1 South Korean Economic Development in Perspective

On January 1, 2010, South Korea became the twenty-fourth member of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD). The DAC is a forum for discussing issues related to development and poverty reduction in developing countries. When the decision to admit the country to the DAC was made on November 25, 2009, the South Korean government made much fanfare, emphasizing that the country had become the first to turn into an aid donor after being an aid recipient. In a national radio broadcast on November 30, the then-president Lee Myung-bak defined the event as "a miracle that our great people have accomplished and an amazing success story in world history." He further stated that the Republic of Korea (the official name of South Korea) was "a success model of international aid and cooperation and a beacon for developing countries in the twenty first century."[1]

To those who remembered the country's past, Lee's words were not an overstatement. Up to the early 1960s, the South Korean economy was virtually propped up by foreign grants-in-aid, mostly from the United States. From 1953 to 1962 – the first decade for which data are available – grants-in-aid accounted for about 14.3 percent of GDP; this represents even a higher proportion than in many recent "failed states" of Sub-Saharan Africa.[2] South Korea's transformation into a donor nation within less than 50 years was certainly a remarkable accomplishment.

[1] http://world.kbs.co.kr/service/contents_view.htm?lang=k&menu_cate=&id=&board_seq=256434.

[2] Grants-in-aid as a percentage of GDP were calculated from the Bank of Korea, *Economic Statistics Yearbook*, various issues.

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Lee Myung-bak was not the first person to use the term "miracle" to describe South Korea's economic rise. In fact, the term was not popularized by any politician's political rhetoric: Its origins were academic, as it became commonly used around the world after the World Bank published a book titled *The East Asian Miracle* in 1993. As China was not covered in the book, South Korea was described as the leading county behind the East Asian Miracle.

Owing to the "miracle" that it had accomplished, South Korea joined the OECD, the "rich countries' club," in 1996; its admission to the DAC in 2009 represented a further step in the country's OECD membership. The country also became a member of the Group of 20 (G20) summit formed in the wake of the 2008 crisis and was supposed to host the fifth G20 summit in Seoul in November 2010. The summit would deal with the "development agenda," whereby the South Korean government would share its own development experience as an example for the world.

Of course, one could observe that, by 2009, the South Korean economic "miracle" was a thing of the past. After the 1997 crisis, the country's growth rate almost halved: In the 11 years following the crisis (from 1998 to 2008), it grew by 5.0 percent on average annually, while it had grown by 9.2 percent on average in the 11 years before the crisis (from 1986 to 1996).[3] However, a 5.0 percent of average growth rate in the 11 years after the crisis was not a low number in the international context, belonging to the higher end of the average growth rates for OECD countries over the same period. The country was also doing relatively well in 2009: While most OECD countries were recording negative growth rates by a significant margin in the aftermath of the 2008 crisis, it recorded a positive 0.8 percent growth rate. This fact provided some ground for the Lee government to make fanfare about the admission to the DAC.

On the other hand, many South Koreans did not feel comfortable with the admission to the DAC and the fanfare made by the Lee

[3] Growth rates in this book are in 2015 prices unless specifically noted (data source: ecos.bok.or.kr).

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government. They knew that their country was not ready to become a substantial aid donor. More importantly, joining the DAC reminded them of the pains of the 1997 currency crisis, as they believed that the decision to join the OECD in 1996 had been an underlying cause of the crisis. When it broke out, the crisis had been – rightly – called the "biggest disaster next only to the Korean War." In 1998, the economy contracted by 5.1 percent.

Economists were (and still are) divided about the reasons for the fall of the growth rate after the crisis: Some claimed that the growth slowdown reflected the normalization from the "overgrowth" before the crisis; others held that the slowdown represented the "undergrowth" created by the crisis. Whatever the explanation from economists was, the common people, who had been accustomed to a high growth rate for decades, did not take the sudden fall in the growth rate easily. In fact, the fall of the growth rate was painful to them, as it meant not only a slow growth in income but also an increasing scarcity of jobs.

Politicians tried to accommodate common people's sentiments by promising to boost the growth rate in electoral campaigns. In this regard, Lee was best placed to make people believe in his promise of growth, as they remembered him as one of the heroes behind the economic miracle of the 1960s and 1970s. He had been the boss of the Hyundai Construction Corporation, a powerhouse of the South Korean overseas construction drive in the 1970s. In the presidential election campaign of 2007, Lee promised that he would achieve an average growth rate of seven percent in the five years of his tenure as president. By November 2009, it was clear that this was an impossible mission, whether Lee had believed in it or not when he had promised it in 2007. Instead, Lee emphasized the great achievement that had been made before, to which he had contributed as a businessman. This made many people uncomfortable, although presumably only a minority regarded the affair as a ploy from Lee to divert public attention from his failure to meet his promise.

Furthermore, on closer examination, one could easily identify the country's relatively better growth performance in 2009 as deeply ironic, given that it stemmed from the weakness rather than the strength of the economy. When the global financial crisis broke out following the bankruptcy of Lehman Brothers in September 2008, the country underwent another currency crisis, as foreign capital started to flow out in droves. The exchange rate skyrocketed, and the country could barely resolve the crisis with the conclusion of currency swap agreements with the United States, Japan, and China. Subsequently, the exchange rate fell only slowly and was maintained at a high level in 2009. Although the South Korean economy recorded a 0.8 percent positive growth rate in 2009, this was due mainly to the fact that the rise in the exchange rate increased the net exports (exports minus imports), which accounted for 3.1 percentage points of the economic growth, while the domestic demand (consumption and investment) accounted for –2.3 percent points of the economic growth.[4] Thus, South Korea's relatively good growth performance in 2009 was – at least partially– a result of the failure to prevent another currency crisis after undergoing the 1997 crisis; more generally, it reflected the country's high vulnerability to crises.

This book will discuss how South Korea accomplished an economic "miracle" and therefore stands as an "amazing success story in world history." At the same time, it will explain how this miracle has been a tortuous process, ridden with crises such as the 1997 currency crisis and another one in 2008.

1.1 A UNIQUE CASE

What makes South Korea's economic development an "amazing success story in world history"? Lee Myung-bak is likely to have pronounced that statement as a form of political rhetoric, without giving extensive thought to the reasons. The economic development of South Korea should nevertheless have its place in the world history,

[4] The figures are from ecos.bok.or.kr.

as it is the only country to have made the transition from a developing country to a developed country in the last 70-plus years. One can easily realize this by taking a look at the world history.

The most important aspect of human history over the last few hundred years has been the Industrial Revolution. Just like that of all other countries, the economic development of South Korea is inscribed within the Industrial Revolution. The term Industrial Revolution is controversial, as its relevance varies according to the context. Economists rarely use it to describe today's economic development.[5] However, over the long term, there is no doubt that today's economic development forms part of the Industrial Revolution, which indeed represents the largest change undergone by human beings since they settled down as agrarian people after the Neolithic Revolution about 10,000 years ago.

The Industrial Revolution started in Britain in the late-eighteenth century and spread to continental Europe and the colonial offshoots of Europe in the nineteenth century. Of course, it did not suddenly spring out of a vacuum in Britain; it occurred within the broader conditions whereby Europe had forged ahead of the rest of the world. Europe's head start led to Western imperialism around the world. Although Western imperialism had started before the Industrial Revolution, the latter nevertheless made it more intense and pervasive. The "first globalization," which took place from the nineteenth century until the outbreak of the First World War in 1914, meant the expansion of trade, investment, and migration on a voluntary basis among the equal partners of the Western world, but it meant coercion to the rest of the world – coercion first through gunboat diplomacy and then colonization. A very small number of non-Western countries avoided colonization; even those that avoided it often became semi-colonies, experiencing severe infringement on their sovereignty as they found themselves having to cede territories and concede privileges to Western powers. Only Japan survived and

[5] See Lucas (1998) and Acemoglu and Robinson (2012) for the exception.

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succeeded in starting an industrial revolution of its own. Japan then joined the West in the pursuit of imperialism, colonizing Korea and Taiwan.

The first globalization was interrupted by the crisis of the first half of the twentieth century – or more precisely, from 1914 to 1945 – when two great wars and the Great Depression ravaged the West. The nature of the imperialism changed, as the tight control on the colonies was loosened and the imperialist powers redistributed the colonies among themselves. Nevertheless, imperialism persisted.

Imperialism invoked national liberation movements in the countries that had fallen victim to it. National liberation movements and the changing international political economy led to their independence after the Second World War. After gaining political independence, the next goal for those newly independent countries was to achieve economic development, that is, to pursue an industrial revolution of their own. This is how "development economics" was born. Development economics emerged as a distinct subfield of economics when newly independent countries emerged with the decolonization following the Second World War. In an overview article on development economics in the *New Palgrave: A Dictionary of Economics*, Clive Bell uses "pioneers" and "latecomers" as an organizing framework, based on the fact that newly independent countries started out from a state of poverty in a world where there were already rich countries.[6] Although Bell used the more gentle expressions "pioneers" and "latecomers," the harsh underlying reality was that the distinction was in fact between the former imperialist powers and their ex-colonies or ex-semi-colonies. If one excludes gray areas such as Latin America, the dichotomy between developed and developing countries in the last 70-plus years comes from this historical legacy.

Over the last 70-plus years, the ensuing global question has been: Can those newly independent developing countries become

[6] Bell (1987).

developed countries just like their former masters? If so, which countries will? The answer to this question is that, after so many "success stories" achieved by different countries at different times, South Korea has now emerged as the only "country" (if not "economy," as explained later) to have transformed itself from a developing to a developed country.

To be able to claim that South Korea has emerged as the only country to have transformed itself from a developing to a developed country, one must first check that the country is really a developed country. It is defined as such according to the criteria of various international organizations. One of those criteria is membership in the OECD, as the organization is regarded as the "rich countries' club." OECD membership is limited to a small subset of countries (It currently totals 38 members, up from 20 when it was established in 1961), designating about 80–85 percent of the world's countries as developing and about 15–20 percent as developed. Within the OECD, membership in the DAC can be considered a further step in the acknowledgment of a country as developed. International organizations such as the United Nations Development Program (UNDP), the World Bank, and the International Monetary Fund (IMF) also classify countries into developed and developing ones, employing different methods of classification and using different names to define developed countries' status: "developed countries" (UNDP), "high-income countries" (World Bank), and "advanced countries" (IMF). These organizations all classify South Korea as a developed country.

Then, one must check that no other former colonies are featured on the list of developed countries. Three other ex-colonies – Hong Kong, Singapore, and Taiwan – also seem to qualify for the list in some way. However, one has to consider politics here, as democracy, according to the OECD and UNDP classifications, is one of the criteria for achieving developed country status. It is natural to classify only democratic countries as developed ones considering the importance of democracy in modern world history. Along with the Industrial Revolution, democratization has been one of the most pivotal changes in human society over the last few hundred years. The significance of democratization along with the Industrial Revolution has best been explained by the idea of the "dual revolution" espoused by Eric Hobsbawm, who saw the economic revolution that started in Britain (the Industrial Revolution) and the political revolution that broke out in France (the French Revolution) as the two forces that brought about the most profound changes in the world since the invention of agriculture, cities, and states.[7]

What Hobsbawm meant by democracy was liberal democracy, with the rule of law and civil liberties as major components. Democracy took a long time to take root even in Western European countries, with some of them democratizing only in the 1970s. Today's developing countries learned the idea of democracy from their Western imperial aggressors or colonial masters. The idea of democracy subsequently received a boost as national liberation movements turned into mass movements. After they obtained independence, the majority of developing countries declared democracy as their governing principle. Though they learned the idea of democracy from the West, their democracies often took non-Western, nonliberal forms. Over the years, however, it has become clear that there is nothing like non-Western, nonliberal forms of democracy. South Korea declared liberal democracy as the governing principle of the country; the country underwent authoritarian rules that violated the principle, but it eventually managed to move to liberal democracy.

Hong Kong and Singapore do not qualify as liberal democracies. Hong Kong is part of China, which is not a liberal democracy, and Singapore's democracy may be considered only nominal. In contrast, South Korea and Taiwan have established substantial liberal democracies, meeting, for example, the criteria proposed by Samuel Huntington to measure the consolidation of democracy: two peaceful turnovers of power through elections between political parties or

[7] Hobsbawm (1996).

groups.[8] Hong Kong and Singapore's economies are also exceptional in the global context, as both developed from serving as enclaves for Western countries in the colonial era. They started from a higher base, and thus their growth rates of per capita GDP over the last 70 years have been lower than those of South Korea and Taiwan.

Thus, only South Korea and Taiwan are left on the list of the countries that pass the rigorous test for the transformation from a developing to a developed country. What distinguishes South Korea from Taiwan is its political status on the international stage. Although both belong to divided nations, their political statuses are very different from each other's: South Korea is treated as a country, whereas Taiwan is regarded as an "economy." Thus, while South Korea joined the OECD, became a member of the DAC, hosted the G20 summit at which it shared its experience of economic development with the world, the same was out of the question for Taiwan. Whether that kind of activity, together with events such as hosting the Olympics in 1988 and 2018 and the World Cup in 2002, helped South Korea's economic development is highly questionable; it may well have been the opposite. Hosting the Olympics and the World Cup was expensive, and joining OECD was an underlying, if not a direct, cause of the 1997 crisis.[9] However, if this is true, one may paradoxically say that South Korea has managed to become a developed country even after paying all these costs. South Korea is also larger in size than Taiwan with more than twice the population.

1.2 A TORTUOUS PATH

South Korea's achievement in economic development has been unique, but its process has been a tortuous one. Korea's emergence as a developing country in 1945 in itself indicates the turbulent nature of its history. Being originally part of the "Great Tradition" of East Asia, as defined by the now-classic study by Edwin Reischauer and

[8] Huntington (1993, Chapter 5).

[9] This will be discussed in Chapters 5 and 8.

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John King Fairbank, Korea failed somewhere in its history, eventually becoming a colony.[10] Korea's history after 1945 also started with a series of disasters. Following a period of chaos, the country was divided into the North and the South, and the Korean War broke out in 1950, killing millions. Although the war ended in 1953, South Korea stagnated for another ten years, being virtually propped up by grants-in-aid from the United States. By the end of the 1950s, Washington officials wondered whether the country was a "basket case."[11] A student-led revolution broke out in 1960 and a military coup followed in 1961.

Unexpectedly, the South Korean economy began to grow rapidly in the mid-1960s. This economic growth was sustained longer than in any other developing country. The records for developing countries' growth in the last 70-plus years show that sustained growth has been rare, with abundant cases of years of high growth followed by long periods of stagnation. Many countries experienced years or even decades of growth but fell into a long stagnation at middle-income levels, failing to graduate to the ranks of developed countries. In the recent economic development literature, this phenomenon has been called the "middle-income trap." This book does not address whether this phenomenon exists worldwide. However, the concept helps with understanding South Korean economic development by indicating that sustaining growth is at least as difficult as, or often more difficult than, starting growth itself.[12] The fact that South Korean economic growth was sustained, and thus enabled the country to avoid a middle-income trap, really speaks to the uniqueness of its economic development process.

South Korea seemingly ran through a turnpike since the mid-1960s, judging from the fact that high economic growth (HEG) was sustained longer than in any other developing country; however, the growth was actually accompanied by recurring crises. Aside from

[10] Reischauer and Fairbank (1960). See also Fairbank et al. (1965).
[11] Mason et al. (1980: 7).
[12] See the literature listed in footnote 20.

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the current crisis caused by the pandemic and Russia's invasion of Ukraine, four crises stand out. In the early 1970s, the firms that had incurred domestic and foreign debts in the late 1960s found themselves unable to pay the debts back. The country resolved this crisis through an emergency decree to reduce their debt burden in August 1972. In 1979, a bigger crisis broke out, contracting the economy in 1980 for the first time since the end of the Korean War. This crisis took years to recover from and led to a drastic switch in economic policies. Then, in 1997, the East Asian financial crisis – the severest and most widely known one – hit the country. South Korea was forced to seek assistance from the IMF to resolve the crisis and carried out a thoroughgoing reform following the IMF demand. In 2008, the country was drawn into another crisis with the outbreak of the global financial crisis. It resolved the crisis through currency swap agreements with the United States, Japan, and China. There were also many other smaller crises. Barry Eichengreen and his colleagues compared the crises South Korea had undergone in the four-plus decades before the 2008 crisis on the international scale and found that the country was on the crisis-prone end of the spectrum.[13] Thus, while South Korea showed an outstanding performance in sustaining growth, it showed at best a mediocre performance when it came to avoiding economic crises.

In addition, there were a number of political crises that had implications for the economy. HEG began under the authoritarian rule of Park Chung Hee, who had waged a military coup to topple the elected government in 1961. The subsequent economic growth was accompanied by an incessant movement to restore democracy, until that goal was achieved in 1987. South Korea provides a typical example of a developing country that grew rapidly under an authoritarian political regime and then democratized. The country thereby managed to become the only country to eventually transform itself from a developing to a developed one. However, this process was

[13] Eichengreen et al. (2012, 277–278).

not a smooth one, involving political crises, which were often intertwined with economic ones. The economic crisis that broke out in 1979, for instance, was coupled with a major political crisis whereby Park Chung Hee was assassinated and succeeded by another military strongman, Chun Doo-hwan. During Chun's rule, the economy flourished, but a political crisis developed to potentially jeopardize the very foundations of the Korean economic miracle. This crisis could be diffused, this book will argue, only through the democratization of 1987. After democratization, South Korea's economic growth did not slow down. According to Lant Prichett and Lawrence Summers, South Korea is the only country to have experienced a rise in growth rate following democratization.[14] However, democratization may have worked in one way or another as a cause of the 1997 crisis.

The country continued to face problems after the 1997 crisis. Growth slowed down remarkably, more than the natural slowdown expected with the maturation of the economy. The meaning of the slowdown differs depending on whether it represents the normalization from overgrowth before the crisis or the newly emerging undergrowth after the crisis. This book will argue that the slowdown represents undergrowth, as the radical reform after the crisis, while trying to make the economy less crisis-prone, undermined growth by making the economic system less aggressive. It is also questionable whether the economy really became less crisis-prone, as illustrated by the outbreak of another crisis in 2008, after which growth slowed down further. Income inequality also widened after the 1997 crisis, so one may say that the economy moved from "growth with equity," as characterized by the World Bank, to "slowdown with inequality."[15] Though the enhanced welfare system has offset the widened inequality of market income, the welfare system has its own problems, especially because of the rapid aging of the population.

[14] Prichett and Summers (2014).

[15] See World Bank (1993: Chapter 1) for characterizing the East Asian economic performance before the 1997 crisis as "growth with equity." Chapter 11 will discuss "slowdown with inequality."

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Finally, the country is facing the changes in the international environment more fundamental than anyone it has encountered in the last 70-plus years. Beginning with the 2008 crisis, advanced countries' economy has been undergoing a stagnation not seen since the end of the Second World War. Developing countries are doing better, but globalization has slowed or reversed. The rise of China is posing a challenge to the US hegemony, the political base of the postwar international economic order. The country is thus facing a tectonic shift of the international environment that it has no experience in dealing with.

This book explains how South Korea's economic development unfolded through a tortuous path to become a unique case globally. It first shows how it historically emerged as a developing rather than a developed country but launched the economic miracle in the 1960s, defining the process as "the great divergence" and "the great convergence." The book next describes how economic development proceeded after the HEG began, summarizing the pattern as "sustained but crisis-ridden growth." Finally, it briefly discusses the problem of coping with the changes in the international environment.

1.3 THE GREAT DIVERGENCE AND THE GREAT CONVERGENCE

To see how South Korea historically emerged as a developing country in 1945, but launched the economic miracle in the 1960s, one first has to explore how Korea failed earlier in history. The country failed first because East Asia lagged behind Europe in the modern era. Why this happened is a seminal question on which a substantial amount of ink has been spilled; this book uses the term "the great divergence" to describe this lag, following Kenneth Pomeranz.[16] Within East Asia, China, Japan, and Korea took different paths in the nineteenth century, the explanation of which being another seminal historical question. One also has to examine what happened to Korea under

[16] Pomeranz (2000). See also, among others, Landes (1998) and Morris (2011) for the comprehensive account of Europe's forging ahead in the modern era.

the Japanese colonial rule (1910–1945), as many observers think this affected the future economic development of South Korea.[17]

It is also important to understand what happened from the liberation in 1945 to the beginning of the HEG in the 1960s. Korea went through disorder, division, and the Korean War in 1945–1953, and the South Korean economy stagnated after the war in spite of the massive amount of US aid. However, many conditions that would help future economic growth formed during this period. According to Daren Acemoglu and James A. Robinson, the two Koreas are the model examples of successful and failed states where a difference in institutions introduced at the time of the division made a critical impact.[18] South Korea actually differed not only from North Korea but also from the majority of the ex-colonies at the time, which may have contributed to future growth.

Finally, one needs to explain how HEG began in the 1960s, which more or less remains an unsettled issue. Earlier explanations emphasized the working of the market, emphasizing the pursuit of export-oriented industrialization, which became the mainstream view among economists. Later, some political economists presented a revisionist view, focusing on the role of the government. Some compromise was made as the mainstream view recognized the presence of heavy government intervention, but a difference remains as the mainstream view newly named itself the "market-friendly view." The market-friendly view holds that it was market forces rather than government intervention that drove the economy to high growth.[19]

The three chapters following this introductory chapter explain what occurred during the three aforementioned periods, respectively:

Chapter 2, "The Great Tradition That Failed," explains how Korea emerged as a developing rather than a developed country in

[17] Eckert (1991), Woo (1991: Chapter 2), Kohli (1994).

[18] Acemoglu and Robinson (2012: Chapter 3).

[19] See Keesing (1967), Krueger (1979, 1997b), Amsden (1989), Wade (1990), and World Bank (1993: Chapter 2). They will be discussed in Chapter 4.

1945. After describing the traditional Korean state and economy briefly, the chapter explains how the country failed, by discussing the great divergence between Europe and East Asia and the different paths taken by China, Japan, and Korea in the nineteenth century. It then examines the economic changes made during the colonial period.

Chapter 3, "Some Lights in the Dark," discusses what happened from 1945 to 1960. This chapter describes the mixture of the darker aspects of the time and the brighter aspects of the succeeding period. The division and the Korean War made South Korea's economic system a big exception among the ex-colonies, which would help growth later. After the war, growth was not impressive in spite of massive US aid, but some additional conditions for future growth were formed.

Chapter 4, "Kicking Off the Miracle," explains the achievement of the great convergence, beginning with the HEG in the 1960s, as the leadership change enhanced state capacity with the export-oriented industrialization already in place. The chapter then examines how the fiscal, monetary, and financial policies worked. It next investigates trade and exchange rate policies and the role of exports in the economy. It finally examines how South Korea overcame the bottleneck to the incipient HEG.

1.4 SUSTAINED BUT CRISIS-RIDDEN GROWTH

The book next discusses how South Korea sustained growth, but the process was crisis-ridden. It does so by referring to studies that have tried to explain the sustainment of growth worldwide. They have identified a wide range of conditions for sustaining growth, but three conditions stand out: macroeconomic management, structural transformation, and the management of social conflict.[20]

[20] See, among others, Aiyar et al. (2013), Benhabib and Rustichini (1996), Berg et al. (2012), Doner and Schneider (2016), Eichengreen et al. (2012), Eichengreen et al. (2013), Hausman et al. (2005), Jankowska et al. (2012), Im and Rosenblatt (2013), Lee (2019), Lin and Wang (2020), Rodrik (1999), and Vivarelli (2014).

Macroeconomic management is vital for sustaining growth. A country may initiate growth with price stability, but it may lose control over prices later. A high rate of inflation is detrimental to growth; a moderately high rate of inflation may not undermine growth much, but, depending on the circumstances, it may also be incompatible with growth in the longer run. The business cycle is inherent to the market economy, but a big boom, which is often accompanied by overinvestment or an asset price bubble (or both), involves domestic spending based on borrowing and drives the economy above its potential output. The subsequent overcapacity and bursting of the asset price bubble may cause a credit crunch and so cause many of the loans to stop performing. Moreover, inflows of foreign capital are sometimes followed by a sudden reversal, precipitating a currency crisis, which is far more difficult to deal with than domestic financial crises.

Structural transformation is also critical for sustaining growth. A country may begin to grow by exporting commodities, but it needs to diversify its industrial structure to insure against idiosyncratic shocks in the form of sudden export collapses or a sudden deterioration of the terms of trade of the exported commodities. In the initial phase of development, a developing country can compete in the international markets by producing labor-intensive, low-cost manufacturing products, using technologies imported from abroad. However, over the years, wages rise, making the labor-intensive exports less competitive in the world markets. Thus, the country needs to move up the value chain to avoid finding itself stuck in the middle, between rich and poor countries.

The third condition for sustaining growth is the management of social conflict. Although social conflict is ubiquitous in human society, it may become more remarkable in the process of economic development, as dislocations and strains accompany industrialization and urbanization. Conflict may develop among various social groups such as workers, industrial and business people, the military, bureaucrats, landlords, and peasants; conflict may also arise among ethnic, tribal, and regional groups. If the conflict intensifies and takes a violent form, such as a civil war, economic growth will collapse. Even if the conflict does not become violent, it may create uncertainties large enough to discourage investment. Social conflict also undermines growth by diverting people's activities from the productive to the redistributive sphere as they aim to capture a larger share of the output through political means.

Meeting these conditions is a recurring challenge in the process of economic development. The nature of the challenges changes over the years, as domestic and external situations change. The problems faced by a country at the middle-income stage differ from those faced at the low-income stage. The international environment may also change as, for example, the international economic order, which is beyond the control of a developing country, changes. If a country fails to respond to these challenges well, it will undergo a crisis. Responding to these challenges in an impeccable way is of course impossible, so it is inevitable to undergo crises, large or small, in the process of economic development. However, if a country makes a serious mistake in dealing with any of these crises, a crisis that could otherwise be short-lived will evolve into a longer one, leading to long-term stagnation.

South Korea's economic growth was sustained but crisis-ridden because, while the country did not respond to the aforementioned challenges well, it managed to make the ensuing downturns relatively short-lived. Yet, the 1997 crisis became a watershed event in this regard. Before the 1997 crisis, the country sustained HEG, recovering the same growth dynamism after going through crises; after the 1997 crisis, the economy recovered quickly and continued to grow, but the growth momentum weakened remarkably. It is also questionable whether the economy became less crisis-prone after the crisis, and inequality widened.

This book examines the three aforementioned conditions for sustaining growth by classifying the period from the beginning of HEG into two sub-periods, with the 1997 crisis as the dividing line.

It explains in separate chapters how each of the three conditions for sustaining growth worked itself out respectively in each of the two sub-periods. There are thus six chapters altogether assigned to showing how South Korea's economic development was characterized as sustained but crisis-ridden growth. In addition, one chapter is inserted before the three chapters covering the period after the crisis to explain the nature of the 1997 crisis and the ensuing reform. Thus, Chapters 5–7 respectively discuss macroeconomic management, structural transformation, and social conflict management before the 1997 crisis; Chapter 8 discusses the nature of the 1997 crisis and the ensuing reform; Chapters 9–11 respectively explore macroeconomic management, structural transformation, and social conflict management after the 1997 crisis. The contents of the seven chapters from Chapter 5 to Chapter 11 can be summarized as follows:

Chapter 5, "Contours of the High Economic Growth," deals with the macroeconomic management before the 1997 crisis. The economic system supporting the HEG tended to precipitate crises, which led to a big crisis in 1979. The country implemented a strong disinflation policy after the crisis, bringing about the recovery and boom in the 1980s. It then sustained HEG by boosting construction investment and riding the emerging global boom, but vulnerabilities to crisis remained.

Chapter 6, "Industrial Policy and Chaebol," is about the structural transformation before the 1997 crisis. The government initially implemented both vertical and horizontal industrial policies, and chaebol played a major role in structural transformation while emerging in a full-fledged form. Industrial policy then moved weight to horizontal policy while chaebol firms became global players in higher-technology industries. Yet the vulnerabilities surrounding chaebol were ready to precipitate a crisis.

Chapter 7, "Growth with Equity?" deals with the management of social conflict before the 1997 crisis. HEG created jobs, reducing inequality, but there were also factors increasing inequality, which weakened over the years. South Korea sustained HEG through democratization mainly because it was limited in scope. Inequality did not narrow after democratization, but it led to reforms to enhance the transparency of the economy and allowed the emergence of independent unions.

Chapter 8, "Crisis and Reform," discusses the nature of the 1997 crisis and the subsequent reform. The causes and resolution process of the crisis reflected South Korea's failure to adapt to the changing international environment of the 1990s. Yet, South Koreans tried to utilize the IMF conditionality as a momentum to carry out thoroughgoing reforms, which left many questions unanswered. The chapter then briefly surveys the contents of the reforms and their immediate consequences.

Chapter 9, "The Slowing Engine of Growth," deals with macroeconomic management after the 1997 crisis. Growth slowed down as the reform purged the previous system supporting the HEG while trying to make it less vulnerable to crises. However, the new system could not prevent another crisis in 2008. South Korea subsequently faced a deflation threat, and fiscal policy became a major issue. The country fought the coronavirus crisis from 2020 well, but risks in the financial markets remain.

Chapter 10, "Industrial Policy and Firms," is about the structural transformation after the 1997 crisis. Industrial policy remains alive, while services have become more important. Chaebol firms became true global players with less vulnerabilities but have many downsides unsolved. Venture business and foreign direct investment (FDI) failed to replace the role of chaebol, but their role is not the same as before. Small- and medium-sized enterprises (SMEs) continued their plight.

Chapter 11, "Inequality, Jobs, and Welfare," deals with the management of social conflict after the 1997 crisis. The chapter first shows that inequality widened after the crisis. It then explains how inequality widened as jobs became scarcer, labor market dualism deepened, the labor share of income fell, and unions often failed to represent the interest of the entire working class. The rise in welfare expenditure reduced inequality, but the welfare system has faced its own problems in coverage and sustainability.

1.5 QUESTIONS FOR THE FUTURE

Finally, there are the questions for the future. The future of the South Korean economy will depend first on how the country deals with the problems discussed in Chapters 9–11. Furthermore, the country is facing a tectonic shift in the international environment. This makes it helpful to go back to the longer span of history, and the book assigns another chapter to deal with the question briefly:

Chapter 12, "Questions for the Future," first explains that South Korea is facing a tectonic shift in the international environment that is not seen in the last 70-plus years. The chapter then discusses the country's relationships with the great powers, seeking hints from what happened in the nineteenth century. The chapter finally discusses the country's ability to manage the international relations with domestic cohesion.