

THE ROLE OF FOREIGN AID ON ECONOMIC GROWTH:

Lessons from the Korean Economic Miracle

By

Mebrahtu, Kiros Tikue

THESIS

Submitted to
KDI School of Public Policy and Management
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ABSTRACT

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One of the gaps in development economics has been its inability to see the possible impact of foreign aid clearly. All economists who participated in the area came out with variety of results. In this regard the case of the Korean rapid economic development could be considered as one of the unconcluded issues.

According to several politicians and researchers, the Korean economic development resulted from the huge flow of foreign aid. Despite, the internal quality of the nation in its take-off, many researchers and politicians had been observed when they conclude the reverse.

The main them of this manuscript fall on assessing the role of foreign aid on development with especial consideration to the Korean case. In this material the basic questions like 'what is the role of foreign economic aid in Korea's early development (take-off)?' And 'Why the Korean Economy grew fast after the early 1960s? Was Korea got more foreign aid after 1961 than before?' are assessed in depth.

In order to consolidate the discussion the flow of foreign aid before and after 1961 are shown in detail. Based on the nature of the data simple techniques like graphs and tables are used. In addition, some basic economic indicators like GNP, national savings, trade balance and imports by type of expenditure are assessed.

The evidences in the material showed that the role of foreign aid is found to be insignificant in the economic take-off and economic development in South Korea. The volume of foreign aid and the economic performance in the nation showed to be opposite. Thus, foreign aid in Korea was very high in the 1950s, which had been characterized with economic stagnation. In contrast, the Korean economy grew with in very short time when the foreign aid declined and stopped in the early take-off.

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Table of Contents

Abstract	ii
Acknowledgements	iv
Table of Contents	v
Figures	vii
Abbreviations	viii
Chapter-1-	
Introduction	1
Overview and Objectives	1
Map of the Paper	6
Methodology	7
Chapter-2-	
Basic concepts of foreign aid	8
Defining foreign economic aid	8
The role of foreign aid on economic growth	11
Summary of the chapter	15
Chapter-3-	
Major arguments on Korean economic miracle	18
Arguments regarding foreign economic aid to Korea	20
Arguments regarding the Korean export and the U.S. market	24
Chapter-4-	
Foreign economic aid and economic growth (independence-1961)	27
Economic growth strategy in the period	27
Overview of foreign economic aid before 1961	30
Economic performance prior to 1961	36
The trade balances	37
Gross Domestic Product	40
National savings and gross investment	42
Chapter-5-	

Foreign economic aid and economic growth (after 1961)	46
Economic development strategy	46
Overview of foreign economic aid after 1961	51
Measures taken towards implementing the export-led development strategy	55
Major economic policies	55
Incentives to promote the export sector	57
Direct incentives	58
Indirect or administrative incentives	60
Rapid economic growth after 1961 (take-off)	61
The trade balance	62
Per capita GNP	64
 Chapter-6-	
The role of foreign economic aid in the rapid economic growth	66
Foreign aid had played insignificant role during the take-off	66
Market favor as other side of foreign aid	70
 Chapter-7-	
Conclusion and Recommendations	73
Conclusion	73
Recommendations	75
References	78

Figures

1. Figure 4.1. Foreign economic aid (1948-1961)	33
2. Figure 4.2 Aid financed imports relative to total imports 1953-1970.....	34
3. Figure 4.3 The trade balance (1955-1961).....	39
4. Figure 4.4 Korea three-years moving sums of national accounts, 1957-64	41
5. Figure 4.5 Korea national savings and gross investment, 1957-64	43
6. Figure 5.1 volume of grant and loan financed imports, 1953-74	52
7. Figure 5.2 Foreign economic aid received, 1948-83.....	53
8. Figure 5.3 The trade balance, 1965-85.....	63
9. Figure 5.4 Growth of per capita income, 1965-85.....	65
10. Figure 5.5 GDP Vs Foreign aid, 1965-85.....	67
11. Figure 6.1 Share of exports by major trading countries (10-years average, 1967-1974).....	71

Abbreviations

BOK: Bank of Korea

DAC: Development Assistance Committee

GDP: Gross Domestic Product

GNP: Gross National Product

IMF: International Monetary Fund

KOTRA: Korea Trade Promotion Corporation

KTA: Korea Trade Association

ODA: Official Development Assistance

Chapter 1

Introduction

1.1 A Brief Statement of the Problem

It is much more clear that Korea was one of the poor countries, which marked with weak economic performance in 1950s. It was the main foreign aid receiving country in the world. Imported goods to the nation were financed through grant from foreign countries and agencies for the whole decade. The major economic indicators for the period showed that the living standard of the Korean citizens in the period was 32 times lower than of their grand sons.

Surprisingly, Korea became one of the newly industrialized nations with in less than one generation. Recent reports on science and innovation proved that the nation is among the top Knowledge based economies. According to the OECD Science, Technology and Industry Scoreboard, Korea is the second country in high and medium-high-technology manufacturing.¹ Thus, its economic progress is among the impressive economic changes in the century.

¹ OECD Science, Technology and Industry Scoreboard, 2001

The rapid change from very low economic performance to high economic strength and prosperity in Korea provokes to raise very important questions in the area of economic development. Why South Korea grew fast and other similar countries are not? What are the main factors for the Korean success in the early 1960s (take-off)? Such basic questions are in the mind of researchers and politicians in the world. This is the reason why several researchers devoted their time to digout the secret of the economic success in South Korea.

In answering such basic questions all people took different stands on the factors of economic miracle in South Korea. Many of the researchers and politicians in less developed countries stressed that the Korean success is directly related to foreign aid.

As the effect of the above conclusion, the leaders and politicians in less developed countries dragged their feet to learn about the Korean economic development experience. In stead, they linked the success to the flow of foreign aid and concluded that Korean economic miracle is exceptional phenomenon in the world, which

happened because of the special interest of the United States in the region and its support for the nation.

This paper is devoted on the line with the contribution to prove the role of foreign aid in economic development. The corner stone of this paper falls on the argument that foreign aid has no significant role on fast economic development. The sole example on this regard is the case of South Korea. In contrast to the conclusions from politicians and scholars in less developed countries the success of South Korea goes to the internal strength of Koreans theme selves.

To prove the weak effect of foreign aid on the course of building the Korean economy, I strongly stressed on answering and assessing puzzles like, 1) what is the role of foreign economic aid in Korea's early development (take-off)? 2) Why the Korean Economy grew fast after the early 1960s? Was Korea got more foreign aid after 1961 than before? And 3) comparing the export volume of Korea to American market with respect to the Korean miracle.

According to the findings in the paper the clear difference between foreign aid and the economic progress could be showed in two main periods, before 1961 and after 1961. The period before 1961 observed to be characterized with huge flow of foreign aid and economic stagnation. South Korea showed as the main foreign aid receiving country in the period.

Thus, we can confidently conclude that South Korea was running through foreign fund. Unfortunately, the economic indicators in the nation continued to be worst until the early 1960s. Therefore, the empirical findings in this material showed that foreign aid had no significant impact on the economic performance of South Korea. Plenty of evidences are presented on the line with to prove the economic stagnation and the pick time of flows of foreign aid for the period.

In the same way, the trends of foreign aid and the economic progress after 1961 continued to be opposite. Chapter 5 of this material shows that foreign aid to Korea in the considered period is much lower than in the period before 1961. This flow of foreign aid became negligible during the 1960s and totally stopped after the

early 1970s. In the opposite direction the economic progress of the nation became very impressive and the Korean economy became among the fast progressing economies and prosperous in short time. Therefore, all evidences for all periods in the material showed that foreign aid has almost negligible impact to economic development in South Korea. The case of South Korea is also considered as sole example to see the impact of foreign aid on economic development is more less than right domestic strategy and policies.

In the paper, the perception of leaders and politicians in less developed countries is given top priority. Many of them observed when they highly relied on foreign aid and focus on external economic factors based on the miss leaded conclusions on the Korean miracle. Thus, this material contributes on explaining the Korean economic miracle correctly and it may beneficial for these who are poor countries and interested to seize the relevant experiences.

1.2. Map of the Paper

The paper starts by demonstrating the basic concepts of foreign aid. It consists definitions and arguments regarding foreign aid. The followed chapter gives special focus on the arguments regarding the role of foreign aid in the Korean economic development. The arguments in this part are the main motive to develop this material.

The next chapter explains the economic development strategy, the economic performance and the export sector by comparing with the volume of foreign economic assistance in the period prior to 1961.

In addition, the paper tried to assess the period after 1961 by giving glance to the above main issues and the share of Korea's export to the United State in order to see its role in the export and economic growth.

In chapter 6, the role of foreign aid on the Korean economic development is discussed separately. Then the paper ends up with final conclusion and recommendations.

1.3 Methodology Used

The paper depends on the data from Bank of Korea website and data in different literatures, which may be used for other purposes. The research problem based on the conclusions and findings from some books and understanding of leaders and politicians in developing countries regarding the Korean economic development success.

The main tools used in my analysis are graphs and tables. The nature of this paper is more qualitative. In order to elaborate the discussion I have used several graphs by dividing the economic history of Korea in to two parts, before and after 1961.

Chapter 2

Basic Concepts of Foreign Aid

2.1. Defining Foreign Aid

According to different literatures, the term foreign aid takes several definitions. Not only in its definition, by name refers to foreign assistance or development cooperation even sometimes partnership. According to the history, foreign aid as an instrument of national policy dates from the 18th century, when Frederick the Great of Prussia subsidized certain allies to assure their military support and effectiveness. This practice continued intermittently in Europe during the 19th century. (Britannica, vol.4 877)

The concept of aid is quite broad in its variety and dimensions. As Peter Burnell noted out, aid goes to a states, proto-states and would-be states, even countries with whom the provider doesn't have normal diplomatic ties, for instance North Korea's receipt of rice aid from South Korea and Japan.²

In the other side, foreign aid could be used as main tool for some strategic or political interests. Even we can't deny that it some

² Peter Burnell, *Foreign Aid in a changing World*, 1997, Open University Press

times and by some donor governments used as a means to strengthening trade relations with receipt countries. Therefore, foreign aid is huge & complex area of economic development. Because of its complexity, clear definition of the term is the prerequisite for this material.

In common usage of the term foreign aid, it takes the form of humanitarian aid, transfer of lethal equipment between governments (which includes military assistance or military support). On the other hand, the tax incentives and cash grant member states offer for a certain country to attract inward corporate investment also are often referred to as aid.

Further more, the loan provided by International Monetary Fund (IMF) and other banks, which much of their financing is at interest rates barely more favorable than commercial or near-to-market terms is conjunct with aid. Similarly some market arrangements for imported goods from a certain country also considered as one form of aid.

So far so forth, the common usage of the term aid in the above explanations doesn't provide a clear and consistent lead for the analysis of the economic impact of foreign aid in developing countries. Thus, summarized and clear definition of the term is strongly needed for the impact analysis of foreign aid on economic growth.

Foreign aid is international transfer of capital goods or services for the benefit of other nations and their citizens. Official foreign aid is offered in two major forms, capital transfers, in a cash or kind, either as grants or loans and technical assistance and training, usually as grants in the form of human resources and technical equipment. (Britannica, vol.4 877)

In the same way, the Development Assistance Committee (DAC) defines oda as resources transferred on concessional financial terms with the promotion of the economic development and welfare of developing countries as the main declared objective. This embraces humanitarian assistance and emergency relief, which have a longer history than development project aid.³

³ Peter Burnell, Foreign Aid in a changing World, 1997, Open University Press

2.2. The Role of Foreign Aid on Economic Growth

Intensive studies had been conducted regarding the role of foreign aid on the growth of developing economies. The main intuition here is to give general highlights on the findings and conclusions with respect to the main objective of the material.

Dozen of economists argued that growth of developing economies depends to a large extent on their own economic policies. For instant, Craig Burnside and David Dollar noted that poor countries with sound economic policies benefit directly from the policies, and in this environment aid accelerates growth. In highly distorted economies, however, aid is dissipated in unproductive government expenditure.⁴

In the same way, they figured out that aid might have more impact on growth in the developing world if it were systematically allocated toward good policy environments.

On the other hand, many economists argued foreign aid has no positive impact on the growth of developing economies. Peter

⁴ The American Economic Review, Vol. 90, Number 4, 2000.

Boone has presented a simple analytical framework where poverty is caused or enhanced by distortionary policies introduced by politicians. According to him, aid does not promote economic development for two reasons: poverty is not caused by capital shortage, and it is not optimal for politicians to adjust distortionary policies when they receive aid flow.⁵

Not only Peter Boone other economists share this argument. Peter Burnell underlined the role of foreign aid as insignificant at all for economic development in less developed countries. According to Burnell, aid is neither a necessary condition nor a sufficient condition for development or economic growth.

Even the DAC acknowledges that Official Development Assistance (oda) is less important than 'healthy access' to international markets, capital, and technology, and that all of the external factors play only a secondary role to the efforts of the people in developing countries. Figures consistently bear out a positive correlation between economic growth rates in the developing world and

⁵ National Bureau of Economic Research, Working Paper 5308, 1995

integration into world markets for goods, services, capital and labor.⁶

Some of the researchers also noted that the foreign aid impact on the economic growth is mixed and contradictory. A more recent empirical work on the impact of aid on growth made use of data 1960-70, 1970-80, and 1980-83, and added two more variables as possible determinants: exports and literacy proved the result is mixed.

The study concluded "that aid in the aggregate has no demonstrable effect on economic growth in recipient countries in either period," contradicting Papanek's findings for the 1960s. The multiple coefficient of aid on growth is negative (-0.0492) and significant at 5 percent in the 1960s, positive but altogether insignificant in the 1970s and 1980s.⁷

The other extreme side advocated that foreign aid plays critical role in economic growth of some developing countries. The sole example

⁶ Peter Burnell, *Foreign Aid in a Changing World*, 1997, Open University Press.

⁷ Romeo A.Reyes, *Absorptive Capacity for Foreign Aid*, 1993, Philippine Institute for Development Studies.

for this side is the case of economic development success in South Korea.

According to David C. Cole, the massive inflow of foreign assistance before and during the Korean War was essential to the survival of South Korea as an independent country. Continuation of a high level of economic assistance for the decade after the war probably made the difference between the small 1.5 percent per annum growth rate and no growth at all in per capita income. Without this growth, the living standard of the population would have remained desperate, political cohesion would have deteriorated, and the foundations for subsequent high growth would have not have been forged.⁸

The above arguments are some of the different conclusions drawn by economists and politicians. These arguments indicate that foreign aid is huge, complex and fragmented subject. The findings on the subject not only they are inconsistent but also contradictory each other.

⁸ Cole, D., Korean Economy: Issues of Development, (1980) (P.26)

It was learned that the final conclusion on the developmental role of foreign aid is a question with out clear-cut answer negatively or positively. I feel this may be concluded by Henry Bruton remark. According to him 'aid is necessary in a variety of ways, but one of the great failures in development economics has been its inability to see clearly where aid can help and where it harms and defeats.'⁹

2.3. Summary of the Chapter

From several researchers, we can understand that foreign aid is unsettled aspect of development economics. Nevertheless, researches conducted in this area can't be undervalued in their contribution to analyze its impact. They provided us very important guide for other researches that can give generalized and consistence answer for role of foreign aid in the future.

We have learned that the role of foreign aid in economic growth is not defined clearly where it could be useful. Based on previous findings, additional effort is needed in the area.

⁹ Henry J.Bruton (1985), P.1120.

In any side, we can put the following four different conclusions in previous works:

1. The first side has concluded the role of foreign aid on economic growth is almost negligible. Even though, they failed to give precise answer if foreign aid affects the economic growth negatively or positively, they confirm that foreign aid has no any correlation (negatively or positively) with economic growth.
2. The second group believes that foreign aid can affect the economic growth of developing countries if it is allocated in good domestic policies.
3. Foreign aid plays crucial role in economic growth through filling the capital shortage in developing countries.
4. The last and the fourth group say that foreign aid affects economic growth negatively by increasing government structure and/or expenditure.

Even though the above conclusions are different and may be contradicted, all of them have their own credits. This is true because of two main reasons: there is considerable difference in their data considerations and for sure there is no standardized data

classification and clearly handled data in this area. For the purpose of this study the above conclusions can be as initial fact. Therefore, this study is expected to contribute some evidence on one of the above-discussed four different findings in previous studies.

Chapter 3

Major Arguments on Korean Economic Miracle

Intensive studies had been conducted regarding the rapid growth of the Korean economy and the export sector. My intention here is not to explain the detail history of the Korean economic development nor the export growth.

The main focus of this paper is on assessing three basic puzzles, which are 1) what is the role of foreign economic aid in Korea's early development (take-off), 2) why the Korean Economy grew fast after the early 1960s, was Korea got more foreign aid after 1961 than before. And 3) comparing the export volume of Korea to American market with respect to the Korean miracle.

Before my detail discussion on the above puzzles, it is quite important to mention the major arguments and believes regarding the rapid Korean economic growth.

In fact, many scholars have tried to assess these topics in different dimensions. But I strongly believe that every scholar doesn't explain clearly and in balanced way about the internal strength of

Koreans in their early development or explained in biased way that gives more emphasis to the role of outsiders.

The sentiment of the American scholars and some Koreans who assess the Korean economic development is basically the same. They tried to bold the role of the U.S. and they stress more on the weaknesses of the developmental state at that time.

In the same manner the leaders of today's low-income developing countries lack commitment to seize the important elements of the Korean economic development experience. In stead, they claim to get open market for their exports from America as well as massive economic aid from foreigners. They believe Korea had succeeded because of these factors. Therefore, the correct explanation of the economic growth of Korea has very important implication for all low-income developing countries.

The main motive for developing this material falls on the arguments and controversies on the experience of the Korean miracle. Despite, some general statements, most of arguments on the issue are

along the side of appreciating and bolding the foreign aid and other external factors in the Korean economic success history.

Most of the extreme arguments in favor of foreign aid for its crucial role in Korean economic take-off could be represented by the following some arguments.

3.1 Arguments Regarding Foreign Economic Aid to Korea

Ethiopian People's Revolutionary Democratic Front (the current ruling Party in Ethiopia) has designed comprehensive economic plan to achieve rapid economic growth in the country. In its economic plan, it took in to account the economic development success of South Korea and Taiwan.

Unfortunately, many politicians and scholars argued that this plan is simply dream and impossible to realize. According to them, South Korea or Taiwan's economic success strongly depended on massive foreign aid. Particularly, U.S. interest in the region enabled them to collect large sum of aid and the only reason for their success was foreign aid.

Based on this argument, do you think we have the same opportunity like South Korea and Taiwan to get massive aid? If not, what will be the way to achieve fast economic development like that of the Korean and Taiwan economic miracle?¹⁰

The above comment and/or question were directed from journalists to Prime Minister Melles of Ethiopia in Amharic (local language) on Oct 26/2001.

Indeed, this idea certainly shared by most politicians and scholars in developing countries. Whether they have sufficient evidence of the matter or not, they tended to conclude South Korea's economic success was the result of massive foreign aid.

In similar way, we can see the other part of this argument from some scholars. The book written by David C. Cole, Youngil Lim, and Paul W. Kuznets can be my main reference to the whole issues of discussions in this regard. The scholars' main target in their discussion was to show us the dominant role of economic assistance from U.S. for the Korean economic development. Despite their data,

¹⁰ Prime Minister Melles's interview with local journalists Amharic TV (translated to English), Oct 2001

they tried to magnify the role of foreign economic assistance by even trying to include the military imports as one of the economic assistance and basic investment. These scholars explained the foreign assistance to Korea in the following way.

The availability of national accounting statistics from 1953 on makes it possible to assess the role of foreign assistance in a more quantitative framework than is possible for the previous years. But there is still a problem in arriving at exact figures, because Korean statistics have tended to understate the magnitude of foreign aid by omitting military assistance, loan-financed economic assistance, some portions of the PL 480 agricultural commodities, and Japanese grant aid. The United States, on the other hand, publishes comprehensive statistics on obligations or payments for U.S. fiscal years, but these seldom bear any resemblance to the Korean statistics, which are in a calendar year arrivals bases. Thus, it is not easy to relate annual aid flows precisely to concurrent national accounts magnitudes in Korea.¹¹

¹¹ Cole, D., *Korean Economy: Issues of Development*, (1980) (P.12)

From the above brief explanation in the book written by these scholars, we can simply grasp that they tended to conclude the Korean economy grew because of the American aid including the importation of military equipments. In their explanation they mentioned that it is difficult to take inventory of the foreign assistance. But they have tried to give emphasis to the critical role of foreign economic assistance. Even though, they had no any empirical evidence, their final conclusion on the matter is the following.

The massive inflow of foreign assistance before and during the Korean War was essential to the survival of South Korea as an independent country. Continuation of a high level of economic assistance for the decade after the war probably made the difference between the small 1.5 percent per annum growth rate and no growth at all in per capita income. With out this growth, the living standard of the population would have remained desperate, political cohesion would have deteriorated, and the foundations for subsequent high growth would have not have been forged.¹²

¹² Cole, D., Korean Economy: Issues of Development, (1980) (P.26)

According to the writers the contribution of foreign assistance to a country's development is generally assessed in two main dimensions: (1) as a supplement to domestic savings that makes possible a higher rate of capital formation; and (2) as a supplement to imports that permits a higher rate of production from existing capacity.¹³

3.2 Arguments Regarding the Korean Export and United States Market

Most of the arguments regarding the Korean economic growth emphasis on the U.S. market opportunity. These arguments showed that trade relationship between these two countries had critical impact on the overall Korea's economic growth. Similarly, leaders of less developed countries argued that they could not be blamed based on the Korean rapid economic development. Because they believe Korea grew by special market opportunity from United States.

Not only these people, different scholars also agree on this issue. They have given top importance for the U.S. market in the history of Korean economic growth. But the Korean exports to U.S. market

¹³Cole, D., Korean Economy: Issues of Development, (1980) (P.26)

was not very far large when compared to the exports to Japan. And when we see the import-export of Korea for several years, we can observe that there were several countries, which were trade partners to Korea.

In the other part of this paper we will assess the other markets including the exports to U.S. But in this topic we can see the argument given by David C. Cole in his book, which explains the role of U.S. in the Korean economic growth.

Indeed, exports have not only been the leading sector in the Korean economy, but they have also stimulated growth in other sectors. It is noteworthy that, during the 1960s, the demand for Korean merchandise grew even faster in the U.S. than in the rest of the world. In 1968, at the peak of this trend, Korean exports to the U.S. amounted to 52 percent of her total exports. Thereafter, this percentage declined, but it has stabilized for the past five years at about one-third of Korean goods, and is likely to remain so for decades to come.¹⁴

¹⁴ Cole, D., Korean Economy: Issues of Development, (1980) (P.31)

Cole, D. emphasized on the role of U.S. markets but not other markets. This implies that he tended to magnify the role of the U.S. market for Korean economic growth. The main concern here is not the issue of simple explanation of the Korean export volume to U.S. market. But it is beyond the simple explanation and has very important meaning to these of still poor countries.

Chapter 4

Foreign Economic Aid and Economic Growth (Independence – 1961)

4.1. Economic Growth Strategy in the Period

An independent government was established in August 1948 in South Korea after 36-years Japanese occupation. According to different writers, this time was a separation of the South from the North and the separation from the Japanese economy.

Therefore, liberation and independence was not an easy task for new South Korea. The new nation remained only with agriculturally suitable environment and light industries. The natural resource potential and heavy industries remained in the North part. Simultaneously, Japan had quieted its major supply of capital goods and finished consumer goods to South Korea.

As a result of the evacuation of Japanese considerable gaps were created in the areas of technicians and management manpower. In other words, there were bottlenecks in the Korean economy, which challenged the nation as a new and small country.

On the other hand, the government was faced with vast problems, mainly, higher rate of unemployment, hyper-inflation, trade balance deficits, food shortages including day-to-day necessities such as medicine, power, fertilizer, etc...Therefore, South Korea had appeared as independent & liberated nation with set of problems. As a result the whole economy was subject to foreign economic aid.

Similarly, Korea was challenged by nation-wide problem after its independence. Despite its economic and human crises, the Korean War was the challenging problem after 2-years of independence, in 1950. In fact, this war was the worst phenomenon in the Korean history.

During the war unemployed mass including the displaced people were suffered with starvation and disease. Existing infrastructure and poor economy were destroyed during the war. In sum, the period 1948-53 was a great challenge for Korea as a nation and governments in that period.

The above-mentioned problems were the main motives to the government to device sustainable solutions. It was expected to

focus on long-term solutions instead of short-term solutions, which were subject to massive relief aid.

Therefore, the government gave great emphases on in-ward looking development strategy. The main focus was on substitution of consumer goods and some heavy industries like cement and fertilizer.

The in-ward strategy was supported by protective measures. Quantitative import restrictions and high tariff are the measures, which almost completely sealed off domestic industries from foreign competition.

In addition to the above restrictions, the official exchange rate was overvalued. In this period, import-substituting industries were significantly subsidized. They had been receiving tax and financial subsidies. Unlike to the import substitute industries, the export producing industries were not subsidized significantly.

Despite its vision, government in the period 1953-61 failed to bring about stable and fast economic progress. Therefore, they divert

their attention to mitigate the trade deficit and the whole economic problems by only trying to raise high foreign economic aid and restrain import demand. Suk Tai-Suh summed up the situation in his article.

...The period of 1953-61 during which the real GNP grew at 4.4 percent annually on average was characterized by the following three factors: (1) heavy dependence on foreign economic aid, (2) heavy protection of domestic industries from foreign competition, and (3) a consistently over-valued foreign exchange rate policy coupled with severe foreign exchange control.¹⁵

4.2. Overview of Foreign Economic Aid before 1961

Korea had received massive foreign economic aid for continuous period, starting from independence to 1961. In most cases the foreign economic aid donated to Korea was not in loan form but almost fully in grant form. Particularly, during the period 1945-53, the nation received a total grant of 1041.1 million U.S. dollars.

¹⁵ Suk Tai Suh, The effects of export incentives on Korea export growth, 1981, Korea Development Institute

Some scholars (e.g. Suk Tai Suh) argued that the annual in flow of foreign economic aid to Korea reached about \$200 to 300 million U.S. dollars in the period prior to 1961.¹⁶

This shows that the government top priority was financing its balance deficits through foreign aid as all developing countries are doing today. Table 3.1 shows the amount of economic assistance donated to Korea during 1945-1953. This table could be useful to compare the volume of foreign aid before independence and the years after independence.

Table 3.1. Economic Assistance to Korea 1945-53
(Millions U.S. dollars)

Year	Total Amount
1945	4.9
1946	49.9
1947	175.4
1948	179.6
1949	116.5
1950	58.7
1951	106.5
1952	161
1953	188.6
Total	1041.1

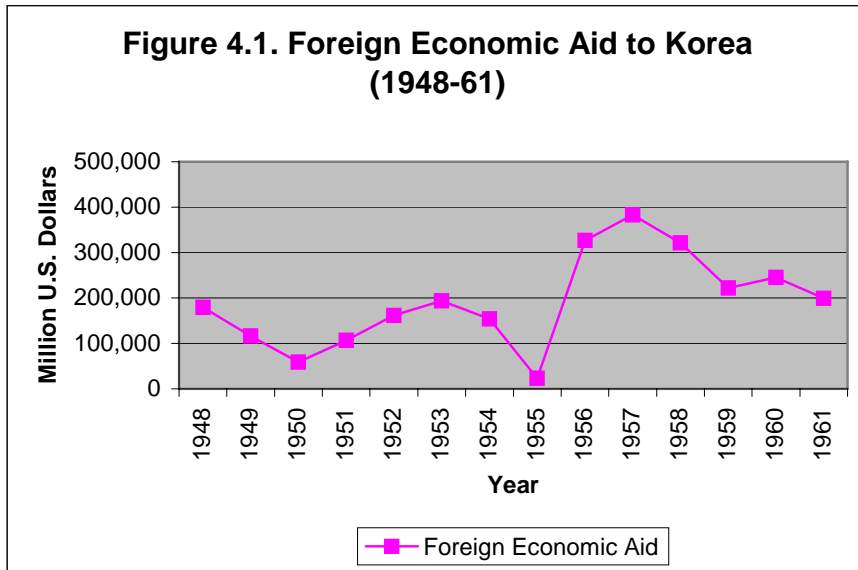
Source: Korean Economy: Issues of Development, Cole, D., 1980

¹⁶ Suk Tai Suh, The effects of export incentives on Korea export growth, 1981, Korea Development Institute

As we can observe from the table, the average grant for Korea for these 9-years calculated around 120 million U.S. dollars annually. It was considerable amount of money by the time. It is observed clearly that the nation received higher amount of foreign aid after independence than the years before independence.

Not differently, foreign economic aid to Korea had been pumped continuously up to 1961. The economic assistance provided to Korea during 1953 to 1961 was highly grant dominated. Figure 4.1 explains the trend of foreign aid to Korea from independence to 1961.

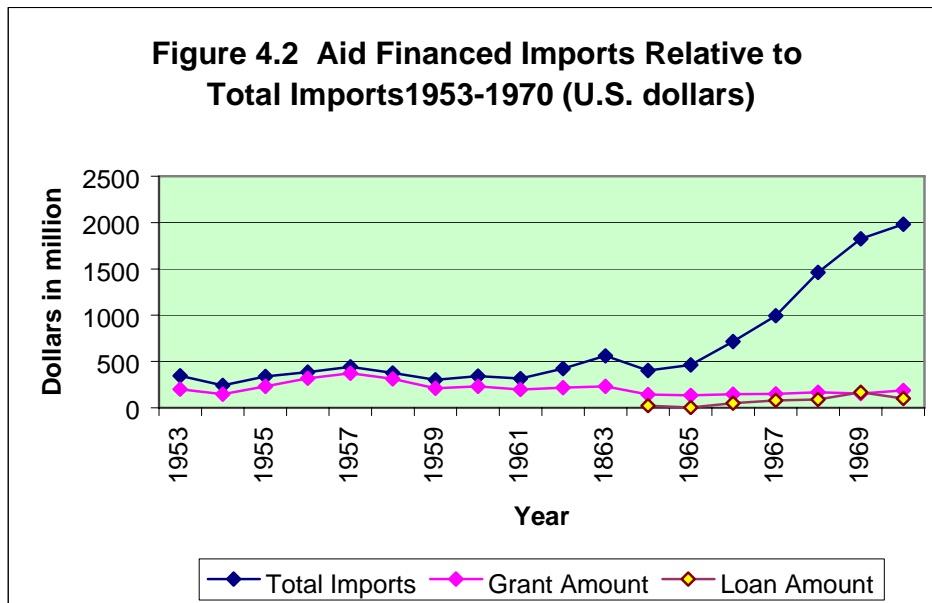
As it is shown in the figure, foreign economic aid to Korea in this period observed to be very high in the Korean economic history. Donor countries and agencies, like U.S. and UNKRA pumped large amount of resource in the period.



Most of researchers in the issue appealed that South Korea had received the highest amount of foreign aid compared to another time. Among the researchers, Cole, D. considers the period 1953-61 as of high aid decade. According to him the massive inflow of foreign assistance before and during the Korean War was essential to the survival of South Korea as an independent country.¹⁷

In addition to the above evidence, the data in the book written by Cole, D proved the same fact regarding the volume of foreign economic aid in the period.

¹⁷ Cole, D., Korean Economy: Issues of Development, 1980



Source: Korean Economy: Issues of Development, Cole, D., 1980

If we see the proportion of grant and loan in total imports of Korea during 1953-1970, it is easy to predict the amount of grant donated to Korea. It doesn't required deep analysis to conclude that imports before 1961 highly grant dominated compared to the total imports to Korea. Almost 80% of imports to Korea were in the form of grant up to 1961. Foreign aid institutions and countries started to give aid in the form of loan after 1961.

To sum up the previous explanations and figures proved that South Korea had been receiving huge amount of foreign aid in the period before 1961. Even though, the period after 1961 is covered in the

next chapter, the volume of foreign aid to Korea after 1961 is much lower than the volume before 1961.

As Cole, D mentions it; no one denies that foreign economic aid for Korea in the considered period is important. But this general conclusion could not give clear answer what was its role for building sustainable, stable and healthy economy in Korea. Why it could not resulted fast economic development like Korea recorded after 1961?

The scope of the present topic is not to give final argument regarding these questions. But the most important element here is aid volume in this period is much higher than any time. I recommend my readers to keep these questions for next discussions.

In order to give full answer for these basic questions or puzzles, however, we need to overview the economic performance of South Korea before 1961. In order to see the economic performance, it is possible to employ some economic indicators. Among the economic

indicators, GNP, trade balance, saving and investment are covered in the following topic.

4.3. Economic Performance Prior to 1961

Despite the massive foreign economic aid, the economic growth of Korea was stagnant in the period prior to 1961. Even though, the economy of Korea performed better than Latin American Countries at that time, it showed very little change as compared to growth in 1960s. Adelman noted the economic performance of Korea in the period prior to 1961 as follows.

During the years immediately preceding the beginning of the First Five-Year Plan, Korea was marked not only by political chaos but also by economic stagnation. Perhaps the most striking condition was the low growth level of GNP- and the stagnation in per capita private consumption and government consumption, which accompanied it. Investment, more than two-thirds of which was financed by foreign savings, was quite low. There was an encouraging increase in exports in 1961, but a large and increasing import balance overwhelmed this.¹⁸

¹⁸ Adelman, I. Practical Approaches To Development Planning, 1969

Different economic indicators for the period proved that the economy was not healthy for the whole period. Among the main indicators like trade balance continued to be negative until 1962. GNP of the nation showed very little change as Adelman explained it already. National savings were negative for the whole period. Imports from abroad were fully financed by grant, which pumped by foreign aid agencies and countries like U.S.

4.3.1. The Trade Balance

It is not new explanation that the trade balance for South Korea was a large negative number almost for the whole period prior to 1961. In addition to the couple problems faced the nation, the strategy the government followed was ineffective to bring about immediate solutions.

Suk believed that some export incentive policies were adopted to promote export promotion although their effectiveness proved to be low. According to him the most important of these was the so-called export-import link system, which permitted the conversion of export earnings to foreign exchange certificates that were freely

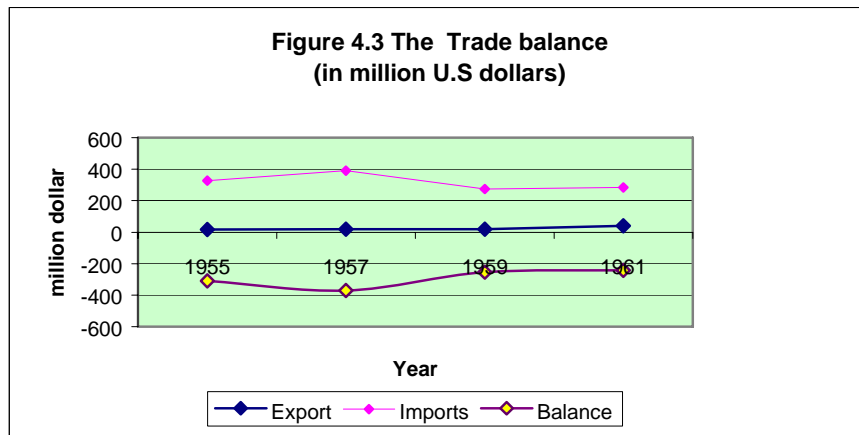
bought and sold at a high premium in the foreign exchange market.¹⁹

He also added that incentives like direct incentive that was paid at varying rates depending upon the type of export goods. These export incentive measures were not effective in inducing the labor-intensive light manufacturing sectors to expand for export production since they did not compensate for the over-valued exchange rate that penalized exports.²⁰

Because of unsound policy measures and inefficient incentives in to the export sector, this sector continued to be stagnant and leads to negative trade balance for the long time. In addition to Suk Tai Suh explanation, the following diagram can give us full picture about the trade balance in 7-years.

¹⁹ Suk Tai Suh, The effects of export incentives on Korea export growth, 1981, Korea Development Institute

²⁰ Suk Tai Suh, The effects of export incentives on Korea export growth, 1981, Korea Development Institute



Source: Calculated from the data in Suk Tai Suh, 1981

If we observe Fig.4.3 carefully, we can see to what extent the trade balance deficit continued throughout the whole period and how it was worst. Export had been failed to compensate the import volume sufficiently. The export sector was neglected or not given due attention through out the period as explained earlier. Import substitution industries were running on the expense of export sector because of the in-ward looking strategy.

As far as the government's development strategy was in-ward looking strategy, the main focus of the government continued to be the same with out looking other alternative policy measures. Its main solution was raising more foreign economic aid. The major

international institutions and countries like U.S.A. responded positively and they pumped massive aid.

However, this massive foreign economic aid could not made considerable improvement in the economic performance of Korea. I believe this is a good indicator to evaluate the government and its economy, which had been highly depended on foreign aid.

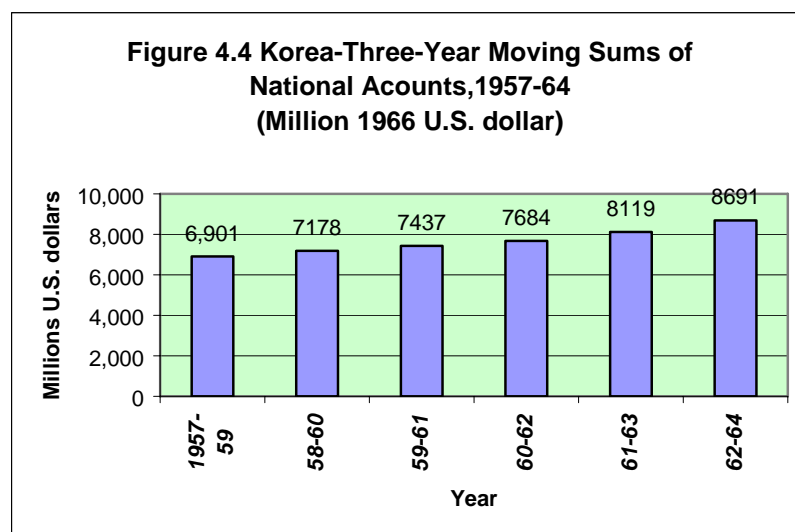
4.3.2. Gross Domestic Product

To analyze the Korean economic performance prior to 1961, sophisticated techniques and large amount of data is not required. Many researchers and political analysts had discussed about this issue deeply and sufficiently. My objective here is to highlight the general economic indicators, which can help me to consolidate my point of discussion. Among the few economic indicators the Gross Domestic Product could be given priority. According to different studies, GNP of Korea grew insignificantly prior to 1961. Once again, I would like to take Adelman's explanation.

During the years immediately preceding the beginning of the First Five-Year Plan, Korea was marked not only by political chaos but

also by economic stagnation. Perhaps the most striking condition was the low growth level of GNP- and the stagnation in per capita private consumption and government consumption, which accompanied it. ²¹

There are several factors that caused the stagnant economic growth of Korea in the considered period. Even though, Korea had several challenges one after another, its in-ward looking economic strategy considered as the main reason for this poor economic performance.



Source: *Korean Economy: Issues of Development*, Cole, D., 1980

Figure 4.4 explains GNP growth in the form of three-year moving sums. According to the figure, GNP continued with very little increment through out five years, 1957-1961. Therefore, GNP for

²¹ Adelman, I. *Practical Approaches To Development Planning*, 1969

Korea was not attractive for the whole period independent to 1961. In the same manner, the per capita GNP for the period is very low, which showed negligible increment from 71.4 in 1955 to 89.7 in 1961.²²

4.3.3. National Savings and Gross Investment

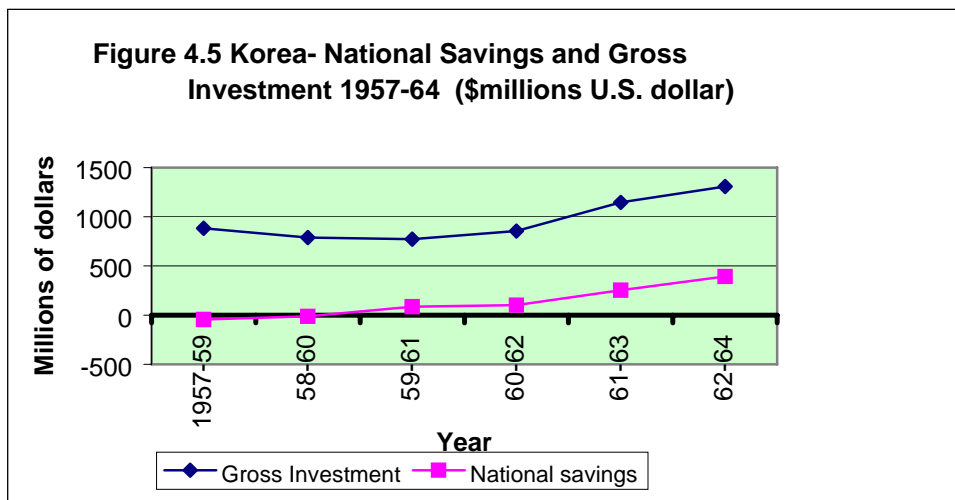
In the same case, the national savings showed large negative number for the whole period independence-1961. As I have pointed out earlier, the direction of the government was focusing on import substitution.

In order to achieve its target it had invested large amount of capital that was over stated, when it was compared with that of national savings. Why the national savings become very low? We may put several reasons for this issue.

If we mention some of the important reasons, our attention will fall on unsound policy measures. On the other hand, the over all impact of the policy measures in the economy like low per capita income and high level of unemployment are also important factors.

²² Figures are from Suk Tai Suh, effects of export incentives on Korean export growth.

Whatever is the reason, the national savings for the period is one of the indicators that could show us the unhealthiness of the economy. The gap among the savings and investment was quite large and unmanageable.



Source: Korean Economy: Issues of Development, Cole, D., 1980

As explained in Figure 4.5, saving is negative in the period 1957-1960. Where as the gross investment for this period observed to be more than 800 million U.S. dollars annually for the same period. This implies that foreign savings covered this large investment. Based on Adelman explanation, more than two-thirds of the total investment was financed by foreign savings.²³

²³ Adelman, I. Practical Approaches To Development Planning, 1969

Based on the above brief explanations, we can put one simple argument, which is based on the Cole, D. explanation about the role of aid in Korean economic development. As it is discussed in the first part of this paper, Cole, D. argued that foreign aid had played a critical role for development of the Korean economy. But as we proved it already, the decade before 1961 was high foreign aid decade as he explained it. However, we also observed that the Korean economy showed insignificant improvement during this period.

To sum up, the Korean economic performance prior to 1961 was characterized with slow GNP growth, chronic trade balance deficits, negative savings, aid dominated, and protectionist economy.

Based on the above results, it is possible to give summarized argument regarding foreign economic aid and economic growth in the period prior to 1961. All results regarding the issue proved that the volume of foreign aid in the entire Korean economic history.

In contrast, the economic growth for the period showed stagnant, when it is compared with the period after 1961, the period with

very little foreign aid volume compared to the previous period.(see next chapter)

This trend gives us that foreign aid, which was the highest in volume, could not pushed up the Korean economy in the period. This is also good evidence for the insignificant positive relationship between foreign aid and economic growth in Korea in the considered period.

My intention here is not to conclude that foreign aid is not totally important or harmful to Korea in the period. The general argument is, however, there is no strong positive relation between foreign aid volume and economic growth so far observed.

Chapter 5

Foreign Economic Aid and Economic Growth (After 1961)

5.1. Economic Development Strategy

A new government led by Park Jung-Hee, who came into power in 1961 had initiated the First Five-year Economic Development Plan. As of any country, Korea had two alternatives of economic development strategies: inward-looking strategy based on import substitution and outward-looking development strategy based on exports.

From the experience of other developing countries, the inward-looking economic development strategy was not successful. Particularly, governments before Park Jung-Hee tried this approach and the result was as we have discussed above. Furthermore, Korea's poor natural resource endowment and small domestic market were considered as the main reasons to adopt out-ward looking based on export development strategy.

Similarly, Park's government strongly recognized that domestic market of Korea is small to observe the labor productivity of the nation. As Kim Kihwan explained it, the essence of the outward-

looking strategy adopted in the early 1960s was to promote labor-intensive manufacturing exports in which Korea had comparative advantage.²⁴

The other external factor was the declining of grant or economic aid from U.S. government. Suk Tai Suh had explained the issue in his paper, the shift in the U.S. aid policy in 1961 from reliance on a grant-type economic aid to a loan type economic assistance exerted pressure on the Korean government to search for an alternative source of foreign exchanges.²⁵

Park's administration had taken these considerations aggressively. Kim Kihwan again explains the strong point of the government: for a nation with a long inward-looking tradition, the adoption of the outward-looking strategy was indeed very remarkable, and it is truly to the credit of the political leadership at that time that such strategy adopted.²⁶ Therefore, the economic growth strategy was founded on realistic evaluation of Korea's comparative advantage

²⁴ Kim Kihwan, *The Korean Economy: Past Performance, Current Reforms, and Future Prospects*, KDI, (1984)

²⁵ Suk Tai Suh, *The Effect of Incentives on Korean Economic Growth: 1953-79*, KDI, (1981)

²⁶ Kim Kihwan, *The Korean Economy: Past Performance, Current Reforms, and Future Prospects*, KDI, (1984)

and alternative economic development strategies with their merits and demerits.

After the development of the strategy, the Park administration had continued to take different types of reforms that are relevant to the export sector. The following part explains the main policy reforms that played crucial role in the export sector growth.

In order to implement the export-led economic development strategy, the government's prior task was encouraging export by employing direct and indirect incentives. In addition to the incentives, close follow up by means of sound policies had been the routine task of Park's government. In addition, President Park used his military discipline to shape the government structure and his officials as they allow him to achieve his objective. Article from Hun-Joo explains Park's role as follows.

As a powerful military commander with multiple organs of repressive state machinery at his service, Park, to a large degree, institutionalized his rule through brute force. In the aftermath of the coup, the military council moved decisively to put an end to the

leftist demonstration: it imposed martial law on the country, arrested over 6,000 gangsters and suspected communists, and purged and replaced more than 4,000 politicians and bureaucrats with a new generation of military officers loyal to Park.²⁷

In addition, the government allied with big enterprises (Chaebols) and gave them unexpected resource support as well as gave them his great effort to get good working environment locally and outside of the country. In turn, Chaebols became more confident on the government and the government on the Chaebols. They become two faces of the same coin. Hun-Joo also has explanation on this issue.

Notwithstanding his predisposition to support small business, Park realized that the big businessmen, whether or not they stood accused of illicit wealth accumulation, were a scarce resource and that without their “proven” entrepreneurial skill at work, the promotion of rapid economic growth would not be feasible. Thus the military-turned-political-power holders exempted all of the indicted businessmen from criminal prosecution, limited the asset

²⁷ Hun-Joo, Park (David), *The SWORD-WON NEXUS AND The Origins of Korea’s Diseased Development*, (P.9)

confiscation to their commercial bank shares, and had them build new factories and donate their shares to the state. After that, big business became the proxy in the lop-sided nexus, subject to subordination and for the regime; the government funneled its financial and administrative support in their favor, while limiting market competition.²⁸

On the other hand, financial institutions, line ministries and other offices evaluated on the basis of their contribution to export, which is the first target of the development strategy. Relationship between the government and Chaebols was highly subject to their export volume. If they export more it is more likely to get preferential loan and other incentives to exist as big Chaebles. President Park followed-up each Chaebol's export volume and its activity closely. Financial institutions were forced to give loans for export industries (chaebols) with out any pre-conditions beyond the export volume. In more detail, the incentives and the macroeconomic policy measures, which are directly related with export growth, are presented in next discussions.

²⁸ Hun-Joo, Park (David), *The SWORD-WON NEXUS AND The Origins of Korea's Diseased Development*, (PP12-13)

Despite the real picture of the Korean economic miracle, many people argued that the economic success is merely from the charity or donation of outsiders. In order to see to what extent foreign aid played its role in the course of the Korean economic miracle, we have to assess the volume of foreign aid after 1961.

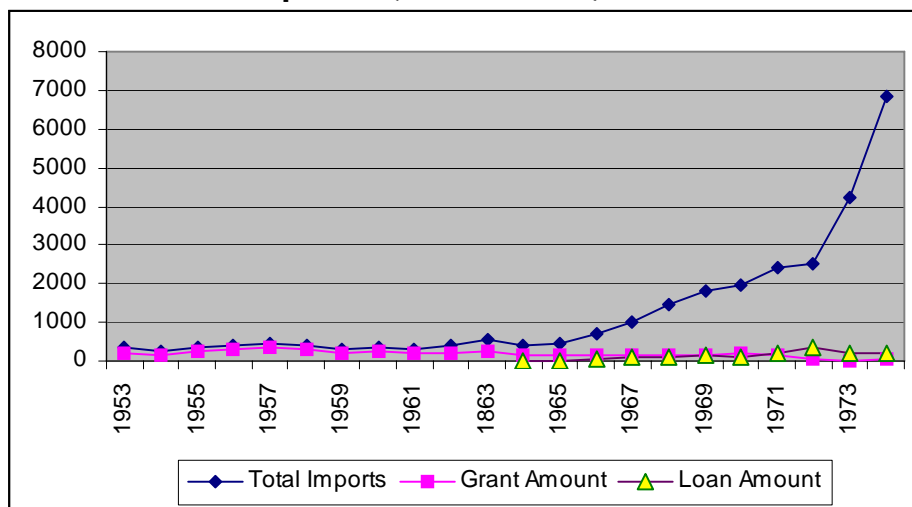
5.2. Overview of Foreign Economic Aid After 1961

From previous discussions we have proved that the decade 1950s was high foreign economic aid decade in the Korean economic history. The nation had received higher amount of aid when compared to the time before and after the decade. Based on the empirical figures, foreign aid in the period after 1961 had been declined continuously.

Not only in volume, the nature of the donation was changed from grant type to loan in the considered period. All countries and donor agencies started to change their donation in to the form of loan. According to empirical evidences regarding the issue, 1960s was the first time to receive aid in the form of loan in Korea. If we see the volume of grant and loan financed import presented in Figure

5.1, foreign economic aid to Korea had been observed to be smaller starting from the early 1960s.

Figure 5.1. Volume of Grant and Loan Financed Imports (1961-1974)



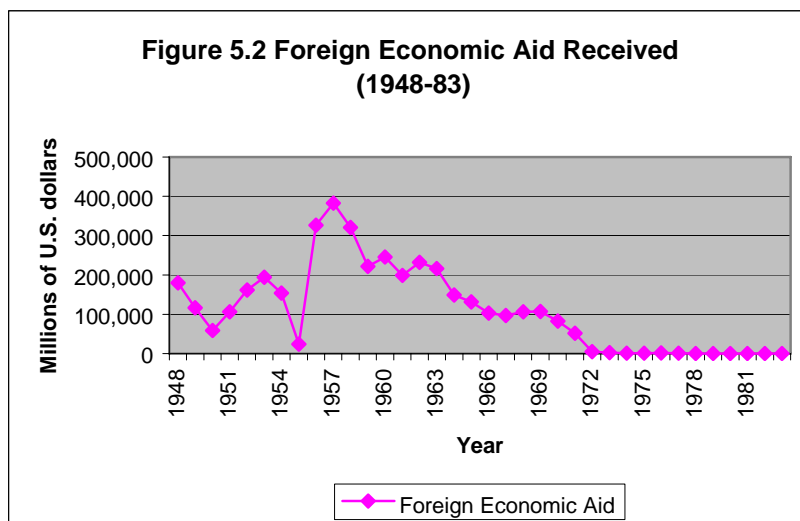
Source: Calculated using data in Cole, D., Korean Economy: Issues of Development, (1980)

Based on Figure 5.1 imported goods and services before 1961 to Korea had been financed fully through grant. Further more, we can observe that loan financed imports totally introduced after 1961.

In the same trend, grant financed imports had been sharply decline when we approach to the year 1961. This implies that foreign aid had sharply declined during this period. In contrast, the import volume has been increased sharply and the nation was in the position to cover its much of imports from its own sources.

In other words, the gap between total imports and amount of imports financed through loan and/or grant became wider. This confirms that foreign aid to Korea after 1961 is much smaller than foreign aid in the period before that year.

Accounts from Bank of Korea for the period also proved the same fact regarding foreign aid and its volume. As we have discussed already the period 1950s was high foreign aid decade in the Korean economic history. The nation had received significantly high amount of foreign aid. In 1957 alone the country had received 382,893 million U.S. dollars. This amount of foreign assistance is the highest amount in the history of Korea.



Source: BOK, Economic Statistics Yearbook, 1984.

Unlike to the 1950s, foreign aid volume after 1960s became smaller and totally negligible amount in the end of 1960s and after 1970s respectively. Figure 5.2 depicted to explain the trend of foreign aid volume to Korea starting from 1948 to 1983. Careful observation on the figure is enough to see foreign aid to Korea declined after 1961 and almost approach to zero in 1970s.

Both empirical figures proved the same fact on the volume of foreign aid in the considered period. Thus, the volume of foreign aid to Korea after 1961 is much lower than the time before.

In addition to the above figures, some arguments and the analysis of the rationale to adopt export led economic growth strategy in the 1960s prove the same conclusion on the matter. Most of researchers in the area have agree one of the reasons to adopt the export oriented economic development was a sharp declining of foreign aid (grant) to Korea in the early 1960s.

In sum, we can conclude this discussion with the following explanation in the book "Developing Country Debt and Economic Performance. According to the book all of Korean imports and gross

investment was financed by foreign aid during the 1950s. However, the importance of foreign aid declined precipitously during the 1960s, becoming a negligible source of funding by the mid-1970s.²⁹

5.3 Measures Towards Implementing the Export Led Economic Development Strategy

5.3.1. Major Macroeconomic Policies

Park's administration had taken very important macroeconomic measures to stimulate the economy and to create good environment for export in his first step. Among them may be mentioned the nominal interest rate. Based on the note from Kihwan, to mobilize domestic savings the government allowed commercial banks to raise interest rates on deposits from 12% to as high as 26.4%. For three years in a row after 1965, the year when interest rates were raised, savings deposits in Korean banks nearly doubled each year.³⁰

This was one of the mechanisms used to organize or mobilize the limited resources for investing on the export sector. Even though, the economic performance of Korea at the time was at very low

²⁹ Jeffrey D. Sachs and Susan M. Collins, *Developing Country Debt and Economic Performance*, 1989

³⁰ Kim Kihwan, *The Korean Economy: Past Performance, Current Reforms, and Future Prospects*, KDI, (1984)

level, the domestic policy enabled the government to utilize the available resources in the country.

In addition, the government used the same approach to attract foreign capital in the early 1960s. According to the article written by Kihwan, to encourage the inflow of foreign savings to make up for the insufficiency of domestic savings, in 1966 the government enacted a comprehensive Foreign Capital Promotion Act Whereby the government underwrote the risk borne by foreign investors. The other important macroeconomic measure taken by government was the exchange rate adjustment. As Kihwan putted it in his article, in 1964, the multiple exchange rate system and the Korean won were devalued by nearly 100%, thus eliminating a bias against the export sector.³¹

These macroeconomic policies were in favor of the export sector through increasing investment in the country. As discussed in previous chapter, domestic savings were shown very low for very long time. In Park administration, however, savings grew sharply.

³¹ Kim Kihwan, *The Korean Economy: Past Performance, Current Reforms, and Future Prospects*, KDI, (1984)

The government succeeded to mobilize the resource in the country. As the result the Korean economy stimulated with in short time.

As it is mentioned earlier, the export sector was the engine of the Korean economy during the take-off. The government prior objective was developing the export sector as means of economic growth in the nation. Therefore, it is vital to see what measures had taken to encourage export in the early economic take-off.

5.3.2. Incentives to Promote the Export Sector

This topic explains the main export incentives, which are provided to export industries, export trade companies, and importers of raw material for export production. In order to ease my explanation, I divided these incentives in to direct and indirect incentives.

Incentives included under direct incentives are the incentives related to tax, loan, tariff and financial reserve, which provided to export producers, trading companies and importers of raw materials for export production. On the other hand, indirect incentives are incentives that help exporters by giving them good environment in the production of export goods and trading.

a) **Direct Incentives**

The following are some direct incentives, from the paper written by Suk Tai Suh.

1. Full indirect tax exemption and 50 percent reduction in the business income tax
2. a) Short-term preferential loans at interest rates below the commercial bank discount rate for exports, coupled with automatic loan approval, and
b) Medium and long-term preferential loans for capital investment for export production.
3. Full exemption of tariff on raw materials imported for export production
4. An export-import link system largely abolished in the early seventies, by which exporters of certain specified items were granted an automatic approval of the importation of certain items not otherwise imported
5. The wastage allowance system by which certain proportion of raw materials imported duty free for export production was allowed for domestic use
6. Generous depreciation allowances for capital equipments used in export production

7. Special provisions for reducing the taxable income earned on export production by a certain proportion (usually 1 percent) of total export sales
8. Special provisions for the large trading companies that exported more than the annually adjusted export target and met the commodity and market diversification requirement since 1976, which includes
 - establishing a larger reserve fund for possible loss in exporting to foreign markets for the purpose of reducing income tax
 - increasing foreign exchange holdings in excess of the limits set by the existing foreign exchange regulations.

These direct incentives were implemented in close follow-up of high-ranking government officials including President Park. Financial institutions were highly controlled by government in order to get power to direct the financial resource towards the first objective. Government officials were very active to implement these incentive programs in proper way. In addition, Park's government structure and institutional settings were adjusted to wards this program.

b) Indirect (Administrative) Export Promotional measures

These incentives were very crucial in the promotion of export. Growth of the export sector could not be achieved only through direct incentives. Favorable environment like; efficient bureaucracy, good coordination among government offices, managerial talent, technical Know-how are needed. The very strong point of the Park administration was achieving these preconditions that help for fast growth of export.

Pre-conditions like; effective bureaucracy and coordination was the core competence of Koreans at that time. This also helped Korea to take the advantage. These administrative incentives may include the following:

1. The actions taken by the Ministry of Commerce and Industry, Ministry of Economic Planning Board, the Ministry of Finance and the Ministry of Foreign Affairs in the support of exports
2. The activities of the Korea Trade Promotion Corporation (KOTRA), a semi-private corporation, to collect overseas market information, to help with the overseas exhibitions, and to otherwise assist in foreign market.

3. The activities of the private Korea Trade Association, to provide policy recommendations, to assist with research for export promotion, and to act as a channel between the private business sector and the government in general.
4. A monthly export promotion meeting was held every month, at which the current state of export activity and the related problems were reported to the president. This monthly meeting was a manifestation of the priority afforded to export promotion in the nation's economic policies.

5.3. Rapid Economic Growth After 1961 (take-off period)

Before 1960s, Korea was marked with poor economic performance and it was among the poor countries in the world. In the year 1961, however, a new economic development strategy emerged and the country starts to experience the golden era in its economic revolution. The following some indicators can explain the fast improvement in the Korean economic performance after 1961.

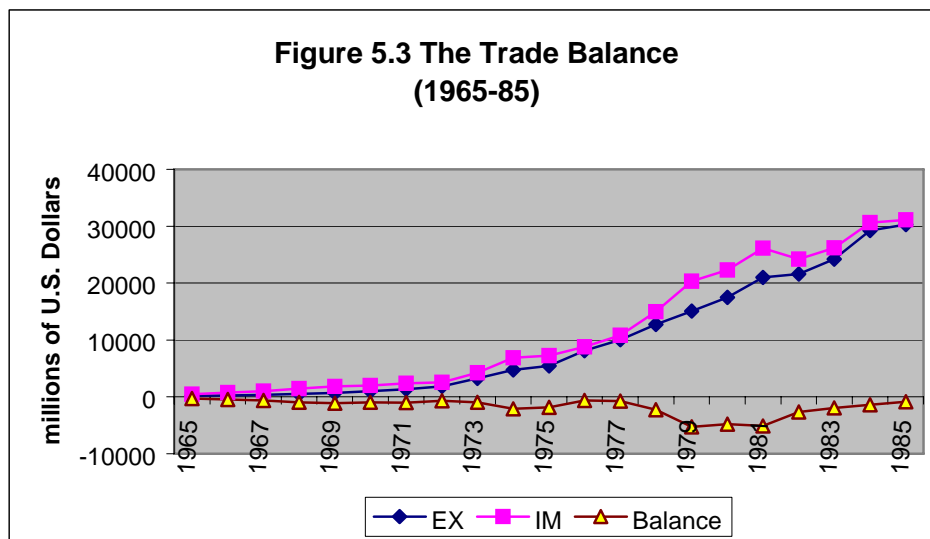
5.3.1. The Trade Balance

Based on the economic development strategy, which gives strong emphasis to export, with the support of especial macroeconomic policies and incentives, Park administration laid a cornerstone for the Korean economic development with in a short time. It able to mobilize, coordinate and channel the resources to its prior objective, which is export-led economic growth. The people of Korea and its government did miracle with in less than one generation. President Park Chung Hee had explained the efforts and the success in few years in his speech on January 16, 1965 speech.

From many years, Korea exported only \$ 20 million to \$30 million worth of goods a year. Even such exports were negligible, except for tungsten. But in these past few years, the government and people awoke from a sleep and strove. Exports began to expand rapidly. Last year, our exports exceeded the \$120million mark. Although there is still a gap in the balance of payments, this much is true: that we have acquired the self-confidence that we, too, can favorably compete with others in the international export race. ... The international community is gradually awakening to the export

potentials of Korea. I believe that the time has come finally for us to reap the fruit of our investment.³²

In the decade remarkable improvement had been recorded in the export regime. Export volume increased sharply from less than 100 million U.S. dollars in the early 1960s to as much as 3257 million U.S. dollars in the early 1970s. Even though, the export sector was in poor performance for the whole period prior to 1961, it was learned that Korea exported 32 times as higher as than 1962 in the consecutive decade.



Source: Bank of Korea various sources

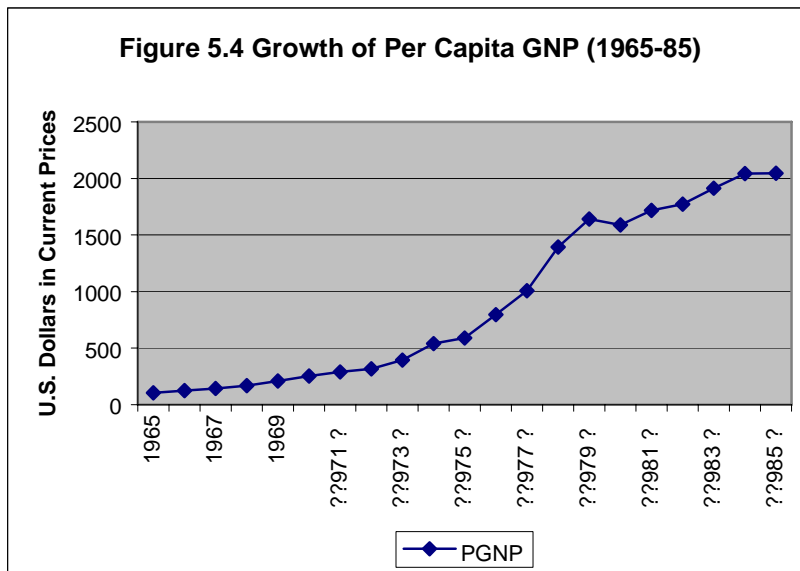
³² Park Chung Hee, Major Speeches By Korea's Park Chung Hee, Hollym Corporation Publishers, 1970 (PP.297-313)

As shown in the above figure, the trade balances for the period after 1961 were observed to be much better than the years before. Even though the trade balance is negative in the period, it is clear the performance is much better than the situation explained in chapter 4 Figure 4.3.

5.3.2. Per Capita GNP

The rapid export growth was accompanied with fast improvement in the economic performance of the country. All economic and social development indicators proved that Korea had emerged as strong economy within a decade. As Cole, David noted out; the dominant feature of the Korean economy since the early 1960s, the feature that has been most influential in shaping the structure and character of the country's everyday economic life, has been the extraordinary rapid rate of economic development. Real gross national product almost quadrupled from 1963 to 1977, making the average annual growth rate of 10% one of the world's highest. Population rose from 27 million to between 36 and 37 million during this period, an increase of 35%, while the average Korean's annual

consumption more than doubled, reaching the \$450-\$500 level by 1977.³³



Source: Bank of Korea various sources

Among the economic growth indicators, growth of per capita GNP could be given attention. As noted by several researchers per capita GNP had been increased sharply with in short time after 1961.

The above figure depicts per capita GNP growth for 20 years, 1965-85. In 1961 per capita income in Korea was not exceed 90 U.S. dollars. After three years, however, per capita GNP grew more than triple. Similarly, it showed more than 10 folds after 10 years.

³³ Cole, D., Korean Economy: Issues of Development, (1980)

Chapter 6

The Role of Foreign Economic Aid in the Rapid Economic Growth

6.1. Foreign Aid Played Insignificant Role During the Take-Off

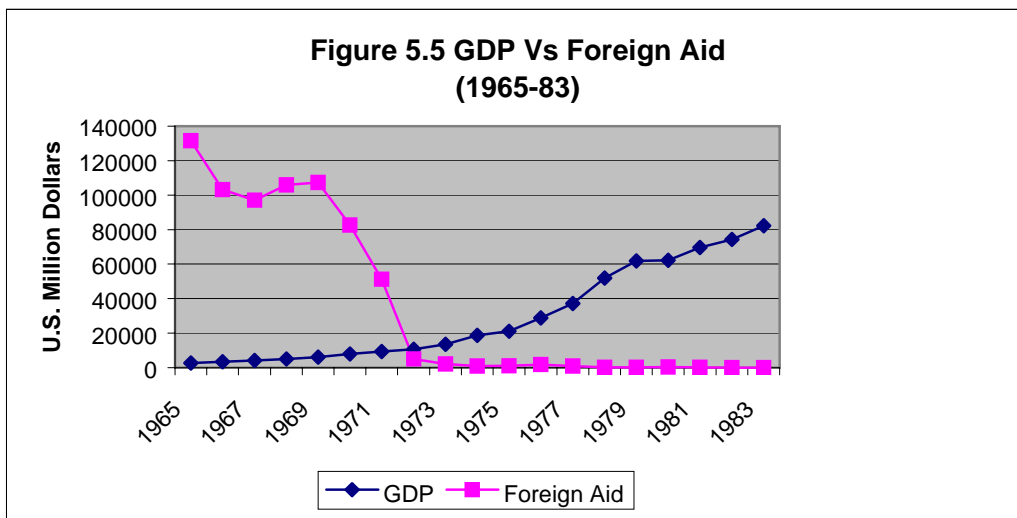
In previous chapters, we proved that the volume of foreign aid to Korea in the period before 1961 was very high and declined consequently. Additional works in the area showed that flows of foreign aid rose to a high of 16 percent of GNP in 1957, averaged 8-9 percent during 1959-62, 2 percent during 1966-68, 1 percent during 1969-71, and have been negligible since 1972.³⁴

Despite the negative trend on the flow of foreign aid to Korea, the history of economic growth for the nation showed extremely fast speed on its improvement. The improvements in the basic economic and social development indicators were much higher than one can imagine.

Therefore, all evidences on the issue showed that there is no strong correlation between foreign aid and economic growth in the

³⁴ Jeffrey D. Sachs and Susan M. Collins, *Development Country Debt and Economic Performance*, 1989

economic history of Korea. To strengthen the discussion point, we can take the following some empirical evidences, which based on the basic economic indicator 'GNP' and flow of 'Foreign Aid'.



Source: BOK, Economic Statistics Yearbook, 1984.

As shown in the above figure and already discussed in previous discussions, the trend on flows of foreign aid to Korea declined continuously and became almost negligible in the 1970s.

In contrast, Gross Domestic Product increased steadily starting from the early 1960s and reached the highest level during the period at which foreign aid volume became a negligible source in the Korean economy.

These all evidences are cornerstones for my conclusion on the role of foreign aid on the rapid economic growth. Based on the empirical facts on foreign aid and economic growth, we can conclude that the impact of foreign aid on the economic growth in Korea was almost negligible.

The miraculous economic growth in Korea was registered in the period at which foreign aid became to the very small contributor in to the economy and very small source of funding.

However, there are plenty of evidences that can prove all possible grants from outside utilized wisely in the period. The government in the period and its policy could be considered as very good environment for the coordination of foreign capital inflow. The following is President Park's speech about production, export and construction on January 16, 1965.

Loans to be granted by the United States, Federal Republic of Germany and other European nations, and Japan will amount to a considerable sum this year. What is needed is reorganization of our aid-receiving posture. To receive foreign capital promptly and use it

correctly, I plan to reform and strengthen parts of the economic administration setup for more efficiency. As I have mentioned already, medium and small industries will receive special attention. First, the government will support conversion to export industries.³⁵

Thus, Park government had been devoted to exploit the domestic resource and to an impressive level efficient to utilize wisely all foreign capital inflows. Even though, the volume of foreign aid was very small compared to the early period, the following strong points enables to record the economic miracle with in short time.

The right choice of economic strategy was the main factor for success. The strategy strongly advocated on development of the export sector as its prior objective. The main secrete of the strategy goes to allocating the available resources to this objective. Not only the resources all policies and rules deliberately referred to the export sector. All projects proposed for loan approval screened on the basses of their contribution to export promotion.

³⁵ Park Chung Hee, Major Speeches By Korea's Park Chung Hee, Hollym Corporation Publishers, 1970 (PP.297-313)

The favorable policy environment in the country with combination to disciplined work force and relatively skilled manpower in the early time enabled to Korea to record rapid economic growth.

6.2. Market favor as Other Side of Foreign Aid

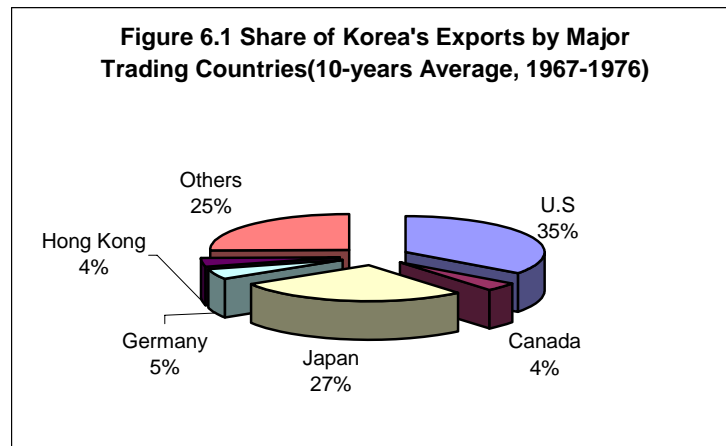
Based on different literatures regarding the role of U.S. markets, it was critical for the Korean economic development. Particularly, Cole, D. explained that US markets were the main host for the Korean exports.

Basically the US market was one of the main markets for Korea's commodities. As Chong-Hyun Nam explained it, ever since Korea began its outward-oriented economic development in the mid-1960s, access to the U.S. market has been critical to Korea's export success. Since 1965, except for a single year 1973, the US has provided the largest market for Korea's exports.³⁶

Ironically, the US market to Korean exports was very important in the initial export growth. But what is the share when it is compared with other markets? The following figure shows an average export

³⁶ Chong-Hyun Nam, US Trade Policy and Its Effects on Korean Exports, 1990 (P.5)

volume of the Korean merchandise to five selected countries during 1967-1976.



Source: Suk Tai Suh, The effects of export incentives on Korea export growth, 1981,

During the period, 1967-76, the annual Korean export to US market amounted 35 percent in average. However, the Japan share is not small which amounted 27 percent in average. Though American market had higher share, the difference is not that much exaggerated with respect to the Japan share.

On the other hand, we can understand that Korea had several trade partners from the beginning and its export was not especial favor from US but based in quality and competition.

Regarding this issue Paul Krugman have putted his conclusion from empirical studies. Based on his conclusion Korean exports tend to be systematically of higher quality than Taiwanese exports, at least when quality is proxied by unit value.³⁷

Therefore, one of the issues to be considered here is the competence of Korea's exports in the world market. In the same way, Chong-Hyun Nam explained that while bilateral trade between the two countries grew tremendously in size, the bilateral trade balance was persistently in favor of the US until 1981. It shifted into Korea's favor beginning in 1982 and has since grown to a significant magnitude, reaching a peak at \$ 9.7 billion in 1987.³⁸

Ironically, integration to the world market is more important for economic growth of nations. Trade partners to Korea in its early development played crucial role in the process of economic development.

³⁷ Paul Krugman & Alasdair Simth, *Empirical Studies of Strategic Trade Policy*,
University of Chicago Press, 1994

³⁸ Chong-Hyun Nam, *US Trade Policy and Its Effects on Korean Exports*, 1990 (P.10)

Chapter 7

Conclusion and Recommendation

7.1. Conclusion

In previous discussions, this material tried to give a brief explanation on puzzles like, 1) what is the role of foreign economic aid in Korea's early development (take-off)? 2) Why the Korean Economy grew fast after the early 1960s? Had Korea got more foreign aid after 1961 than before? In addition the paper gives brief explanation on the export volume of Korea to American market with respect to the Korean miracle.

The findings showed that foreign aid to Korea before 1961 was much higher in the history of the nation. The nation received huge sum of resources from outside. The governments in the period exerted their maximum efforts to raise foreign aid. All countries like U.S.A and international organizations showed their strong interest to pump their aid to the nation in the period.

However, the economy had been observed to be stagnant through out the whole period before 1961. The basic economic indicators

like national savings, GNP, trade balance and others observed to be worst. Thus, the huge amount of foreign aid in the period could not made any significant change on the economy.

Despite, very limited amount of foreign aid in the period after 1961, the Korean economy recorded significant change with in very short time. The basic economic indicators showed impressive improvement with in less than three years. Therefore, we can seize that foreign aid impact on economic development was negligible in the economic miracle in South Korea.

On the other hand, the US market played important but not critical role for the export growth vis-à-vis economic growth of Korea. From the previous discussions, we proved that Korea had been made trade relationship with many other countries in the world. Particularly, Japan was other largest host for Korean exports. The average difference for 10 years when compared with exports to US was not more than 6-7 percent of the total exports of Korea.

In addition, other evidences proved that Korean exports had been based on quality than on especial favor from US. Similarly, US had

highly benefited from the mutual trade than Korea in the early period. Then we can conclude that Korea's exports to US based on quality and on the principle of market. As far as U.S.A. benefited more from the mutual trade, we cannot say U.S.A. has gave market favor to Korea. Evidences on the competence of Korean exports in the world market are strong than of the other way.

My final conclusion is then the Korean success falls on the internal strength and quality than external factors. Though foreign aid has its own impact, internal factors, like effective development strategy after 1961, sound policies, committed workforce and leadership and other internal qualities should be given more weight.

7.2. Recommendations

The secret of the Korean miracle goes to the right choice of development strategy. The outward looking development strategy adopted was highly based on careful study of Korea's comparative advantage. The elite in the period evaluated the strong and weak sides of the nation.

Based on realistic evaluation, administration in the time identified the prime target of the strategy (export sector) and designed comprehensive development plan. This system helped the government to allocate the scarce resources to the prime target, which is promoting export.

The other important lesson is the human resource development that played a vital role in achieving the prime objective. In the early take-off, Korea had relatively educated manpower. The government also took very important steps to mobilize intellectuals in inside and overseas. The sole example for this is the establishment of KDI and KIAS in the early 1970s. These institutions were established to encourage and to utilize the Korean intellectuals in the economic

development process. Similarly, the government bureaucracy was designed in the bases of the first objective of the nation.

The current leaders in developing countries should seize the above qualities during their economic planning. Instead of searching open market and massive economic assistance from outsiders, they should focus on their internal quality to utilize what they have and work on the preconditions to take any advantage from outside.

They should have to show commitment to design effective development strategy, to build committed bureaucracy and work force that can implement their program. It is true that the environment is changed and there is no easy environment like the Korean take-off period. Now days, international regulations like WTO regulations are other difficulties to these poor countries. But the sentiments I have discussed above may aggravate the problem more.

Thus, poor countries should focus on their internal quality first as Koreans did in their first efforts for success. Then they have to

identify the priority target and design policies depending on their internal qualities.

There is no doubt the Korean experience will not a blue print and applicable as it is. How ever, its clear explanation my help the poor countries to see their internal qualities instead of searching easy market opportunities and foreign aid. These couldn't be the final solutions for their poverty and source of success.

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