs to strengthen the economic vitality of the nation. For example, participation by women in the labor market should increase. Investments that develop human resources, such as education, should be stepped up, as should investment to accelerate the development of new technologies. Entrepreneurial spirit should be fostered. Taxes should be levied in ways to encourage bold, new investments and in particular stimulate development of the technology sectors.

Finally, Lee recommends expedient implementation of reforms. As became clear with the adoption of laws on the use of "real" identifications for financial transactions, certain sectors of the society—those adversely affected by even the most enlightened policies—will resist changes vehemently, threatening the success of the constructive reforms. Nevertheless, moments of opportunity must be seized and policies implemented.

As the world continues to watch Korea, I expect Hyung-Koo Lee's work to provide inspiration and impetus that will help the nation advance toward the ranks of global economic leadership.

Charles S. Sanford, Jr.  
Chairman, Bankers Trust Company

## INTRODUCTION

Today we are being inundated by the changes taking place in the world. Each period in the history of humankind has had its own share of changes, but today's world is experiencing changes on a scale unprecedented since the dawn of civilization. These changes are not only the natural by-products of the advent of the mass information age, but also testify to the fact that we are living in a period of epic historical transition.

As the Cold War receded with the collapse of communism, it has been replaced by the emergence of a "new world order." Politically, the United States has emerged as the sole superpower. Economically, leadership has been evenly divided between the United States, Japan, and the European Union. In the past, national strength was determined largely by military prowess. However, in today's world, national strength depends on a country's level of technological development, based on its economic power. This new trend is encouraging a realignment among the nations of the world that are bent on pursuing their own national interests. The structure of multinational negotiation based on the Brettonwoods Accord is giving way to regional economic integration such as APEC and NAFTA. With these changes, the legal concept of the state is becoming meaningless, and the economic activity of nations is being oriented toward the interests of each individual, enterprise, and nation. Merchandise trade, which previously involved the site of production and the site of demand, is now increasingly taking place at the site of demand, where products are directly produced and distributed.

These global changes clearly reflect a shift in the existing order—the globalization of economic activity is rapidly taking place and the distinction between domestic and external markets is blurred. Hence, it is becoming ever more difficult to protect domestic industries or markets. The era of unlimited competition has arrived and is here to stay! Now, everyone in this country, from households and workers to the enterprises and the government, is called upon to do his or her utmost amid these global changes, united under the same goal to enhance competitiveness.



Huge changes have also been taking place on the domestic front. First, a glance at the present stage of Korea's economic development would bring home to us the magnitude of structural changes. Since the per capita GNP reached \$ 7,000, there has been a noticeable shift in both the trends and structure of consumption: in parallel with rapid technological development, industries are undergoing structural adjustment. The standards of comparative advantage among industries are changing. A new social justice policy should incorporate equitable distribution of wealth, relaxation of the concentration of economic power. Fair trade should be further encouraged. Maintaining consistency between macro level and sectoral level policies is not easy any more. Nor is it easy to strike a balance between economic development and policy implementation.

We are troubled in the face of the vast gulf between our goals and the reality. We are witnessing the explosion of pent-up demand that has accompanied democratization, while at the same time disorder, self-indulgence, and irresponsibility have become rampant in our society, where "authoritarianism" is mistaken for "authority." Amid the changes of today, we develop a longing for reestablishing a social order based on a changed, bona fide social authority, replacing the artificial one imposed during the authoritarian era.

Changes are also spilling into North-South relations, enhancing the prospects for the reunification of the two Koreas. We, the Korean people, all hope for reunification, but at the same time, we cannot lose sight of its potentially huge cost. The more fervent our wishes become toward reunification, the more resolute we have to become to work hard for it. We have to realize that reunification is significant not only as a union of the Korean people, but also as a symbol marking Korea's joining the ranks among advanced countries.

This period of change demands its acceptance and adaptation. We simply cannot disregard the tide of change. If we do so, it would be like the ostrich burying its head in the sand. What price have we paid for refusing to open our doors to the outside world and ignoring the tide of change in the late nineteenth century? Like it or not, we must not be blind to this new era of change and global competition. Acceptance of change should occur with the full knowledge of going into global competition. In this era of economic war, we have to pool our wisdom to make the best of the situation. This calls for the complete overhaul of our economic policy. Structural problems that have been postponed under the guise of gradual solution have to be tackled from the perspective of reform. This has to be approached and implemented with a new way of thinking. We have no time for further procrastination.

This book is intended to explore and discuss ways to triumph in the economic war in this era of change from the strategic point of view—how are we going to tackle the structural challenges confronting us within the scope of economic policy? At this important juncture, when we have to make radical changes in existing policies to ensure the development of more mature capitalism, how are we going to approach it?

This book consists of eight chapters. Chapter 1 is devoted to presenting the changing trends currently sweeping the world along with an outlook on future changes. Chapters 2 through 4 discuss how the Korean economy has evolved from a policy perspective. Particular focus is given to a discussion of the bright and dark sides of the Korean economy. Chapters 5 through 7 examine how Korea is going to transform its society amid this deluge of change. Today, the Korean economy faces the daunting task of removing backwardness to advance the nation's economy in preparation for the twenty-first century. In that respect, Chapter 8 deals with what we will have to do to make that goal come true. The appendices are reserved for the principal economic indicators of Korea over the past forty years.

I feel that writing this book has been an enormous burden for me, considering my lack of learning and time. However, I dared to write this book because I felt that not enough effort was being made to cope with the tide of change sweeping the world today, and therefore, I humbly offer my suggestions on the best way to prepare ourselves for the century ahead.

# CONTENTS

Foreword by Patrick Yeoh	ix
Foreword by Charles S. Sanford, Jr.	xi
Introduction	xiii
Chapter 1 Changing Society	1
Changing Values and the Emergence of a New Ethics	1
Technological Innovation and the Industrial Structure	7
Changes in the Input-Output Structure	12
Chapter 2 The Development Process	17
The Dawn of Economic Development (1961)	17
Full-Fledged Economic Development (1962–1971)	18
Achieving Self-Reliance (1972–1979)	19
Implementation of an Economic Stabilization Policy (1980–1987)	22
Korean Economy in Transition (1988–1994)	26
Chapter 3 Economic Policy in a Time of Transition	35
The Engine of a Growth-Oriented Economic Policy	35
Stimulation of the Economy and Investment Policy	39
The Pursuit of Economic Stability	44
Industrial Policies Amid Structural Changes	49
The New Industrial Policy	51
Trade Policies in the Global Age	52
The Corporate Financial Situation and Financial Policy	59
Chapter 4 Democratization of the Korean Economy and Implementation of Nord-Politik	65
Policy Reform for Democratization	65
The Korean Bubble Economy	74
Northern Policy and North-South Korean Economic Cooperation	76

Chapter 5	A Major Turnaround in Economic Policy	79
	The Korean Approach to Becoming an Industrialized Nation	79
	Attitudes in an Era of Unlimited Competition	84
	Revision of Policies for Economic Justice	89
Chapter 6	A New Paradigm for the Changing Era	103
	Introduction of New Thought	
	in Administration and Bureaucracy	103
	A Blueprint for Sharpening the Competitive Edge	
	of Korean Businesses	106
	The Advancement of the Financial Sector	115
	Redefining the Roles of the Government and Finance	130
Chapter 7	The Economic Policy of a Reunified Korea	139
	Lessons from the German Reunification	141
	Economic Cooperation Between the Two Koreas	142
Chapter 8	A Vision for the Korean Economy and the Attitude	
	of Koreans in the Twenty-First Century	149
	The Historical Meaning of the Twenty-First Century	
	for Korea	149
	Possible Scenarios for the Korean Economy	150
	Middle- and Long-Term Prospects for the Korean Economy	151
	The Attitude of Key Economic Players Toward the	
	Twenty-First Century	158
Appendix	1 Principal Economic Indicators	161
Appendix	2 Gross National Product by Industry	179
Appendix	3 Expenditure on Gross Domestic Product	187
Appendix	4 Population and Employment	195
Appendix	5 Structure of Manufacturing Industry	199
Appendix	6 Investment Resources	207
Appendix	7 Scale of Financial Savings	211
Appendix	8 Major Currency Index	215
Appendix	9 Consolidated Central Government Financing	219
Appendix	10 Tax Receipts	223

Appendix 11 Balance of Payments	227
Appendix 12 Structure of Commodity Exports	231
Appendix 13 Imports by Type and Financial Resources	235
Bibliography	239
Index	247

## *Changing Society*

The twenty-first century will be marked by sweeping changes affecting every aspect of our lives “political, economical, and sociological.” The changes will be more radical and abrupt than those we are currently experiencing, and to adapt to them, it is important that we discard the fixed notions we have carried thus far. In another words, a flexibility of thinking is necessary for access to change. I recall a few years ago hearing that the Boston Symphony Orchestra played jazz music for the first time ever in the history of classical music. This would be comparable to the KBS (Korea Broadcasting System) Symphony Orchestra playing popular tunes or a famous opera singer singing popular songs. Trivial as this incident may look, it is an example of sweeping changes without delay.

### CHANGING VALUES AND THE EMERGENCE OF A NEW ETHICS

To ensure sustained development of the Korean economy into the twenty-first century, we have to examine how the changes in the values and ethics of our people will affect our society at large. In general, the development of society means qualitative changes to better the social structure, and economic development that acts as a catalyst for such changes. Although economic development, the driving force behind the development of society, is admittedly driven by material factors such as natural resources and capital, it is driven to an even larger extent by the mental factor, that is, “entrepreneurship.”

The importance of an enterprising spirit in economic development has long been emphasized by scholars. Max Weber pointed out in his famous work, *Protestantism and Capitalism*, that Western capitalist civilization bloomed from the seeds of Puritanism, which stressed thrift and industry along with realistic vocational views. Alfred Marshall, a modern economist, asserted the importance of the mental sphere in eco-

economic development by drawing a comparison between Ancient Greece and Rome. Ancient Greece easily attained economic affluence on the basis of its abundant natural resources, but it sunk into decline for lack of discipline and an earnest mental attitude. In contrast, despite its relative disadvantages in natural resources, Rome established the Roman Empire, ruling for a millennium, because its people had firm goals and a strong will. In *The Theory of Economic Growth*, Arthur Louis also gives top priority to "the enterprising spirit" among the many factors behind economic development.

In fact, studies show that the rapid and dramatic development of the Korean economy would not have been possible without the strong enterprising spirit of the Korean people. Everyone who lived through those times fondly recalls the 1960s and 1970s, when most citizens were happy working long hours on assembly lines to make products for export. The government also had a firm will toward economic development: government officials crisscrossed international financial markets to obtain financing for development projects and worked extensively, formulating economic policies. In contrast, other countries that were also on the threshold of joining the ranks of developed countries failed to do so for lack of entrepreneurship.

In view of these historical precedents, it becomes abundantly clear that economic development and the development of society are predicated on the establishment of solid ethical values and sound social mechanisms.

### *A Society for the Welfare of the Individual*

Although industrial society is marked by a constant pursuit of advancement, the twenty-first century is expected to undergo a second cultural revolution, characterized largely by the quest for individual happiness. In this kind of society, the pursuit of individual interests will be given higher priority than the formation of wealth on a national level, since all people aspire to lead wealthy and affluent lives.

In this type of society, every kind of economic activity will be affected by the tide of change. Take broadcasting, for example. Today's industrial society is based on mass production, mass media, and mass communication. Under these circumstances, therefore, the concept "I" has relatively little significance, drowning in a wave of "mass." This situation does not enrich an individual's life or help bring about personal happiness.

The twenty-first century promises a radical reversal in this trend. The individual will be put on a pedestal. Broadcasting will be on the cutting edge of this change. This would mark the advent of an era of a

"narrowcasting system," which is attuned to individual choice, replacing the current broadcasting system. While technological development has so far been geared toward industrial technology, it will in the future be oriented toward the development of technologies that will boost individual welfare. This idea of putting the individual before the mass was given eloquent backing by E. F. Schumacher who wrote *Small Is Beautiful* as a protest against the mass-oriented society.

### *Changes in Lifestyle and the Second Renaissance*

As the interest in individual welfare and the tendency to seek individual identity in the midst of the masses becomes more prominent, the people's lifestyle will change. As technological and economic development accelerates, people will reevaluate the meaning of their existence, leading to greater interest in the arts and the spiritual realm.

With the resolution of the problem of providing basic necessities—clothing, food, and shelter—people's activities will transcend the level of mere subsistence to reach that of enjoying their lives to the fullest. As the human life span rises dramatically because of epoch-making progress in medical technology and nutrition, the "gray society" will appear. In the twenty-first century, women will expand their activities in broader areas—politics, economy, and culture—enabling them to maximize their potential. With people's lives increasingly focused on making qualitative improvements, per capita consumption of energy, food, and various natural resources will dramatically increase.

People will have a greater need for religion and spiritual fulfillment. Accordingly, the number of religious organizations and cultural activities such as symphony concerts and art exhibitions will proliferate. Recreational activities like professional sporting events will expand. The "material civilization" will demand greater access to such leisure activities. The government will have to support more cultural facilities in an effort to meet the increasing demands of people. Therefore, the next century will see the blooming of the Second Renaissance, overflowing with various cultural activities as John Naisbitt foresaw.

### *Change in People's Ways of Thinking*

The worldwide changes just noted and the cumulative effects of Korea's accelerated economic growth have recently had a considerable impact on Korean attitudes. In carrying out the countless development projects that established Korea's economic foundations, such as building the Seoul-Pusan expressway and Pohang Iron & Steel Co., Ltd., Koreans were satisfied with thinking this would enhance their own welfare. However, when it turned out that a continued economic growth over thirty



to forty years did not bring the expected level of individual well-being, Koreans started to think, "I couldn't care less about the construction of the Seoul-Pusan expressway when the roads in our town still remain dirty and my village doesn't have an adequate elementary school. I don't give a hoot about huge investment somewhere else."

Koreans have become increasingly reluctant to work for economic development at the expense of their individual well-being. They are no longer willing to work on Sundays as in the past, and companies have a hard time putting workers on Sunday shifts. Company machinery in the so-called three-D sector—dirty, difficult, and dangerous—is often left idle for lack of workers.

Frugal consumer behavior is also becoming a thing of the past. It seems that Koreans are obsessed with spending for today rather than investing their increased income for a better tomorrow: the purchase of large fridges and TVs is increasing. Koreans show a growing penchant for oil-guzzling luxury cars.

Unsound consumption patterns have been fanning social corruption and opportunism. Although real estate speculation has greatly abated since the late 1980s, it had been rampant, sending housing and land prices sky high. Workers, for their part, seem to care more about spending their rising incomes than focusing on enhancing their productivity.

The greed of caring only about grabbing one's own piece of the pie is becoming too widespread in Korea. All kinds of people—workers, civil servants, doctors—in our society seems to care only about pursuing their own interests. Particularly, this fierce pie-grabbing contest that started in the ranks of blue collar workers is now spreading to white collar workers. Even many people who are engaged in specialized work are displaying near-sightedness by running after tangible profits, a trend that severely erodes the credibility and role of the leaders of our society, who are miserably failing to guide public opinion in the direction of developing the society.

### *Change in the Desires of Consumers*

The changes in most Koreans' social behavior is having a tremendous impact on the values of consumers. Consumers now show a tendency to seek qualitative improvement in their lives, whereas up to now they had put more emphasis on quantitative and material affluence. Moreover, thanks to an enhanced awareness and a continuing consumer protection campaign, consumers have become more actively involved in fighting for their rights; they have become more assertive in demanding higher quality and service, let alone lower prices. Thus, refusing to follow in the footsteps of yesterday's consumers, who were passively dominated