

Economics Series

No. 112, June 2010

Post-Conflict Planning and Reconstruction: Lessons from the American Experience in Korea

Marcus Noland



EAST-WEST CENTER
COLLABORATION • EXPERTISE • LEADERSHIP



The East-West Center promotes better relations and understanding among the people and nations of the United States, Asia, and the Pacific through cooperative study, research, and dialogue. Established by the U.S. Congress in 1960, the Center serves as a resource for information and analysis on critical issues of common concern, bringing people together to exchange views, build expertise, and develop policy options.

The Center's 21-acre Honolulu campus, adjacent to the University of Hawai'i at Mānoa, is located midway between Asia and the U.S. mainland and features research, residential, and international conference facilities. The Center's Washington, D.C., office focuses on preparing the United States for an era of growing Asia Pacific prominence.

The Center is an independent, public, nonprofit organization with funding from the U.S. government, and additional support provided by private agencies, individuals, foundations, corporations, and governments in the region.

East-West Center Working Papers are circulated for comment and to inform interested colleagues about work in progress at the Center.

For more information about the Center or to order publications, contact:

Publication Sales Office
East-West Center
1601 East-West Road
Honolulu, Hawai'i 96848-1601

Telephone: 808.944.7145

Facsimile: 808.944.7376

Email: EWCCBooks@EastWestCenter.org

Website: EastWestCenter.org



Economics Series

No. 112, June 2010

Post-Conflict Planning and Reconstruction: Lessons from the American Experience in Korea

Marcus Noland

Marcus Noland is a Senior Fellow at the East-West Center and Deputy Director and Senior Fellow at the Peterson Institute for International Economics.

This paper was prepared for the Summit on Entrepreneurship and Expeditionary Economics, 25-27 May 2010, Kauffman Conference Center, Kansas City. I would like to thank Jennifer Lee for research assistance.

East-West Center Working Papers: Economics Series is an unreviewed and unedited prepublication series reporting on research in progress. The views expressed are those of the author and not necessarily those of the Center. Please direct orders and requests to the East-West Center's Publication Sales Office. The price for Working Papers is \$3.00 each plus shipping and handling.

**POST-CONFLICT PLANNING AND RECONSTRUCTION:
LESSONS FROM THE AMERICAN EXPERIENCE IN KOREA**

Marcus Noland
East-West Center
Peterson Institute for International Economics

21 June 2010

Paper prepared for the Summit on Entrepreneurship and Expeditionary Economics, 25–27 May 2010, Kauffman Conference Center, Kansas City. I would like to thank Jennifer Lee for research assistance.

South Korea is arguably the premier development success story of the last half century. Fifty years ago it had a per capita income lower than that of Mozambique or Bolivia; today it is richer than Portugal, a member of the OECD, and in November will be the first Asian and first non-G7 country to host a summit of the G20, the unofficial steering committee of the world economy. And as spectacular as South Korea's economic performance has been, its political development has been as impressive, if not more so: In the space of a single decade between 1987 and 1997, leadership of the South Korean government went from an authoritarian strongman (General Chun Doo-hwan) to his elected but hand-picked successor (General Roh Tae-woo) to an elected centrist civilian politician (Kim Young-sam) to a former dissident (Kim Dae-jung). In 2012, South Korea is scheduled to host the second Nuclear Security Summit.

The contrast with North Korea is stark: during the same period it experienced a famine that killed perhaps 3 to 5 percent of the population, and remains mired in an anachronistic Stalinist dynasty that systematically denies its populace the most elemental human, civil, and political rights.

Same people, same peninsula, very different outcomes.

It would be natural to ascribe these very different trajectories to the differences in tutelage that the two halves of the peninsula received from their respective patrons, the United States and the Soviet Union. And while there is certainly much in this notion, what is less commonly appreciated about the South Korean experience was that the period between the establishment of US military governance immediately following the Second World War defeat of Japan in 1945 to the initiation of a wide-ranging reform program by Park Chung-hee in 1963 were years of relative stagnation. Between 1953 and

1962 in purchasing power adjusted terms the economy grew 3.4 percent annually (figure 1). In the following decade, growth accelerated to 8 percent a year. For 45 years starting in 1963, the economy averaged over 7 percent growth annually, and experienced only two years of economic contraction: 1980 after the second oil shock and the assassination of President Park Chung-hee, and 1998 at the nadir of the Asian financial crisis. The period of rapid growth commenced a decade after the Korean War armistice, and 15 years after the founding of the republic.

This paper will argue that American support during the initial period of military occupation and the later period of rebuilding following the 1953 Korean War armistice was a positive influence but not the primary explanation for South Korea's subsequent economic success.

The paper proceeds by first examining the diplomatic maneuvering over the Korean question and the initial attempt to establish administration in South Korea following the defeat of Japan in the Second World War. The next section reviews and assesses the economic policies applied. The third section addresses the political economy of establishing institutions of governance in post-conflict situations through the lens of the Korean experience. It goes without saying that it is practically impossible to write about this history in 2010 without the US experiences in Afghanistan and Iraq coming to mind. The fourth section considers the issue of "portability": the extent to which the South Korean experience may reflect unique and irreproducible conditions and the fifth applies these ideas by comparing the South Korean experience to the contemporary case of Afghanistan. Some conclusions and policy recommendations are contained in the final section.

DIPLOMACY AND ADMINISTRATION¹

Annexed by Japan in 1910, the Korean question occupied an anomalous position in the diplomacy of the 1940s. President Roosevelt supported the idea of trusteeship but was opposed by the UK (and the representatives of free France), which feared the implications for their own colonial dominions. The Koreans were promised their independence “in due course” by the US, UK, and China at the Cairo Conference in 1943, which was reaffirmed at Potsdam in 1945. The State Department began planning for Korean trusteeship that would involve China, US, and USSR. State Department planning recognized the possibility of an interim US military government but this was not accompanied by any real operational preparations, and State Department documents through 1945 bear little resemblance to what would eventually transpire. Planners in both the State and War Departments (the latter would be the lead agency until 1947) were mainly China or Japan specialists with little knowledge of Korea.

The war ended before the victorious powers could reach agreement on a trusteeship formula and the US and USSR hastily agreed to assume responsibility for accepting the surrender of Japanese forces and temporarily occupying the country, dividing responsibility in accordance with an American proposal at the 38th parallel, which had been previously identified as a possible boundary of Russian and Japanese spheres of influence in 1896 and 1905.

¹ This section draws primarily on accounts found in McCune (1946, 1947), Henderson (1968), Cumings (1990), and Matray (2005).

With Soviet forces moving into the Korean peninsula from the north, in August 1945, the XXIV Corps under General John R. Hodge was rushed from Okinawa to Korea. The choice of Hodge and the XXIV Corps was purely expedient—based on proximity—not any special training or expertise in administration, but in this respect it was reflective of general practices and not unique to the Korean case. It was not until October that the first civil affairs units began to arrive and they had been trained for the Philippines, not Korea.

Technically Korea was an “occupied,” not a “liberated,” territory but Hodge’s orders reflected the peculiarities of the Korean case. The surrendering Japanese led Hodge to expect revolutionary forces that might seek to seize Japanese arms and foment an insurrection, and in the absence of any real planning, and an apparent lack of personal interest, General Douglas MacArthur gave Hodge a relatively free hand—to which he was entitled since technically it was an “occupation” and there was no indigenous political entity with whom to share power.

By the time of his arrival there was considerable agitation on both sides of the peninsula, and Hodge initially made a mistake in announcing that hated Japanese colonial administrators would be retained, a decision that was reversed a week later. The 70,000 Japanese colonial administrators (including key technicians) disappeared rapidly and by the spring of 1946, all were gone.

Yet it was not evident who would replace them. A leftist People’s Republic had been declared in September (which Hodge would ban in December.) The Korean nationalist movement was highly fragmented. There were local nationalists and prominent personages. There was the Provisional Korean Government in exile in

Shanghai, which US authorities blocked returning to the peninsula until November. There was a communist faction allied with the Soviet Union (from which the leadership of North Korea would come) many of whom had been jailed by the Japanese and were released from confinement when the Japanese surrendered in August. Finally there was a US-based faction led by Rhee Syngman, who upon his return in October proved to be a polarizing, not unifying, figure. There were inter-generational splits within these groups as well. Within South Korea there were numerous political parties, including four with significant following: two on the left and two on the right. As one contemporary observer noted, “The net effect for the Korean people of the Japanese administration was a thirty-five year intermission in political responsibility and administrative experience” (McCune 1947, 610). He goes on to observe that under these circumstances, “In the opening stages of recruiting personnel, American Military government leaned heavily upon wealthier Koreans and those who could speak English,” lending a rightward tilt to US administration (McCune 1947, 612).

Moreover, what little operational planning that had occurred before the occupation assumed that the division of the peninsula was temporary and little thought was given to establishing permanent stand-alone institutions of governance for the southern half of the peninsula. In McCune’s words, “The Korean occupation was primarily a political and economic problem rather than military. General Hodge was prepared militarily but not politically or economically,” (McCune 1946, 34) and that “Since the end of the war American policy toward Korea has tended to drift without definite direction” (McCune, 1946, 33).

In the December 1945 Moscow conference, representatives of the US, USSR, UK, and China agreed to a trusteeship of up to five years. Understandably the agreement was unpopular with the Koreans. Furthermore, the US and Soviet military commands could not reach agreement on a formula to hold elections. As the Moscow conference formula did not play out, the US came up with plans for the UN to supervise nationwide elections, but with Soviets in opposition occupying half the country and holding a veto on the Security Council, this proposal was a non-starter.

In the absence of a path to independence, the US tried to “Koreanize” the administration and established an Interim Legislative Assembly (December 1946) in the US-occupied zone. However, American “advisors” continued to wield real power with respect to the former, and the latter accomplished little.

These moves were too little, too late. As McCune presciently wrote, “Unfortunately, many observers concluded that civil war was inevitable sooner or later in Korea...Under these conditions, the simultaneous withdrawal of American and Russian military forces would, no doubt, precipitate civil war...the only solution for the dilemma, therefore, lay in arriving at some workable arrangement whereby a middle-of-the-road Korean regime could be installed in authority...under the joint guarantee of the occupying powers. The alternative was the division of Korea into two colonies, or at least two puppet states, and it was hard to foresee a situation more inequitable for the Korean people or more dangerous for Russian-American relations” (McCune 1947, 622–3).

In 1948 independent states staking claim to the whole peninsula were declared in the US and Soviet zones of occupation. On 25 June 1950, North Korea invaded South Korea.

POST-CONFLICT ECONOMIC POLICY²

The thrust of US planning during the war had been multilateral in orientation, establishing, for example in 1944, the International Bank for Reconstruction and Development (the World Bank) and the International Monetary Fund (IMF). In the event, however, post-war reconstruction in both Europe and Asia turned out to be both more expensive and require more direct bilateral involvement than had been anticipated by the planners, as the emergence of the Cold War and the concomitant threat to US political interests in Western Europe lent greater urgency to these matters.

As observed previously, in contrast to liberated areas such as the Philippines, as part of colonial Japan, Korea was classified as a belligerent with local institutions unable to immediately assume political control. Hence bilateral economic assistance between 1945 and 1948 was delivered bureaucratically through the program for Government and Relief in Occupied Areas (GARIOA) financed out of the military appropriation. In addition to the \$326 million of GARIOA assistance, a trivial amount of aid (\$0.6 million) came through the United Nations Relief and Rehabilitation Program, administered multilaterally, but financed mainly by US contributions (72 percent).

Legislatively GARIOA's objective was to provide "such minimum supplies for the civilian populations of such [occupied] areas as may be essential to prevent starvation, disease, and unrest" (Wolf 1960, 15). More than 90 percent of the aid consisted of finished goods, particularly foodstuffs and medical supplies, which could be

² This section draws primarily on Wolf (1960), Krueger (1979), Mason et al. (1980), and Chung (2007).

immediately distributed without further processing. GARIOA-financed imports also included coal and oil following the North Korean cut-off of electricity transmission across the border. By 1947, as the Cold War began to emerge, the program was being justified in terms of fostering local political developments amenable to US interests.

The starting point in August 1945 was not auspicious: Agricultural and industrial production were well below pre-war levels and much of the physical plant and equipment barely functioning. On the ground, US officials were forced to push beyond to the relief-oriented GARIOA guidelines, particularly in regard to the management of the capital stock and enterprises inherited from the departed Japanese colonialists. Twenty-three-year-old Army sergeants found themselves managing factories and mines. Not until 1947 was there a good survey of vested assets, primarily inherited from the departing Japanese. The absence of such a survey would hamper rehabilitation efforts. Inflation hit triple digits. The ranks of the unemployed were swelled by the return of 500,000 refugees from other parts of the Japanese empire. Crime and gang activity surged.

According to Wolf (1960), lack of intermediate inputs was a major constraint on production in both agriculture and industry. Through mid-1948, more than half million metric tons of fertilizer were imported under GARIOA making possible the highest level of fertilizer application in Korean history. Agricultural output rose 11 percent and was 20 percent above the pre-war level. But this is really more akin to reconstruction than development, and Wolf admits that the provision of additional inputs would have been met with diminishing returns.

Until 1947, the implicit assumption in US policy was that the peninsula would be reunited; hence no need to plan for an independent, self-sustaining South Korea. As that

hope faded, emphasis began to shift from humanitarian aid to economic development. In 1948, the US Congress passed the Economic Cooperation Act (ECA) and the first government-to-government pact signed in December 1948 was the ROK-US Agreement on Aid. The agreement set priorities (power generation to offset the loss of North Korean generated electricity and fertilizer production) and specified the policy conditionality for US assistance (which the South Koreans resented).

On 1 January 1949, the US recognized the Republic of Korea (South Korea) and responsibility for US aid was transferred from the Army to the Economic Cooperation Administration, the forerunner of the US Agency for International Development (USAID). While the goals of GARIOA were addressing immediate civilian consumption relief and indirectly fostering a “healthy” political environment, according to the 1949 ECA report to Congress as quoted by Wolf, the purpose of the ECA was “to assist the Korean people in establishing a sound economy and educational system as essential bases of an independent and democratic state” (Wolf 1960 48). Thirty million dollars in remaining funds were transferred from GARIOA to the ECA and in early 1950 the ECA requested a \$350 million Congressional appropriation for South Korea for the period 1951–53. This request was rejected, and instead, the Congress authorized a series of smaller interim appropriations, which together with the remaining GARIOA funds totaled \$140 million. Ironically, Secretary of State Dean Acheson’s “clarification” of US policy toward Asia in the wake of the victory of communist forces in the Chinese civil war, placed South Korea outside the US “defensive perimeter” and undercut the Administration’s advocacy of aid to South Korea (Wolf 1960).

Following the June 1950 North Korean invasion of South Korea, an additional \$90 million for aid was appropriated, but with the war underway, the situation reverted to the pre-1949 ante: administration of the program was returned to the Army, with a focus on relief rather than development. In April 1951, development assistance, apart from relief, was formally suspended. Krueger (1979) concludes that “the delay in passing the ECA bill effectively prevented the inauguration of any sustained development program before the outbreak of the Korean War” (16).

Assessment

Analysts give the short-lived ECA program relatively high marks. South Korea was envisioned as an agricultural exporter. Programmatically emphasis was on boosting available power through expansions of coal and thermal power production and developing fertilizer production. Krueger (1979) attributes to input increases 72 percent of increase in agricultural production, hence aid-supplied inputs should be credited with “a substantial portion” of the increase in agricultural production, which was realized.

US administration made advances in other avenues as well, including the divestiture of assets seized from the departing Japanese and public education. All four major South Korean political parties supported distribution of Japanese-owned lands. The left wanted dispossession of absentee Korean landlords as well. All wanted nationalization of industry, though the right envisioned assets eventually being taken over by Korean big businesses.

The US military government established the New Korea Company to administer vested lands. It began the process of establishing ownership records. In March 1948, the New Korea Company was abolished and replaced by National Land Administration—charged with divesting the land holdings. By September 1948 more than 96 percent of the Japanese-owned land had been sold, and in 1949 most of the land held by absentee Korean landlords had been sold. The land reform reduced the share of rented land from 60 percent to 15 percent, and the share of tenants to 5 to 7 percent of all cultivators. The immediate impact was reduction in output (presumably because of disruption of the provision of inputs) but the long-run impact is universally regarded as positive both directly on agricultural productivity and indirectly through backward and forward linkages with the manufacturing sector. Much less progress was made on the divestiture of industrial assets.

In the field of public education, the US military authorities assumed responsibility for rehabilitating public education, both to remake the existing Japanese nationalist curriculum as well as to deal with the shortage of teachers resulting from the deportation of the Japanese. These efforts appear to have been successful: between 1945 and 1948, the number of elementary and secondary school pupils increased 82 and 183 percent, respectively. The number of available teachers increased 55 percent, 569 percent, and 268 percent, at the elementary, middle, and secondary levels, respectively. The US authorities also established “civic” schools for those outside the normal school age range and adult literacy increased significantly. These educational advances presumably had large payoffs in later years, once the government adopted more sensible economic

policies. Some innovations introduced by the US, such as co-education and local control of schools, did not survive the transfer of control to South Korean authorities.

Post-Korean War Efforts

In certain respects the situation changed following the Korean War but exhibited continuities in other ways. Three-quarters of aid between 1953 and 1960 was commodities: half food; most of the rest oil or fertilizer; only 16.5 percent went directly to support manufacturing, figures similar to those observed in the earlier period. Formally, the South Koreans were in charge, but from 1953 on, the US recognized a responsibility for ongoing economic and military assistance, and South Korea became, in essence, a client state. That year, a new agency, Foreign Operations Administration (FOA), was established to deal with the reality that the peninsula would not be reunited and South Korea would have to go it alone.

It appears that US assistance was associated with a certain amount of overstaffing and corruption. The procedures of the land reform allowed landlords and tenants to game the system, but there is no evidence of large scale fraud. In 1962, resident US staff were slashed from 297 to 144 “without any serious handicap to the mission’s operations” according to Congressional testimony by the Director of USAID quoted by Chung (2007, 394).

One issue took on greater salience in the post-war years. Foreign soldiers needed some local currency to pay for items purchased in the local economy. The host government makes a local currency (in this case, *won*) transfer to the troops’ sponsoring

entity which agrees to pay back this advance. The payment terms are subject to negotiation. In the case at hand, during the 1950s, South Korea had an overvalued currency. From the standpoint of this repayment issue, it was in South Korea's interest to maintain the overvalued currency (and hence maximize the hard currency inflow from the US and UN). There is a self-reinforcing aspect to this policy: the exchange rate overvaluation will tend to depress exports and hence magnify the importance of the transfer in a country's balance of payments earnings. Both Krueger (1979) and Cho (1994) argue that this transfer issue was a significant consideration in South Korean exchange rate policy in the 1950s. Growth or non-transfer sources of foreign exchange earnings, a reduction in the value of the transfer (though a drawdown in the number of foreign troops, for example), or a reduction in unilateral aid will tend to mitigate the incentives to pursue such a distortionary policy.

In sum, US assistance kept South Korea afloat during two critical periods of distress; midwived a successful land reform and contributed to a significant expansion of the educational system. It was less successful in encouraging the divestiture and rehabilitation of formerly Japanese owned industrial assets, and contributed to some undesirable side effects. As Krueger concludes, "Given the destruction and dislocation that had been experienced by the economy, it seems reasonable to conclude that the aid inflow was extremely important in preventing further deterioration in the situation in 1945–47 and in permitting the reconstruction in 1948–49" (1979, 19).

THE FORMATION OF INSTITUTIONS OF GOVERNANCE

At the end of the Second World War, the Korean nationalist movement reflected a wide ideological spectrum and was geographically dispersed: Rhee Syngman, the student of Woodrow Wilson who would eventually lead South Korea, had been in exile in the United States for 30 years; Kim Il-sung and other Korean communists had fled to the Soviet Union; there was a provisional government in exile in Shanghai; there were nationalists who had remained underground in the peninsula. US and Soviet military authorities provided civil order, but this was not a solution to the political vacuum that had been created by the expulsion of the Japanese. After the division of the peninsula in 1948, both Rhee and Kim confronted the same formal problem, namely how to mobilize political support and create institutions through which to govern. Specifically, the former exiles faced a lack of institutional capacity (and hence had to rely, at least initially, on their respective patrons) as well as a basis for political loyalty, which could be compelled via repression or bought through the creation and distribution of economic rents. (Think of Iraqi exiles returning to power—fragmentation, lack of local organs, reliance on patrons, strong-arm tactics, and corruption as a political adhesive.)

The expropriation of Japanese assets—both land and industrial—were one source of potential rents that could be channeled to political supporters. Another was to create them via policy intervention. South Korea inherited an economic legacy of state intervention from the Yi dynasty, through the Japanese colonial occupation (1910–45) that carried into the period of independence, reflecting the dirigiste character of Japanese administration and the continuation of extensive controls by the US military authorities in the immediate post-war period. An interventionist strategy that would permit the dispensation of political favors would amount to a continuation of past practices.

At the end of the Second World War, approximately 94 percent of the industrial assets in Korea were in the hands of the colonial government or Japanese citizens; when the Japanese were repatriated, they left behind roughly 2,500 businesses (Chung 2007). Starting in 1947, the US government began selling or giving away formerly Japanese owned businesses under the Divestiture of Enemy Property Program. But the divestiture of assets accelerated once Rhee took power. The Repatriated Property Law was promulgated in 1949. It stipulated that property be sold at “the market price” but that payment could be by installments over as long as 15 years subject to a 10 percent down payment.

In certain respects the approach was eminently sensible—until property rights were secure and the assets were in private hands it was unlikely that there would be any complementary investment and upturn. The extended payment terms were almost required by definition insofar as few Koreans could mobilize the personal or corporate wealth to pay cash on the barrelhead for these assets. Yet divestiture with low initial payments required was almost an invitation to corruption and would require a very rigorous divestiture procedure.

In actuality, the system was rife with favoritism and corruption. Chung (2007) estimates that the purchase prices for formerly Japanese owned assets were on average less than half their true value. And these conditions were specified in nominal terms. The real value of repayment would be eroded by inflation. So, for example, a purchaser on a 10 year installment in 1955 would have seen the real burden of his debt reduced by more than half.

In principle, the disposal of these assets was to occur through public auctions. If no buyer could be found after two auctions, then the property could be sold to a selected buyer. But in reality, it appears that these procedures were routinely ignored and Chung (2007) estimates that only about one-quarter of sales were via auctions. The majority of the beneficiaries of the divestiture program were individuals who had some prior connection to the asset. Again, on one level this makes sense—it is precisely the former employees of these enterprises who would have the best understanding of the underlying worth of the asset and have the requisite knowledge to operate the plant and equipment. But it also had the effect of channeling economic bounties toward “collaborationists.” In other cases, local investors simply paid a “repatriation cost” to the Japanese owner to secure the title, claim ownership, and circumvent the divestiture program altogether. Many of today’s *chaebol*, or family-run conglomerates, can trace their origins (or at least significant expansions) to the asset divestiture program. The potential for building a political machine through such mechanisms is obvious.

Economic policy under Rhee also reflected the “urban bias” that was typical in developing countries of the period, signaling both the greater affinity of the governing elites with urban residents, as well as their fear that urban discontent, particularly in the national capital, could be politically destabilizing. According to the respected South Korean economist, Cho Soon, the goal was maximizing the value of American aid in the aftermath of the Korean War, which had devastated the country. Aid, which facilitated politicized rent distribution, financed most of the capital accumulation and, at its peak in the late 1950s, roughly 80 percent of imports (figure 2). South Korean policy could be summarized as the “three lows”: maintenance of a low price for grain (courting urban

residents who could most easily challenge the regime); a low, that is, an overvalued, exchange rate; and low interest rates. The latter two conditions create excess demand for foreign exchange and bank loans, respectively, which then creates political opportunities for distributing rents (as well as incentives for corruption). The low interest rate policy had the further consequence of discouraging saving and capital accumulation.

Rhee was eventually driven from power by urban discontent with poor economic performance, repression, and corruption, and was followed for a brief period by a weak government led by Premier Chang Myon. A military government led by General Park Chung-hee took control in 1961. Park lacked any common basis for establishing legitimacy. As a former officer in the Japanese army he could not lay claim to nationalist credentials. Coming from a poor, rural background, he was not a member of the *yangban* (gentry) class and could not position himself as the continuation of a traditional ruling lineage. As Steinberg (2007) observes, he had overthrown a government backed by the United States (the last coup in Korea was in 1392), and, having been involved in the 1948 Yosu mutiny, a communist-instigated revolt (he was later pardoned), he was regarded as politically suspect by the US. He sought legitimacy through his ability to defend the country against Northern aggression and economic development.³

When Park seized power, gross domestic saving net of aid was derisory (figure 3). Gross investment, financed mostly by aid, stood at a bit more than 10 percent of GDP, and the current account was in rough balance. After two years of poor economic performance, the military government unified the existing multiple exchange rate system, devalued the currency, raised the real interest rate, and initiated a series of wide-ranging

³ See, for example, footage of his 1961 visit to Washington and speech in Seoul upon his return: <http://www.youtube.com/watch?v=tdIMyvnwoQs&feature=related>.

reforms. Domestic saving net of aid began rising rapidly (looking at figure 3 one can understand why development economists adopted Rostow's take-off metaphor).

Domestic investment began rising even faster.

In this context, it is worth asking whether there were developments during the period of stagnation that set the stage for the remarkable response once the policy environment changed. The answer is "yes." American aid directly contributed to the rapid expansion of education within South Korea and made overseas education and training possible for thousands of South Koreans. Many returnees played important roles both in policy formation, where American-trained technocrats played a prominent role, as well as in industry, where skills development supported industrialization.

Later, international aid was used to establish institutions such as the Korea Institute for Science and Technology (1966) to acquire foreign technology and adapt it to South Korean circumstances, and the Korean Development Institute (1971) to rigorously analyze development issues.

In addition to these official capacity-building programs, some transfer of technical and management skills undoubtedly occurred through contact with US military forces, but its significance is difficult to assess. Likewise, local firms certainly benefited from participation in local military procurement programs, and later from offshore procurement programs during the Vietnam War.

PORTABILITY VS. IRREPRODUCIBLE CONDITIONS

The purpose of this conference is to analyze the pursuit of economic growth and how best to achieve it in post-conflict environments. Before focusing on the issues of policies and practices that are potentially transferable from the Korea experience to another milieu, it is worth considering whether the experience of South Korea over the past two generations can largely be explained by particular (and largely irreproducible) historical circumstances. It may be that South Korea was “deceptively poor” and much of its outstanding growth performance reflected convergence from a perturbation back to a long-run steady-state growth path.

As seen in table 1, in the 1950s, among the limited number of countries that such data are extant, South Korea had the world’s third highest ratio of human capital embodied in the workforce to the contemporaneous level of per capita income, presumably because most of the capital stock had been destroyed in the Korean War. An indicator of pre-existing Korean technical prowess would be the simple observation that Koreans (possibly with the assistance of American or Soviet engineers) were able to keep industrial assets functioning in the period immediately following the expulsion of the Japanese. Moreover, in the following decades South Korea accumulated human capital more rapidly than comparable developing countries (a phenomenon abetted by a post-war demographic bulge of young people that facilitated training through conventional educational institutions), and, following the economic reforms of 1963, increasing numbers of university graduates specialized in science and engineering, presumably of particular importance in the expansion of industrialization.

Human capital takes a long time to produce (roughly 12 years of schooling for a secondary school graduate) and once in the labor force, human capital of a particular

vintage lasts a long time (perhaps 40 years or more). In contrast, physical capital is subject to relatively rapid accumulation—and scrapping as newer vintage capital embodying technological progress becomes available. South Korea invested roughly 30 percent of GDP for several decades. Moreover, if one believes that human and physical capital are complements in that effective usage of recent vintage physical capital requires skill and/or that high levels of human capital is positively associated with the ability to absorb technological innovations from abroad, then economies with high levels of human capital relative to physical capital are likely to experience rapid rates of total factor productivity growth. In short, South Korea was well positioned for rapid economic growth. At least some of what occurred would appear to be simply an example of neoclassical convergence from an unusual starting point.

Paradoxically, South Korea (along with several other high-performing Asian economies) may have also benefited from unusual endowments, specifically a relative lack of natural resources, in two ways. Figures 4 and 5 are projections of labor, capital, human capital, and arable land endowments onto a two-dimensional diagram.⁴ The average world endowment is represented by the intersection in the center of the triangle of the three rays emanating from its vertices. As one gets closer to the corner, the relative abundance of that factor increases. So, for example, in figure 5, it is clear that Japan is very land-scarce (i.e., it is far from the land vertex), and that Japan has a higher capital-labor ratio than South Korea, which, in turn, has a higher capital-labor ratio than Taiwan.

Given their factor endowments, we would expect extremely land-scarce economies such as Japan, South Korea, Taiwan, Hong Kong, and Singapore to begin

⁴ It would be desirable to have such projections for the late 1940s or 1950s, but 1968 is the earliest date that this data can be assembled for a large group of countries.

manufacturing activities relatively early in their development (as measured by per capita income), and to specialize relatively intensely in these activities (Leamer 1987). In all of these cases the development of export-oriented manufacturing was facilitated by easy access to sea transportation, a condition that may or may not be present in future post-conflict situations.

This relates to the third, and probably irreproducible, initial condition, namely the comprehensive land reforms undertaken with encouragement from the US, which could have reinforced backward and forward linkages and encouraged productivity increases in the agricultural sector. The result was “growth with equity” as the share of tenants or half-tenants fell from 67 percent of the rural population to 15 percent in 1954. The reason that this condition is probably irreproducible is that it is hard to imagine situations in which an incumbent government has enough political capital to take on something as fundamental as a land reform. It is virtually impossible to imagine a democratically elected government having the political power to overwhelm opposition to such a fundamental change. But certain post-conflict situations might present a possibility where outside actors with no real ties to the landlord class, or an indigenous government with weak ties to the local rural elite backed by strong foreign patrons might be able to take this on. In all likelihood, this aspect of South Korea history is unlikely to be reproduced in future post-conflict situations, however.

In sum, one could characterize the post-war South Korea as an economy that had begun industrialization, experienced a political upheaval and devastating civil war, and was essentially engaged in catch-up along a reasonably well-defined industrial path defined by Japan.

MAPPING SOUTH KOREA AND FUTURE POST-CONFLICT CASES

South Korea during the decade 1953 to 1962 (i.e., between the conclusion of the Korean War and the take-off associated with the Park reforms) had the following characteristics:

- ethnically homogeneous population;
- post-war devastation; large displaced population;
- populace mostly rural freeholders;
- relatively high level of education, literacy, technical skills;
- internal security provided by authoritarian government;
- secure borders; conventional external security threat deterred in part by foreign forces;
- small modern sector of the economy characterized by cronyism, corruption; and
- highly dependent on outside patrons for economic, political, and security support.

As an example, how does contemporary Afghanistan stack up? One might characterize Afghanistan today as follows:

- ethnically fragmented;
- chronic war-related devastation; some internally displaced population;
- mostly rural;
- low level of education and literacy;
- opium production important to rural livelihood;

- quasi-democratic government provides insufficient internal security;
- insecure borders; insurgency with some degree of external support;
- customary, Islamic, and modern legal systems operating in parallel;
- little modern economy to speak of; and
- highly dependent on outside patrons for economic, political, and security support.

Hence there are some similarities and some divergences. With respect to population, Afghanistan is multiethnic and has a much lower level of literacy and human capital than South Korea did in the 1950s, and *ceteris paribus*, both characteristics are likely to be impediments to economic development and political stability—not necessarily insurmountable obstacles, but impediments nonetheless.

Both societies were largely agrarian, though the South Korean population of the 1950s probably embodied greater industrial skills than does the population of Afghanistan today, in part because of an influx of population from the more industrialized North Korea during the war. Given its endowment and location, one would expect South Korea to begin industrializing at a lower level of per capita income, and to do so more intensively, than the more resource-abundant Afghanistan. Once industrialization got underway in earnest in the 1960s, South Korea's access to sea transport was an asset that Afghanistan obviously lacks. Furthermore, Afghanistan has the additional and significant challenge of having a major cash crop, opium poppies, being illicit and its marketing controlled by insurgents or criminal gangs with no loyalty to the state.

In both countries, the governments consisted of counter-elites who “returned” to power, in the case of the Koreans, after the end of Japanese colonialism, and in the case of Afghanistan after the overthrow of the Taliban regime. In principle, the elected Karzai government should have more popular legitimacy than Rhee’s government did, though its inability to provide internal security and apparent resort to fraud in the most recent election makes it doubtful that popular support is any greater, and could in fact be less. Moreover, in addition to the resurgent Taliban, Karzai presumably faces more severe potential challenges to his authority from various warlords than Rhee ever did. This is to say, Afghanistan is less secure both physically and politically than South Korea was following the Korean War.

In both cases, the governments were strongly dependent on outside support. Aid financed more than half of South Korean capital accumulation and imports in the 1950s, and the US/UN presence insured conventional security. Nevertheless, despite the Rhee government’s dependence on outside patrons, the difference in state capacity between South Korea then and Afghanistan today appears stark. In Afghanistan today, the state literally does not control the countryside. The simplest sorts of information that would allow one to do rational public policy planning are missing, fragmentary, or unreliable. To cite an example, Afghanistan does not report births or deaths, or the volume of international trade. According to the World Bank, in 2008 GDP was \$10.6 billion and aid was \$4 billion, meaning that Afghanistan is more dependent on outside assistance than South Korea was at its peak.

POLICY RECOMMENDATIONS

So the situation in Afghanistan today does not look very good. But it did not look very good in South Korea in the 1950s either when it was seriously suggested that a line be added to the US government budget for transfers to South Korea, since in effect it would be a ward of the state in perpetuity. One of the basic arguments of this paper is that things can change quickly: South Korea looked bleak in the 1950s, but then experienced an astonishing period of growth. The following policy recommendations are offered in the understanding that there may be as many differences as similarities between South Korea's history and future post-conflict cases. Some aspects of the South Korean experience reflect historically specific conditions and are not reproducible, and one should have low expectations as to what can be accomplished in post-conflict environments, at least in the short run.

First, basic internal security is a prerequisite for sustained growth. It is easier said than done, but until security is established it is difficult to imagine sustained growth.

Second, even before security is established or complete political stability achieved, there are things that can be done. In the case of South Korea, the education and training of thousands of Koreans was underwritten by the international community. The immediate payoffs may not be high (or even evident). Most of these individuals did not return to South Korea, at least immediately. But it is important to establish a cadre of technically competent people whose talents may only become apparent when the policy environment changes, as occurred in South Korea. This group of mainly US-trained technocrats was critical in South Korea.

Third, while foreign forces are operating in theatre, procurement programs can be used to upgrade and expand the capacity of local private sector firms, as occurred in South Korea.

Fourth, objective conditions matter: in the Afghanistan case, its lower population density, landlocked borders, and greater opportunities for making a livelihood in the countryside, all augur against it industrializing in the same way that South Korea did. Agriculture will remain more important for a longer period in Afghanistan than it did in South Korea. As a consequence, agrarian-focused initiatives such as rural road building, electrification, agricultural extension services, and agronomy will be of first-order importance both for generating economic development and for engendering political loyalty and stability. There is no simple policy template applicable everywhere.

Finally, just as some aspects of South Korea's experience appear to be irreproducible, some characteristics of other post-conflict situations have no real counterpart in South Korea's history. An example would be the Afghan opium poppy problem. South Korea's land reform effectively improved the lives of its cultivators and was a boon both politically and economically. However in the Afghan case, the preferred policy—diversification of production away from the production of opium poppies, unless handled extraordinarily carefully, is likely to depress rural incomes, at least in the short run, undermining both the economy and support for the government. The international community could be very important in terms of providing resources to make production of other crops economically preferable to continued poppy cultivation, support for labor-intensive manufacturing to absorb displaced farmers, or even buying up the opium crop

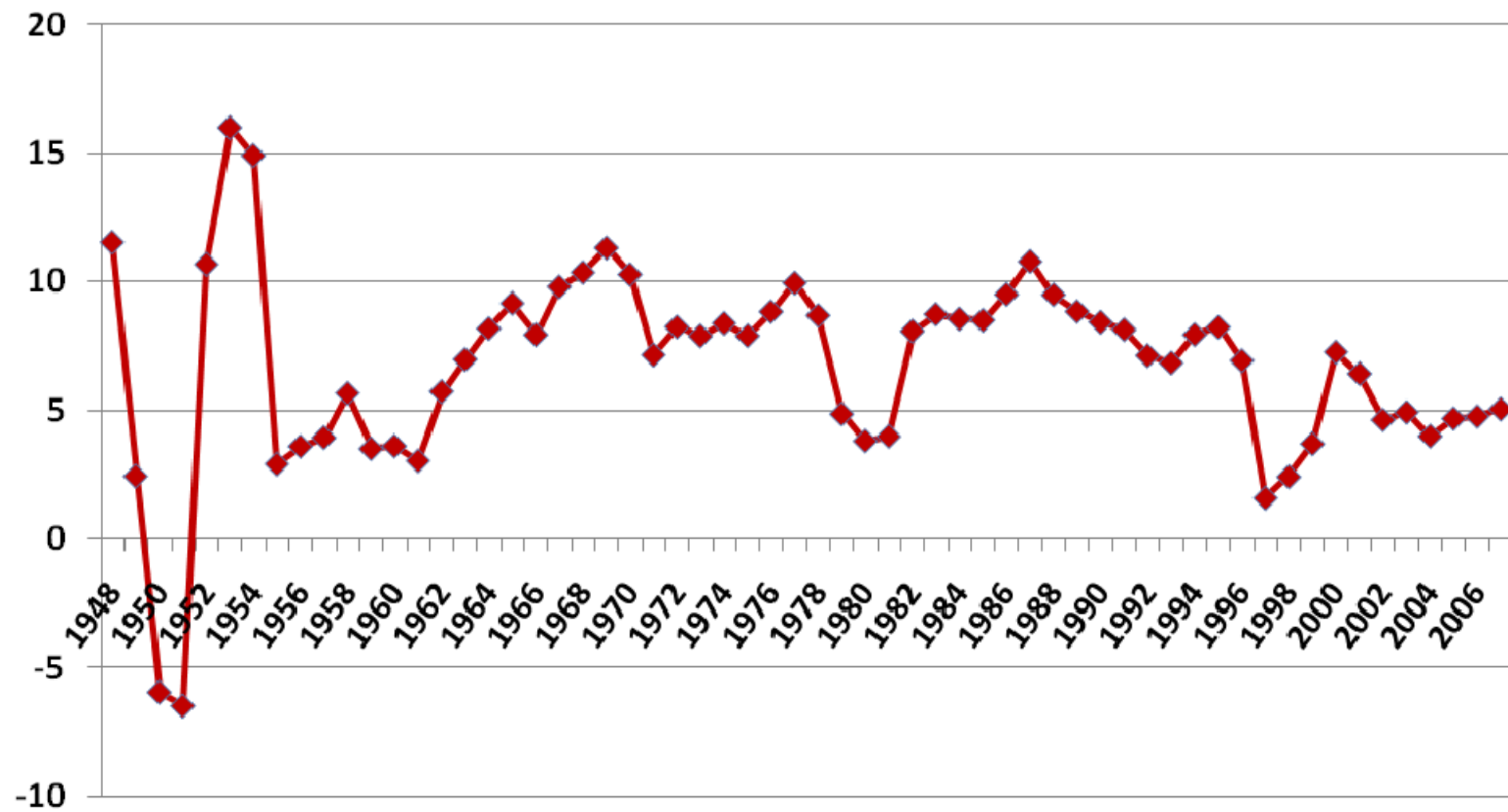
to deny the Taliban revenues from the opium trade. But South Korea's experience offers no guidance on these critical issues.

References

- Cho, Soon. 1994. *The Dynamics of Korean Economic Development*. Washington: Institute for International Economics.
- Chung, Young-Iob. 2007. *Korea In the Fast Lane*. Oxford: Oxford University Press.
- Collins, Susan M. and Won-Am Park. 1989. "External Debt and Macroeconomic Performance in South Korea," Jeffrey Sachs and Susan M. Collins eds. *Developing Country Debt and Economic Performance, Vol. 3*. Chicago: University of Chicago Press.
- Cumings, Bruce. 1990. *The Origins of the Korean War, Vol. II*. Princeton: Princeton University Press.
- Henderson, Gregory. 1968. *Korea: The Politics of the Vortex*. Cambridge: Harvard University Press.
- Kim, Nak Nyun. 2009. "The Long Term Trend of South Korea's GDP and International Comparison," *Working Paper 2009-5*. Seoul: Naksungdae Institute for Economic Research. [In Korean].
- Krueger, Anne O. 1979. *The Developmental Role of the Foreign Sector and Aid*. Cambridge: Harvard University Press.
- Leamer, Edward E. 1987. "Paths of Development in the Three-Factor, n-Good General Equilibrium Model," *Journal of Political Economy* 95, no. 5: 961–99.
- Mason, Edward S., Mahn Je Kim, Dwight H. Perkins, Kwang Suk Kim, and David C. Cole. 1980. *The Economic and Social Modernization of the Republic of Korea*. Cambridge: Harvard University Press.
- Matray, James I. 2005. *Korea Divided*. Philadelphia: Chelsea House Publishers.
- McCune, George M. 1946. "Politics in Korea," *Far Eastern Survey*. 15, no.3: 33–7.
- McCune, George M. 1947. "Government and Politics in Korea," *The Journal of Politics*. 9, no. 4: 605–23.
- Psacharopoulos, George. 1973. *Returns to Education*. San Francisco: Jossey—Bass.
- Steinberg, David I. 2007. "The Development of the Republic of Korea—Models, Lessons, and Warnings," unpublished paper.
- Wolf, Charles. 1960. *Foreign Aid: Theory and Practice in Southern Asia*. Princeton: Princeton University Press.

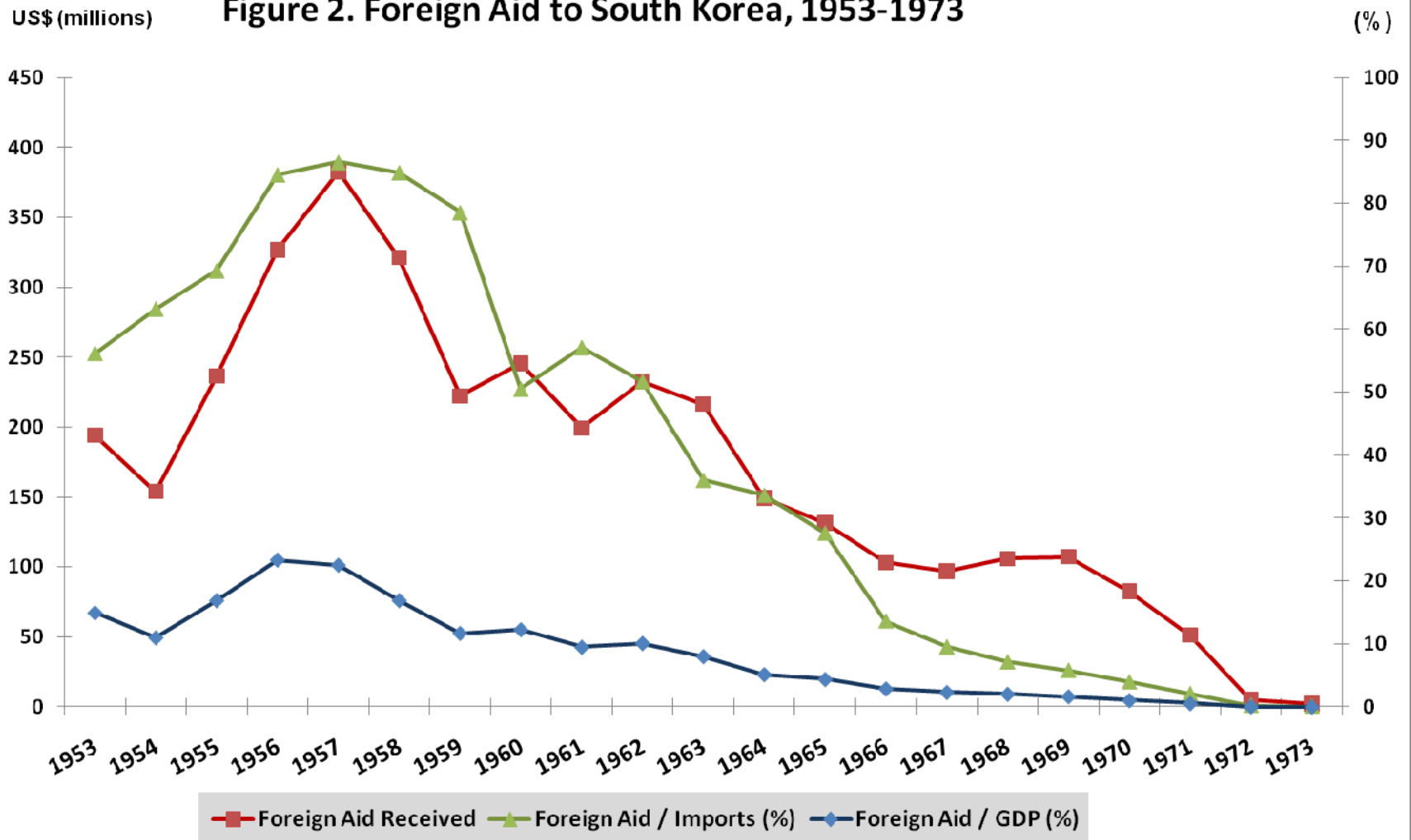
(%)

Figure 1. GDP Growth Rate (3-year Moving Average)



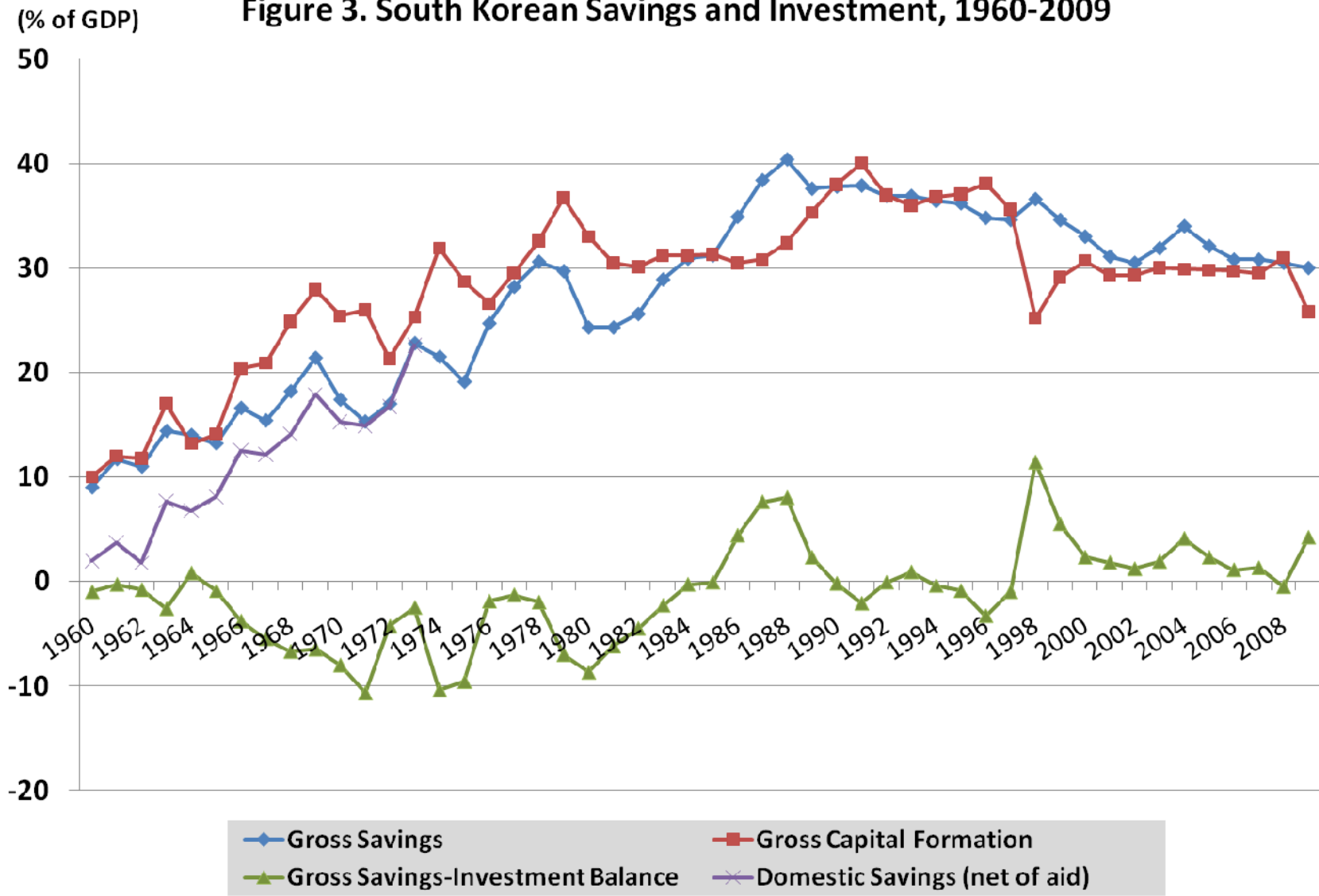
Source: Kim (2009) & Author's Calculation.

Figure 2. Foreign Aid to South Korea, 1953-1973



Source: Collins and Park (1989); World Bank's World Development Indicators; Bank of Korea

Figure 3. South Korean Savings and Investment, 1960-2009



Sources: Bank of Korea, Economic Statistics System; World Bank World Development Indicators

Figure 4. Endowment triangle: labor, human capital, land (1968 data)

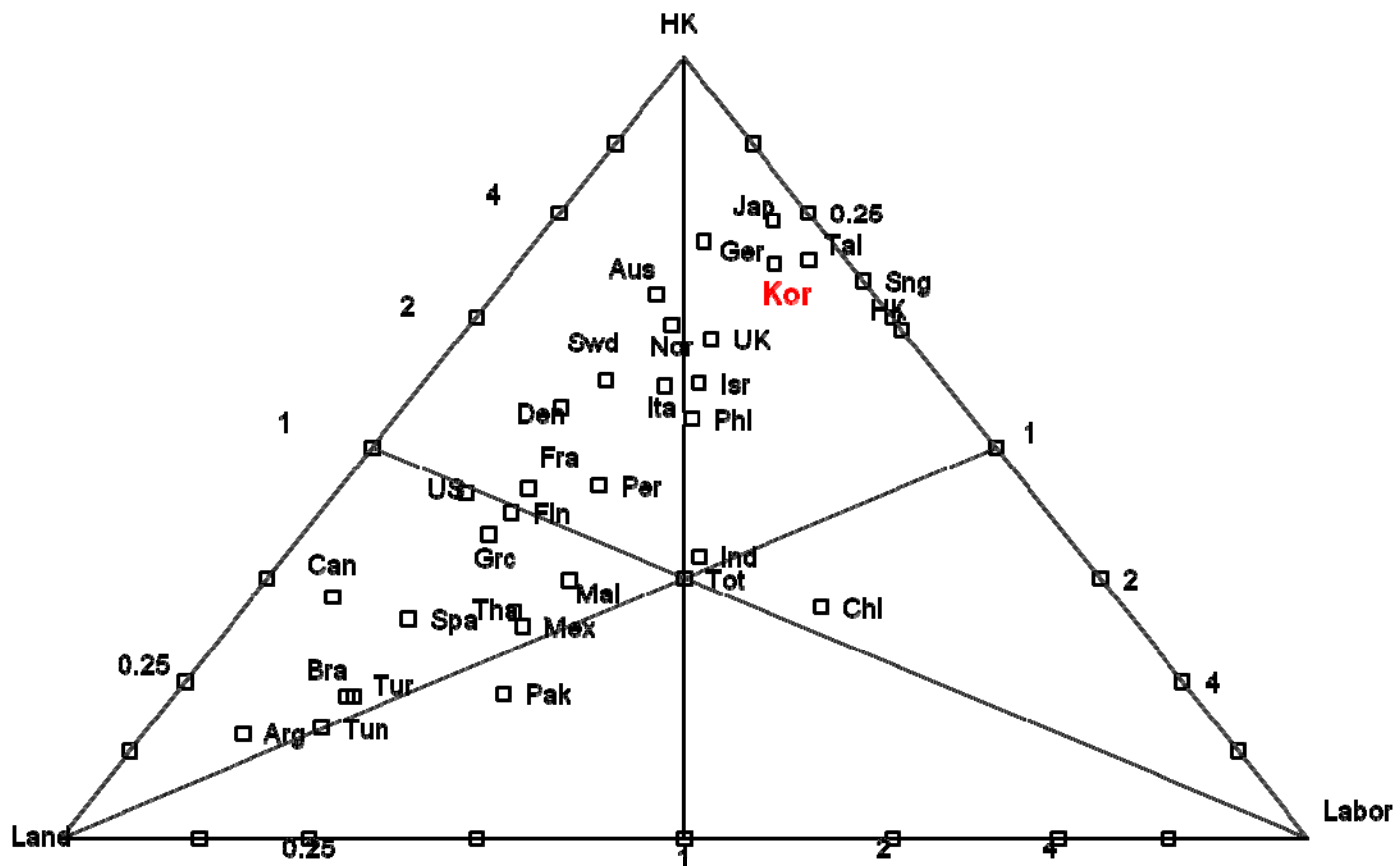


Figure 5. Endowment triangle: labor, physical capital, land (1968 data)

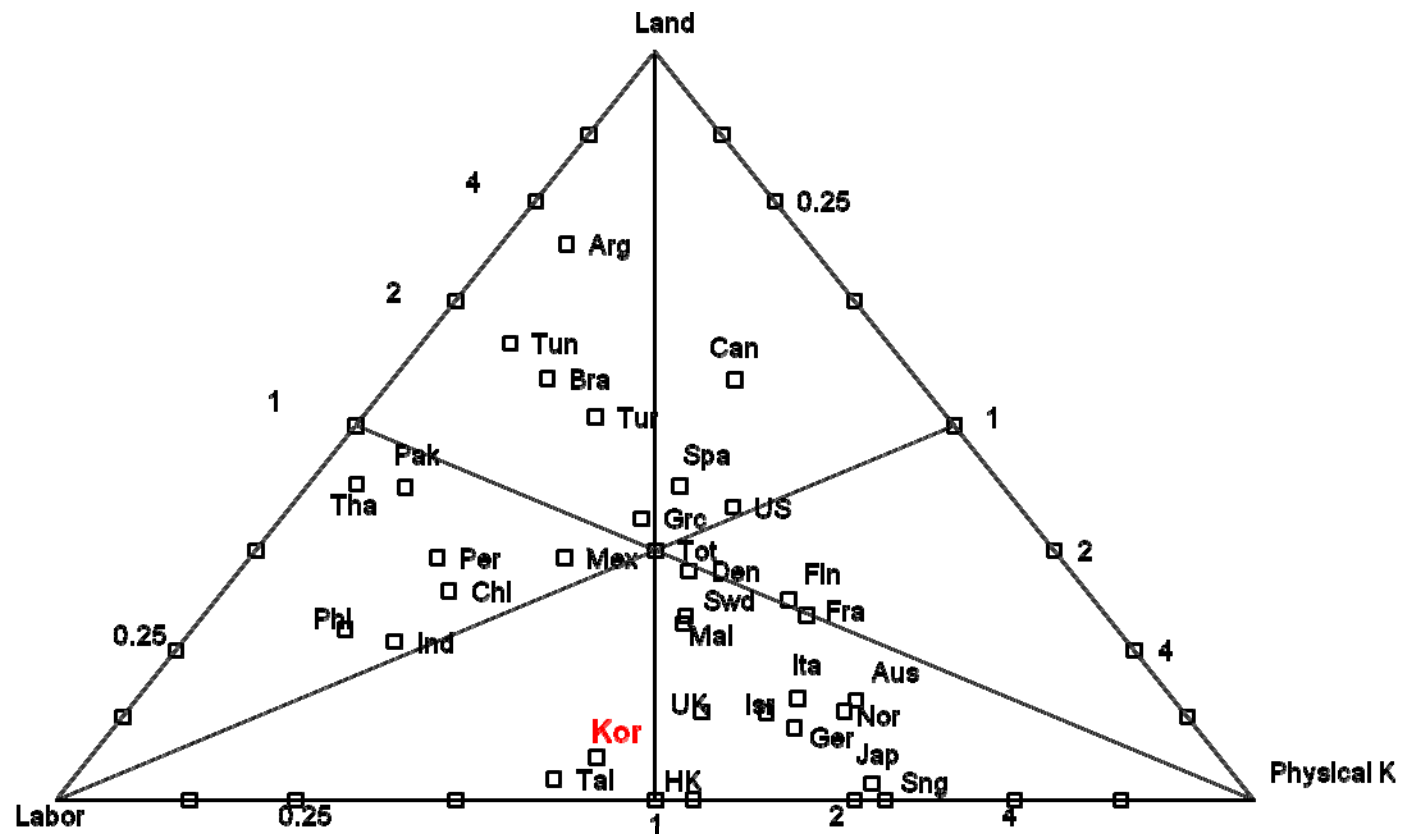


Table 1. Human Capital and Per Capita Income, mid-1950s

Country	Year	Human Capital Index	Per Capita Income	Ratio of Human Capital Index to Per Capita Income
Japan	1955	1673	519	3.2
Korea	1955	494	217	2.3
The Philippines	1956	738	277	2.7
Israel	1954	1200	609	2.0
Thailand	1955	302	181	1.7
Greece	1956	693	468	1.5
Malaysia	1957	334	351	1.0
US	1955	2293	2443	0.9
Italy	1956	787	971	0.8
Turkey	1955	267	365	0.7
Argentina	1955	760	1059	0.7
Mexico	1955	352	637	0.6
Spain	1955	389	652	0.6

Note: Human capital index is educational expenditure embodied in the labor force. See Psacharopoulos (1974). Values for Japan, Mexico, Spain, Turkey, and the US interpolated from 1950 and 1960 observations; values for Greece and Italy interpolated from 1951 and 1961 observations; values for Argentina and Thailand interpolated from 1947 and 1960 observations.

Per capita income is purchasing power adjusted figure in international dollars from the Penn World Tables.