Reverberations Of The Korean War On The South Korean Economy

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Abstract

South Korea’s success story is one to marvel at. They were the first non G-7 country to host a summit of the G-20 countries of the world – the committee that drives the economy of the world today. The shocking element is the ability of South Korea to transform their position from that of “rags” to “riches” as seen in their current position of being the twelfth largest trading nation in the world.

Between the years of 1962 and 1979, Korea’s real GNP grew at an astounding rate of 9.3%. One of the major reasons for their growth was the fact that exports were given prime importance. The significance was such that, the people of the nation coined exports as their “engine of growth”. In 1962, South Korea had annual exports of $55 million. However, the nation managed to grow it to an extent where the annual export value was a staggering $27 billion in the year 1982.

The years of 1966, 1968 and 1969 were extremely profitable for the country. The GNP rose at levels of 12.4, 12.6 and 15.0. Most of South Korea’s imports were financed by foreign aid grants from two major sources: The United States bilateral assistance program and the United Nations Korea Reconstruction Agency (UNKRA) via the United Nations Civil Assistance Command in Korea (UNCACK).

The current study is aimed at analyzing the prelude to the Korean War, which lasted from 1950 to 1953, and the economic implications they left behind for South Korea. It is aimed at understanding South Korea’s sudden economic boom and how they managed to grow at such a fast rate.

Background

Korea was a land which was annexed by the Imperial Japanese. The Japanese upon invading Korea pillaged their lands and exploited their resources similar to the British rule in India, however, one major boon that the Japanese brought into Korea was the element of modernization.

Imperial Japanese Rule (1910-1945)

Imperial Japanese colonial rule lasted from 1910 to 1945. During the period between the years of 1919 and 1925, Korean communists got together to form multiple groups to rid their country of the Japanese, however, they failed due to the fact that they received no backing from an external body.

The Change (1943-1945)

The Change is led by the first element that began Korea’s freedom from Imperial Japan – The Cairo Conference. At this conference, The United States, China and United Kingdom decided to come together and make Korea free and independent.

Soviet-Japanese War (1945)

In 1945, when the Soviet Union declared war on the Japanese, Korea managed to get liberated. These 35 years vastly improved the land of Korea. However, the infrastructural base which the Japanese had left behind was almost completely destroyed during the Korean War, which lasted from 1950-53.

Chinese Civil War (1945-1949)

The end of the war with Japan marked the continuity of the Chinese Civil War. The war in China was between the Communists and the Nationalists. North Korea supported the Communists, assistance which did not go forgotten.

After the People’s Republic of China was formed, they named the United States and other western countries as their biggest threat to national security.
The Korean War (1950-1953)

The main issue with South Korea was the continuity of the wars. Post the situation where they struggled to get liberated from the Japanese; the nation suffered a period of extreme economic disorganization. Before they could recover from that, their northern brethren invaded. On 25th June 1950, South Korea had been invaded by its neighbors in the North. North Korea received support from China, as well as some additional support from the Soviet Union. South Korea was helped by the United Nations, primarily spearheaded by the United States of America.

The division of Korea via the Korean Demilitarized Zone and the Korean Armistice Agreement saw the two put their weapons down. However, owing to the fact that no actual peace treaty had been signed between the North and the South, people interpret the current Korean situation in terms of a “Frozen Conflict” where they believe the countries are still technically at war with one another.

Short Term Effects of The Korean War

The Korean War (June 25, 1950 to July 27, 1953) proved to be destructive for both the Korean nation: north and south. It was timed at the time when the two nations were struggling to attain some stability in their economic and social functioning. The economy was exploited by the imperialistic Japanese rule and was distorted and destroyed after the war. It was taken to an international level and turned out to be more than a civil war between UN forces and north Korean allies. There was mass destruction of physical capital and human capital (nearly 4 million people). The effects of the war were so devastating that the resultant economic system and policy restructured the future of Korean economic development.

The short term direct effects of the war include massive destruction industries which include sectors like chemical and textile. Infrastructural damages in crude damage of rail roads (estimated as high as 49%) and houses (estimated 600 thousand). The worst damages account of mining and power, which faced losses of 50% to 80%. The trade in south Korea in 1953 declined to 44% lower than the 1940 level. The agricultural produce of rice declined till the extent of 65% of the average annual produce.

Hyperinflation was another issue faced by south Korea during and post war, the government, in order to meet its military and defense requirements kept on printing more and more currency which amounted to over 70-90% increase in the money supply. It took huge loans which could be only deemed by a portion till the war ended.

Another immediate effect caused by the war was its influence on the major economic reform policies which could not be implemented due to the occurrence of war. Although, they were then resumed but resultant effects led to further distortion. They were resumed due to their importance in shaping Korea as a market economy. The bills were namely: The farmland reform Act and the Enemy privatization Act. The implementation of these bills did not meet the objectives that they were formulated for. For example: the farmland reform was being used for war supplies and farmer willing to buy those farmlands were taxed extremely high. tab rates rose from 15 to 28%, which had to paid through farm products, that too at the time of sky high inflation.

As a result of this, farmers had to sell off their land and worked as tenants on other farmlands. Now that the farmland owners were forced to sell a major portion of their produce to the government and were also heavily taxed, they had no incentive to continue farming. So .I compensation, they received vouchers from the government, which were also trade at 70%-80% discount on their face value.

Another important policy of enemy property privatization lost its objective due to galloping inflation. The vouchers given as compensation to farmland owners were worthless in terms of real value and hence they sold them at discounts. Only the large farmland was owner retained, which allowed said owners to buy enemy property in the auctions. The revenue gained out of this was again transferred to the government to meet war expenses. This process was carried out on the basis of pre-
emptive rights and priority to former managers and leaseholders, in order to attain efficiency and productivity in the manufacturing.

The impact of the Korean War was even more disastrous in North Korea. The estimated deaths were 5 times that of South Korea. The destruction in agriculture, power and infrastructure was much higher than that of South Korea. But, the only positive point was the successful implementation of the two major reforms, which were executed long ago and were not affected by the Korean War. The North Korean government unlike South Korea did not charge the tenants for distribution of farmlands and did not give any kind of vouchers to compensate the large farmland owners for their confiscated land. The enemy land (of the Japanese businesses) was first confiscated and then nationalized.

**Long Term Effects of The Korean War**

Among the long term effects of the war, the US has been widely criticized for making Korean agriculture dependent on US, and carrying forward Korean economy to a consumer goods oriented one. The aid that South Korea first received was in the form of food and medicine, whereas industrial facilities were much more desperately needed. Also, the sales of US agricultural surplus in order to buy more military supplies from it largely affected Korean agricultural industries as the farmers had to bring down their prices in order to survive in the market. This was a huge setback for the local farmers, as some of them gave up farming. In this way, the United States have been criticized for strategically providing Korea with loans, aids and FDI, in order to control its economy.

Another perspective of the same argument supplemented with facts, show that US aid acted as a facilitator for core economic stabilization and growth. The US aid along with civil relief in Korea and UNKRA, rose three fold from 1950 to 1957 and the defense budget was also fulfilled with aids and external funds by the US. In-spite of the domestic saving ratio remaining as low as 4%, the growth in the economy was picking mostly due to US aid and the galloping inflation declined to 20% from 120% during the war.

After evaluating both the sides, it can be said that, the US cannot be blamed for the decline of the Korean agricultural industry. First of all, having said that Korea was not of prime interest to US, US would not deliberately try to exploit it. Secondly, criticism can be routed towards the militaristic utilization of the aid provided by the US.

There were conflicts between the US and Korean governments over numerous issues. One of them was the utilization of the leftover aid (total aid minus defense expenditure) which accounted for 65% of the funds. The Korean government wants to allocate it for industrial development whereas US wanted to allocate it for economic stability and urgent needs. US wanted Korea to take Japanese assistance in terms of trade of raw materials for manufactured goods. But, the Korean government refused due to unhealthy rations with Japan. The final decision that was made by the governments by allowing indirect trade with Japan, provided that Korea was in-charge.

The second issue was regarding the application of exchange rate. The Korean government wanted to apply official rate in order to import capital goods and intermediate goods for low prices whereas the US government wanted to apply the market rate in order to ease the repayment of its loans from Korea. The rates were finally fixed close to the market rates.

The third and the most important issue was to decide the type of goods to be supplied as a means of aid. US gave priority to consumer goods due to which textile and milling industries showed robust growth, as a result of which Korean economy structured itself as a consumer goods oriented one.

The final issue was to figure out the allocation of aid. US emphasized on sales revenue generation by sale of aid supplies while the Korean defense ministry was in favor of supplying only to operational production units. Consequently, they applied the real demand principle only for major items like cotton wheat and sugar.

The most serious long term effect of the Korean war was its impact on the policies and reforms of the Korean government. One of them was “real-demand principle” due to which people made abnormal gains due to continuously and sharply rising inflation. In addition to it, the supplies
according to this principle were done to operational facilities only and along with this they were given multiple benefits in terms of lower interest rates and tax credits. This boosted their borrowings and ownership ratio offered. This led to corruption and formation of cartels, which eventually established monopolies in prime industries of the nation. These monopolies controlled the market inefficiently as they couldn’t establish optimum production scales and competitiveness in the global market, due to government benefits. The benefits clearly favored big businesses due to which they were able to exploit labor as there was great unemployment. They also gained from the differences in exchange rates.

Another issue created by policies was the low pricing of grains. As 33% of the aid comprised of grains, this created pressure on the local industry in terms of low pricing and heavy taxation by the government. the Korean government is to blame for this, as they tried to keep the prices low so that they could purchase them during wartime for as low as possible and also compensate the landowners for low price (compensation was measured in terms of value of their produce).

Structural Transformation of South Korea

The transformation of Korea from an economy which was a light consumer good oriented society can be attributed to the efforts for equitable income distribution. The country in the 1960s could be identified as a less developed, backward one. Due to lack of natural resources and cultivable land, Korean economy was typically isolated from the West. During the Korean war, the little development in Korean infrastructure that happened during the Japanese rule was also destroyed. The country’s progress from an economic basket case to almost a developed nation was the result of policies which encouraged outward oriented growth strategy. This resulted in decline of unemployment rates and poverty.

The period after the Korean War can be seen as three phases: import substitution, outward orientation and stabilization. The period before these three faces can said to be a period of establishing and growing physical and human capital which proved to be a base for further economic development and growth. After which, the import substitution policies induced growth by leading export based industrialization and export expansion, such that it made more than a threefold contribution to the GDP growth. This created opportunities for better utilization of capital. The high growth rate of debt also led to a few concerns like accumulation of debt (foreign), stimulated inflation and disparities within and between urban and rural areas.

The oil induced recession and inflation in the economy, led to the implementation of stabilization policies by the government in order to make the rapid growth optimal and smoother. In order to correct distortions, government started curbing subsidies and preferential loans. The concept of comparative advantage was being applied to the investment allocation in order to increase competitiveness in the world economy. The government intervened to regulate the market system so that the activities of the private sector are directed towards enhancing the nation’s wealth and industrial strength.

This development strategy proved to be highly successful. Korea saw an increase in the average annual growth percent, per capita income and its industrial structure. The export expansive policies benefited the economy and contributed to robust growth in domestic savings and employment.

Despite the growth in the light consumer good industries, there was experienced a need to develop heavy industries as more exportable products were needed. Also, there were huge disparities between people engaged in exporting and people engaged in domestic business. This resulted into industry specific government benefits and assistance for promotion of such industries.

During 1976-1978, the economy overheated. There was a sudden increase in wages and the middle class construction boom impacted land prices. This sharp rise in inflation lead to weakening exports and slowed the economic growth. But, the upcoming periods of 1980s led to stabilization and liberalization. The economy became more open to foreign investments and there was more and more
technological advancement. The inflation reduction policies took shape and showed results as the economy regained its productivity. In the late 1990s the economy again boosted as the oil pieces were low and the dollar weakened, this led to a surplus in the balance of payments.

The late 1990s also experienced the onset of financial crisis, which hampered growth and development in that period. There was an economic slowdown due to decline in investment and consumption expenditure. This made the profitability of various corporate firms decline, thereby making them indebted for the short term. This created problems resulting in poor supervision, accounting standards and lot of government intervention.

After the crisis, Korea started to restructure its financial and corporate sector which contributed to its growth and helped it become on the leading expanding countries in Asia. During times of slowdown and falling prices, the growth in exports supported the economy.

The prime contributors to the Korean economy were: reforms of stabilization and restructuring of weak and exposed areas, opening the economy to global competition, and concentration of the areas of key advantage in terms of international competition. A high level of investment, workforce participation, and most importantly, a rising level of foreign direct investment have been significant in the economic growth of Korea. The economy can be further strengthened and maintained by stability and innovation to improve productivity and R&D.

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