Political Economy of South Korea’s Transition, 1961-2008

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Introduction: Our Principal Questions

• South Korea is well along the transition toward what we call an open access order.
  – Simultaneous economic and political development
  – Transitions are rare. How has Korea managed this?
    • Economists explain the policies used
    • Missing are the political foundations for these policies.
  – We focus on three major turning points
    • 1. Initiating the transition (1960s)
    • 2. Democratization (1987)

Mo and Weingast, "Political Economy of South Korea's Transition"
Roadmap

• Summarize the framework
• Turning point 1: Initiating economic growth
  – Explain logic of the developmental state
• Turning point 2: Transition to democracy
  – Economic and political effects of democratization
• Turning point 2: The financial crisis
  – Explain how politics exacerbated the crisis.
• Post-crisis reform
• Conclusions
An Analytic Framework

• Draw on North, Wallis, and Weingast (2009).
• Distinguishes different types of political economy systems called social orders.

• The limited access order, or natural state:
  – The political system manipulates the economic system
  – Creates rents to sustain order.

• In open access orders, political, economic, and other forms of competition combine with institutions to sustain order.
The Logic of the Natural State

• The Natural State solves the problem of violence by creating rents.
• Individuals and groups with access to violence have incentives to cooperate.
• The political system uses rents and limited access to sustain order.
• Differences among natural states: the nature of the dominant coalition.
Natural States (cont.)

• We call the limited access order system the Natural State.

• All relationships are personal.
  – [**limited rule of law, public goods]

• Examples.
  – Medieval England, Nigeria, Kenya, Argentina, Mexico, Russia.

Mo and Weingast, "Political Economy of South Korea's Transition"
Open Access Orders

• All citizens have the ability to form contractual organizations.

• Open access creates and sustains:
  – Both economic and political competition.
  – Rich civil society.

• Impersonality
  – Impersonal exchange (North)
  – Impersonal benefits/ public goods.

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The Transition/Doorstep

• Redefines the problem of economic development.
  – Only 6 states since 1960.

• Some natural states move to positions in which moves toward open access can be sustained.

• Doorstep conditions:
  – DC 1: Rule of law for elites
    • Impersonality for elites
  – DC 2: Creation of a perpetual state.
    • Necessary for institutions to bind successor coalitions and rulers.
  – DC 3: Political control of the military

• **These conditions
  – Are central to the transition from a natural state to an open access order.
  – Distinguish a few states in transition from most developing countries qua natural states.]

• All require forms of credible commitments to be sustained.
Turning Point 1: Initiating South Korea's Transition, 1961-1979

• Why South Korea?
  – Transition very rare
  – An explanation for the political foundations.

• Previous explanations
  – Economists (Krueger, Rodrik)
  – Technocrats (Amsdem, Wade)
  – Japanese colonial experience (Kohli)
  – Security
  – Shared growth (Campos and Root).

Mo and Weingast, "Political Economy of South Korea's Transition"
South Korea as a Natural State

• 1950s: Rhee regime not very different from most natural states throughout developing world.
  – Clientelism and personal exchange
  – Rents based on connections
  – Economic policy as an instrument of politics and coalitions (Haggard 1990).
    • [**Foreign exchange
    • Import licenses
    • Grain
    • ISI.]
  – Heavy dependence on American aid.

• Yet unstable.

Mo and Weingast, "Political Economy of South Korea's Transition"
Park and Military Takeover, 1961

- Establishes the developmental state
- Transformation of policy from personal to impersonal basis (Jones and Sakong 1980).
  - Move toward economic independence based on export-led growth
  - Macroeconomic stability
  - Shared growth
- Systematic and simultaneous transformation of polity and economy (from natural state) **[political reform not to democracy, but from clientelistic natural state to one capable of impersonal policies; doorstep]
- New system of coordinated incentives.

Mo and Weingast, "Political Economy of South Korea's Transition"
Incentives for firms

• Economic policymaking in service of economic growth
  – Cooperation of business and government.

• Exports
  – Loans, credit, licenses, refund import taxes
  – Profit opportunities
  – Tournaments (Lazear and Rosen).
  – Impersonality

• Absence of SBC
  – Several restructurings.
Incentives for Bureaucrats

• Meritocratic/impersonal vs natural states/personal
• But not independent of politics
• Rewards for performance
  – Minister shuffling (Root 1996)
  – Monthly meetings (Rhee, Ross-Larson and Pursell 1984)
• Relative absence of bureaucratic corruption?
  – Most natural states, such as India, Mexico
• EPB polices budgets
• Pensions
• Deliberative councils (Campos and Root 1996)
Citizen Incentives

- Repressive regime
  - Absence of political rights (e.g. association)
  - No democracy

- Yet a range of **impersonal** benefits
  - Education
  - Infrastructure (e.g., rural roads to markets)
  - Security.

- Shared growth
  - Open access to jobs in an expanding economy and the bureaucracy.
  - Rising wages (8%/year from 1970-1988, Haggard, Cooper and Collins).

- Contrast with natural state
Government / Coalition Incentives

• To make this system work, government (and coalition leaders) had to have incentives to support system of impersonal exchange.
  – What prevented reneging, especially in crises (e.g., early modern Europe, Latin America, Africa)?

• The security dilemma: threat of communism.
  – Perceptions in 1950s and 60s
  – On-going threat from North Korea and China.

• Credible commitment: [**Differentiates ka from other natural states]
  – Reneging would destroy system creating independence and security
  – Maintain incentives for firms, meritocratic bureaucracy, and citizens.
Turning Point 2: Democratization

• Problems in the mid-1970s
  – Oil crises
  – Heavy and Chemical Industry Plan
  – Park’s assassination.

• Chun Doo Hwan
  – Economic problems
  – Pressure for democratization.

• Failure of Democratization in 1980

• Growing pressures for democratization
  – Chun’s promise of 1 term
  – Growth of middle class, students, and unions
Democratization (cont.)

• South Korea’ Democratization
  – Growth of middle class; combines with labor and students

• A period of high growth

• Role of the United States, 1980 vs 1986-87

• Diminished security concerns
  – South Korea far richer and stronger

• Enters democratization with doorstep conditions
Democratization, 1987

Chun

Democracy

Maintain Authoritarian

Opposition

Challenge

Acquiesce

Preferences

<table>
<thead>
<tr>
<th>Chun</th>
<th>Opposition</th>
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<tbody>
<tr>
<td>A</td>
<td>D</td>
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<td>D</td>
<td>C</td>
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<tr>
<td>C</td>
<td>A</td>
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Mo and Weingast, "Political Economy of South Korea's Transition"
Economic Implications of Democratization I

• Democratic Responsiveness: New demands by citizens
  – Increase in social insurance expenditures
  – Maintenance of investment expenditures
  – Maintenance of Macroeconomic discipline
  – Decline in defense spending

• Some increase in redistribution, but universal rather than particular (open access vs limited access).
  – [**social insurance]
  – Public goods
  – Complementary to markets.

• Rise in the civil society
### Table 1: Number of Interest Groups and NGOs by Year of Registration

<table>
<thead>
<tr>
<th>Period</th>
<th>Number of Industry Associations</th>
<th>Number of Unions</th>
<th>Number of NGOs</th>
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<tbody>
<tr>
<td>~1980</td>
<td>2,031</td>
<td>2,393</td>
<td>794</td>
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<tr>
<td>1981-1986</td>
<td>907</td>
<td>2,417</td>
<td></td>
</tr>
<tr>
<td>1987-1990</td>
<td>209</td>
<td>5,901</td>
<td></td>
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<tr>
<td>1991-1999</td>
<td>1,401</td>
<td>6,647</td>
<td>2,058</td>
</tr>
</tbody>
</table>

Mo and Weingast, "Political Economy of South Korea's Transition"
Table 2: Central Government Expenditures By Function (in percent)

<table>
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<tr>
<th>Year</th>
<th>Defense</th>
<th>Social Services</th>
<th>Education</th>
<th>Economic Development</th>
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<tr>
<td>1986</td>
<td>27.5</td>
<td>12.5</td>
<td>17.0</td>
<td>18.1</td>
</tr>
<tr>
<td>1990</td>
<td>20.0</td>
<td>20.4</td>
<td>17.0</td>
<td>20.4</td>
</tr>
<tr>
<td>1994</td>
<td>17.2</td>
<td>17.8</td>
<td>13.9</td>
<td>25.4</td>
</tr>
</tbody>
</table>
Economic Implications of Democratization II

• Lack of double balance
  – Economic openness
  – Lack of political openness
  – Inability of civil society to counter role of chaebol.

• Role of campaign finance under democracy (Mo 2005).
  – Political officials depend on chaebol

• Massive change in the ability of the government to discipline the chaebol.
  – Business capture
  – Failure of chaebol reform
  – Able to defeat corporate restructuring

• Moral hazard/ TBTF

Mo and Weingast, "Political Economy of South Korea's Transition"
Turning Point 3: Political Economy of The Financial 1997 Crisis

• Lack of double balance
  – Inability to control the chaebol implies moral hazard and TBTF.
  – Big investment boom
  – Growing leverage

• Moral hazard exacerbated by politics.
  – Undoubtedly, financial crisis under any circumstances; but made worse by politics and inability of political officials to control the chaebol and moral hazard.
Post-Crisis Reform

• Kim Dae Jun takes power
• Big economic reform effort
  – [**Details here]
  – Tough IMF agreements for bailout loans
  – Financial restructuring; corporate restructuring for the chaebols.
• More arms length relationship with Firms
• But is it enough?
• Roh Moo Hyun. New politics following generation 386.
Conclusions – And a Look Ahead

• Failure of double balance
  – Developmental state
  – Initial democratization

• Jury is out on the efficacy of reform

• Major achievement was the early move to the doorstep conditions and impersonality policymaking.
  – Shared growth

• Presence of the security threat
  – Compare with Bates’s thesis about Africa

• Korea a model?
  – Democratization without impersonality means particularistic policies rather than universalistic.
  – Democratization and transition in steps (Chile, Taiwan)