

**Korea: A Sixty Year Perspective**  
**Tragedies, Transformations,**  
**Successes and Challenges**

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# **Korea: A Sixty Year Perspective**

## **Tragedies, Transformations, Successes and Challenges**

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My assignment is to provide a long-term perspective about Korea, as a long-time deeply interested observer though I am not a true Korea specialist. I have been something of a student of the Korean economy for many years, and for some years continue to visit Korea at least once a year. I am an economist; and today I want to take a broad political economy approach. I will focus on broad themes, basically reminding you of what you already know. I will talk more about South Korea than North Korea, since I know more about it and since we will have excellent presentations and discussions on North Korea as a main focus of this conference.

I subtitle my presentation as follows: Tragedies, Transformations, Successes and Challenges. My basic concern is the welfare of the Korean people in both South Korea and North Korea. My main indicators are both economic – what has happened to the Korean standard of living, and economic well being – and socio-political, what has happened in terms of political freedom and human rights broadly defined. I start my perspective sixty years ago, not fifty – in 1945, not 1955 after the Korean War ended.

While the foreign policies of both South and North Korea deeply involve China, and Japan, and to some smaller extent today Russia – and perhaps most importantly the United

States – I will not consider them in detail. Korea – US relations have been and continue to be extraordinarily important, but I leave that topic to our later discussions.

### Tragedies

First, tragedies.

The Korean peninsula has suffered three major tragedies over the past 60 years. The first and greatest tragedy was the division of the peninsula into two separate political entities at the end of World War II, once freed from Japanese colonialism. The occupation of North Korea by the Soviet Union and of South Korea by the United States certainly was not a Korean choice; it was one of the consequences of the way the Pacific War came to an end. This is the most enduring tragedy for the Korean people, not yet resolved by reunification, some sixty years later, and not likely to be resolved soon, I believe.

The second tragedy was the Korean War of 1950 - 1953, in which Korean people fought each other with great devastation and losses. The War deepened mutual antagonism, mistrust, and hostility. As you know the War was brought to an end with the armistice, but as I understand it, the two countries have not yet signed a peace treaty.

The third tragedy has been famines and suffering of the North Korean people, especially over the past 15 years or so, a tragedy which persists by virtually all criteria. Interestingly, North Korea economic growth was more rapid than South Korea's for the first 25 years or so since 1945, but eventually, the Soviet-style planned economic system of government direct allocation of resources reached its limits. Economic and technological support from the Soviet Union was very important, and when that came to an end in 1990 the great strains on the North Korean economy worsened and became more obvious. Moreover, North Korea pushed the Soviet model of relatively limited international trade and finance to an extreme with the policy of juche, self determination and autarchic economic development. Autarchy is a failed development strategy, as not only North Korea but Myanmar and, earlier, Albania, clearly demonstrate.

## Transformations

Next, several fundamental transformations.

One of the major transformations in the Korean peninsula has been from North Korea's initial rapid economic development, but for the last 20 years to the flattening out and in some years the absolute decline of its economic performance. The economic data on North Korea are extraordinarily limited and of low quality, but we do know North Korea is very poor, and in recent years has suffered inadequate food supplies, malnutrition, and indeed death by starvation. The Bank of Korea data on North Korean economic performance, probably as good as any, indicate that the output of the North Korean economy (GDP) absolutely declined by 30% from 1989 to 1998; it has grown modestly subsequently, but its GDP is only about 82% of the 1989 level. The Bank of Korea measures North Korean gross national income by the purchasing power parity method, using South Korean prices and a 205 item input-output table for North Korea. Those estimates suggest a gross national income per capita of \$914 in 2004. With a population of 22.5 million, this suggests North Korea's gross national income is in the order of \$20.6 billion, a trivial amount compared to South Korea's economy. One important fact is that relatively it has fallen further and further behind the South Korean economy. The inability of North Korea to feed itself adequately through domestic agricultural production or the production of exports to buy the needed food imports is a dramatic and tragic transformation.

In immense contrast, South Korea has achieved two wonderful transformations, South Korea's rapid, sustained economic development has made it made it the tenth largest economy in the world, with an impressive standard of living, compared dramatically with its poverty and Korean War destruction some 50 years ago. Just as important has been the peaceful political transition from a military – controlled authoritarian state to a vigorous political democracy. Don't get me wrong: South Korea has had and has today many economic and political problems, and these transformation processes have not been very smooth. Nonetheless I cannot think of any other country in the world in the past 60 years that better has both grown out of

abject poverty to a decent standard of living, and also made this political transition to democracy peacefully. South Korea is the world's best success story combining economic and political development.

As is well known, South Korea has been, on the whole, extraordinarily effective in implementing an export-oriented, industrial development strategy. It has been successfully climbing the multidimensional development ladder from unskilled to skilled labor, from simple technology to ever more sophisticated technology, and from limited real capital – machinery and tools – per worker to considerably more and better capital. Human capital is even more important than physical capital. Improvements in education over the past 60 years have been tremendous; and so too has been worker skill development through learning by doing. Technology has been imported successfully through a variety of channels including in recent years the direct investment by foreign companies in Korea, and Korean firms are increasingly doing their own successful R&D and production innovations. South Korea is the only Asian country aside from Japan that has built major multinational companies with globally highly regarded brand names.

South Korea has benefited from its ability to participate successfully in an increasingly global, and competitive, marketplace. As the economy has grown, its structure has inevitably and necessarily evolved; its competitive advantages have shifted. Given its relatively modest land base, only a poor Korea could be competitive in agricultural production. As incomes rose and labor skills developed, Korea shifted away from the labor-intensive sectors such as textiles, and into increasingly sophisticated manufactured goods and, now, services. I am impressed by the penetration of the internet, cell phones, and broadband into Korean households as well as businesses. Nonetheless, to continue to succeed in the never-ending global competitive race Korea has to keep climbing the developmental ladder.

As of last year (2004), Korea had a gross national income in purchasing power parity terms of \$20,400 per person, implying a total GDP by this measure of almost one trillion dollars. Converting GDP at exchange rates provides a per capita gross national income estimate of \$14,162. For international comparisons of living and productivity levels, purchasing power

is a better measure than using exchange rates, even though there are always measurement problems. Thus, South Korea's average standard of living is four times as high as China's, about 2/3 that of Japan or Canada, and about half that of the United States. The only other Asian economies ahead of the South Korean standard of living are Singapore and Hong Kong, and neither has any rural population. This is a remarkable South Korean achievement. It also means that incomes can double in the future by achieving the current US level of national productivity, and of course in the longer run the potential South Korean standard of living will be even higher. These estimates also suggest the South Korean standard of living is on the order of 20 times higher than North Korea, and total GDP 40 times higher. One percent of South Korea's GDP is almost one-half of North Korea's GDP. While the specific numbers are crude, they indicate how obviously huge the economic gap between South and North Korea is.

South Korea's peaceful political transformation from an authoritarian state to a democracy was in substantial part brought on by the successful economic development which created a substantial middle class, but it was more than that. It involved the ethos, drive and great hunger for freedom of South Koreans. It was not just the students, but their parents with them, who demonstrated in the 1980's to bring about peaceful change. Moreover, for all its faults, the Uri Party and President Roh Moo-hyun do represent the development of a real two party system, and with substantial differences in policy platforms, which is important for political democracy.

One current aspect of political development as a democratic society is a renewed sense of Korean self, of what on the whole I consider to be healthy patriotism. Inevitably that nationalism involves a rethinking, a redefinition of South Korea's complex set of relationships with the United States, North Korea and China and Japan as well. Much of this is generational. My sense is that many young Koreans, the 386 generation in particular, may like Americans personally but do not like the current status of the US – Korean official relationship, or many aspects of US government policy. They seemingly do not feel the sorts of obligations their parents have felt as a result of the Korean War and the US role in it. Nor do they seem to share their parents' fear of North Korea as a direct military threat. Rather they seem to feel sorry for

their poor, weak North Korean cousins, whom they may like to visit, but don't want to have moving in with them.

### Demographic Transition

The fourth major transformation, more clear-cut for South Korea than North, is demographic. It is just as dramatic and profound as the industrial transformation. The two are linked, of course. One of the most dramatic value changes in South Korea, and indeed throughout industrializing Asia, has been the shift from the quantity of children each family wants to the quality of their children, as embodied in the family's investment in their children's ever higher education and health, and preparation for different occupations than that of their parents. The Korean emphasis on education is as strong as in any country I know, and education is expensive.

South Korea is well along the demographic transition – from the pre-industrial pattern of high birth and high death rates, relatively short life spans, and rapid population growth, now to low birth and death rates, much longer life expectancy, and population growth slowing down and eventually declining. South Korea's population is expected to peak in about 2023 at 50.6 million, according to the Korean National Statistical Office website.

Without net immigration, for a country to maintain a given population level, women must have on average slightly more than two children during their lifetime. In 1960-65 South Korea's total fertility rate was 5.63 and its population was 25 million. In the early 1980s, the total fertility rate was 2.83. Last year it was 1.19, below Japan, and the lowest of any of the OECD advanced countries; and the current population is 48.1 million. It has been assumed that Korea's fertility rate will be about 1.4 over the foreseeable future – but probably not forever since that would mean that the Korean people would disappear in a thousand years or so. After peaking, the Korean population is predicted to decline by about 12 percent to 44 million or so in 2050. When fertility will rise is anyone's guess, but eventually Koreans will be rich enough to want to have more children, I presume, and will create the sorts of supportive institutions and policies that are necessary, as Sweden has demonstrated can be done.

For the foreseeable future this means not only that Korea's population is now ageing but that the number of persons of work force age will begin to decline absolutely by 2017 or so. Labor shortage will then become a chronic long-term problem. Society will have to pay more to support its retired population – but less to support its dwindling number of children. Some numbers: in 1960, 2.9% of the Korean population was 65 or older, in 2000 7.2%, in 2025 it is projected to be 19.1%, and in 2050 34.4%. We all worry about the implications in an ageing society, but for people to age well is wonderful, especially when you consider the alternative.

This will not necessarily be bad economically and socially. Despite the absolute decline in its future labor force, Korea's economy will continue to grow, if slowly. More importantly people's standards of living will continue to improve and become high.

These population projections assume there will be no major immigration of foreigners into South Korea. More importantly, they do not include the integration of the North Korean population with South Korea. That will certainly slow down and postpone, but probably not fundamentally alter, these long term demographic projections once North Koreans also achieve a decent standard of living and the appropriate fertility incentives. According to a United Nations Population Fund report, North Korea's total fertility rate is 1.97. Once Korea is by no means alone in these demographic projections – Japan is already further along in its demographic transition, and so too are wealthy European countries. The United States, with its substantial immigration, is the only major exception.

In having made all these very positive statements, let me remind you that these complex economic, political, and demographic transformation processes have not been nearly as smooth as a long-term perspective seems to suggest. Indeed, both South Korea and North Korea in shorter-term perspectives always seem to have current difficult problems, and serious crises periodically. I do not have time to consider crises in any detail, but I want to say a few words about the financial crisis of 1997-98, which many South Koreans refer to as the IMF crisis.

South Korea got caught up in the 1997 Asian financial crisis for essentially the same reasons the other countries, notably Thailand, did. It had borrowed too many dollars, yen and other currencies short-term, and exchanged them into the won domestic currency and lent them for long term domestic investment projects. As a result Korea suffered twin crises of lack of foreign exchange and financial illiquidity. Part of the cause of the financial crisis was that the Korean government liberalized foreign capital flows too quickly in the 1990s without adequate development of the domestic financial system, in part because of US government pressures to liberalize, and in part to be able to achieve advanced country status by joining the OECD. The Korean government had to borrow from the IMF and get help from the US Treasury to persuade American and other foreign banks to roll over their short-term foreign currency loans rather than collecting them. The response of the Korean people was extraordinarily patriotic; people contributed gold, jewelry, foreign currency, and other liquid assets.

The IMF requirements were tough. They involved the restructuring of the financial system, including de facto nationalization of virtually all the banks; the privatization of many government enterprises, and other reforms. These IMF requirements have been very beneficial for the subsequent structural reform of the Korean economy and especially its financial system. What is not generally recognized is that the Korean government officials negotiating with the IMF themselves asked that these reform requirements be part of the deal. They felt that the crisis provided the opportunity to carry out the sorts of fundamental economic reforms that it had been so difficult politically for the government to tackle. Some Korean negotiators proudly stated they had achieved an “IMF Plus” set of commitments. The contrast with the procrastinating Japanese experience over the past decade is stark. Compared to the economic reform measures taken by the other Asian countries following the 1997-8 financial crisis, South Korea has definitely done the best. However, compared to the final objective, a considerable amount still remains to be done.

### Challenges for the Future

History is not linear; there are too many unexpected changes and shocks, both external and internal. Nonetheless, a long-run historical perspective does provide insights into some of the longer-run challenges South Korea – and North Korea as well – will face.

By far the most important challenge is when, by what process, and on what terms South Korea and North Korea will be reunified and reintegrated. That indeed is the underlying central theme of this conference. I assume reunification will occur eventually, but not soon, and will be essentially on South Korean terms. The likely path, indeed the best and perhaps the only feasible path, is initially by economic integration. I gather that is the approach of this afternoon's sessions. While in the long run the benefits for South Koreans, and certainly for North Koreans, will be great, the economic and social costs for South Korea along the way will be huge. I wonder what are the perceptions, work habits, and values of the North Koreans, and how will they change. Just being Korean may not be enough. We see significant generational change, as well as continuity, in South Korean values and behavior; perhaps that is occurring in North Korea as well. Are North Korean and South Korean beliefs, values, and modes of behavior now significantly different? How incompatible are they? How will they evolve?

The second challenge is how the South Korean economy will respond to the continuing rapid spread of the industrial revolution to China and throughout Asia, and an increasingly globalized world. Following Japan, South Korea together with Taiwan, Hong Kong and Singapore – the newly industrialized economies – became an early and major player in this development process. This industrialization process is straight forward and long-term. Korea has to continue to educate its labor force to ever higher levels of skill. Workers must continue to shift out of low productivity agriculture to increasingly high-tech manufacturing, and to increasingly sophisticated services. Technology is the long-run driver of successful economic growth. Companies must always be prepared and able to import the best foreign technology, to learn how to use it well, adapt it, and improve on it and develop their own technology. Korea already has many success stories, both large, well known firms and smaller ones. In the future it will have to rely increasingly on domestic R&D, and improved advanced educational and basic science systems that can sustain R&D.

Korea will have to, and indeed will, continue to climb this developmental ladder of increasing skills, investment, and technology. But so will other Asian countries, most spectacularly China. Korea will continue to be squeezed between a lower tech but rapidly improving China and a high tech though slowly growing Japan, just as Japan feels it is squeezed competitively between Korea and the United States. However, the good news is bigger than the bad news. While the rapid growth of China and other economies, and a more globally competitive world, greatly increases competitive pressures on Korean companies and workers, their growth creates even greater markets and opportunities. One of the lessons of the last 20 years for the US, and for South Korea as well, is that the only thing worse than a fast growing Japan is a slow growing Japan. This is a lesson we all need to learn about China.

To grow well, Korea will have to continue to be flexible and effective in its ongoing reallocation of both capital and labor, and in the development and implementation of good economic policy. There will of course be many problems, difficulties and mistakes, but I am optimistic about Korea's future economic performance.

Inevitably as an economy grows and approaches the world's best technology practices – the global production frontier to use the economist's jargon – its growth rate will slow down once its catch-up phase is completed. I expect the South Korean economy to grow at 4 to 5% over the next decade. Three decades from now, maybe sooner, the Korean economy will probably grow at a maximum of about 2 percent per person, since no rich developed country has ever grown faster than over moving ten year average periods. Growth will be constrained by the growth of the labor force, and by the increases in labor productivity through better technologies, more capital and improved skills. Indeed, the twin demographic transition -- to an ageing society and an absolutely declining Korean labor force-- is South Korea's third future challenge, as I have already discussed.

South Korea's fourth challenge, and indeed that of North Korea as well, combines geography and history. The geographical location of the Korean peninsula, surrounded by the powerful giants of China, Japan and Russia, has always been a huge problem for Korea, although certainly there have been benefits as well. Over the past sixty years Japan has been an

ongoing source of industrial technology and a peaceful economic partner. China has become, through its own sustained rapid growth, the largest trading partner for both South Korea and North Korea, and provides significant opportunities for South Korean business investment. While it may not have been true in the past, today China, Japan and Russia – and of course the United States – all want to see peace and prosperity on the Korean peninsula.

The final challenge I want to note is in some ways the most difficult. How Koreans can be both Korean and international? Korean ethnicity and Korean language are deeply ingrained in all Koreans. Yet, Koreans live in a world that is becoming ever more interconnected economically, politically and socially. I am impressed by the common pop culture and instant communications shared by young people in Korea, the US, Japan, China and indeed the world. And English – fortunately for me – has become the international language of business, science, and higher education.

So far as I know, there are no significant minorities who live permanently in Korea. The major South Korean differences are regional identities, commitments, and dialects... and they obviously are very important. However, they have been diminishing over time and will continue to diminish as a result of the common educational curriculum, labor mobility, and especially the role of TV. TV dramas and soap operas convey a great deal about common Korean ways of life, problems, and values. I believe that over time, South Koreans will become at a national level more homogenously Korean.

The Korean peninsula is the only major place where the Korean language is predominant and overwhelmingly so – both spoken and written – even with the notable Korean diaspora. Language adds to the sense of Korean uniqueness. In one respect it is a comfortable barrier to keep out foreigners. In another sense it is a barrier making it much more difficult for Koreans to internationalize.

I have taken advantage of the very broad mandate the organizers have given me not only to discuss a few major features of the past 60 years on the Korean peninsula, focusing mainly on South Korea, but to push the perspective forward another 20 years or so. In doing so,

I probably have raised more questions than provided answers. That is why I look forward to the presentation by Suchan Chae and to the panel discussions this afternoon to provide those answers.