

**2015 Modularization of Korea's Development Experience:
Korea's Fiscal Stabilization Policies
of Transition Period Economic Policy
in the 1980s**

2015

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2015 Modularization of Korea's Development Experience

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MINISTRY OF
STRATEGY
AND FINANCE



Korea Development
Institute



Preface

The study of Korea's economic and social transformation offers a unique window of opportunity to better understand the factors that drive development. Within approximately a single generation, Korea transformed itself from an aid-recipient basket-case to a donor country with fast-paced yet sustained economic growth. What makes Korea's experience even more remarkable is that the fruits of Korea's rapid growth were relatively widely shared.

In 2004, the Korean Ministry of Strategy and Finance (MOSF) and the Korea Development Institute (KDI) launched the Knowledge Sharing Program (KSP) to assist partner countries in the developing world by sharing Korea's development experience. To provide a rigorous foundation for knowledge exchange engagements, KDI School has accumulated case studies through the KSP Modularization Program since 2010. During the first five years, the Modularization Program has amassed 138 case studies, carefully documenting noteworthy innovations in policy and implementation in a wide range of areas including economic policy, administration-ICT, agricultural policy, health and medicine, industrial development, human resources, land development, and environment. Individually, the case studies convey practical knowhow and insights in an easily accessible format; collectively, they illustrate how Korea was able to kick-start and sustain economic growth for shared prosperity.

Building on the success during the past five years, we are pleased to present an additional installment of six new case studies and two e-content topics completed through the 2015 Modularization Program. The six reports employ a wide range of examples to better illustrate the continued efforts to improve the effectiveness of managing the incumbent policy and management. The new case studies continue the tradition in the Modularization Program by illustrating how different agents in the Korean society including the government and civil society organizations worked together to find creative solutions to challenges for shared prosperity.

More specifically, these efforts include strengthening social communication between government and the people for sustainable growth through economic education; as well as open-door policies and measures to ensure fiscal stability while achieving sustainable growth in today's globalized world; and painstaking efforts to reform the financial industry

using the real-name financial system for fairness and equity; the informatization of personal information to increase effectiveness of public services; building up a national early warning system for fiscal stability and soundness.

Further contributing to knowledge sharing, the e-contents section features videos delving into Korea's export-oriented growth, often cited as a key government strategy that facilitated Korea's period of rapid development; and the gaming industry, a key success story in the sector for cultural contents. We also proudly note that the World Bank Group's Open Learning Campus (OLC), which will be launching in January 2016, has confirmed that it will feature the fourteen e-content programs built by the modularization program thus far.

I would like to express my gratitude to all those involved in the project this year. First and foremost, I would like to thank the Ministry of Strategy and Finance for the continued support for the Modularization Program. Heartfelt appreciation is due to the contributing researchers and their institutions for their dedication in research, to the former public officials and senior practitioners for their keen insight and wisdom they so graciously shared as advisors and reviewers, and also to the KSP Executive Committee for their expert oversight over the program. Last but not least, I am thankful to each and every member of the Development Research Team for their sincere efforts to bring the research to successful fruition, and to Professor Taejong Kim for his supervision.

As always, the views and opinions expressed by the authors in the body of work presented here do not necessarily represent those of KDI School of Public Policy and Management.

December 2015

Joon-Kyung Kim

President

KDI School of Public Policy and Management



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Summary

The Republic of Korea achieved rapid economic growth under an outward-looking economic development policy driven by the government, from the first Five-Year Economic Development Plan in 1962 to the fourth Five-Year Economic Development Plan in the late 1970s. Despite limited natural resources and a weak industrial foundation, the Park Chung-hee government aimed to boost its exports and lay the groundwork for an independent economy with the heavy and chemical industry at its center. As a result of the continued effort in implementing the outward-looking economic development policies, Korea achieved a remarkable GDP growth rate of a whopping 14.8% in 1973 and the per capita income of Korea increased by almost 18 times over 20 years, thereby accomplishing the “Miracle on the Han.” However, the government-led growth strategy, which continued up until the 1970s, also resulted in an increase in fiscal spending. It is well-known that expanding tax revenues would cause economic contraction, the government could not expand tax revenues in line with the increased spending and therefore the fiscal deficit was inevitable. Finance procurement by issuing government bonds was even more difficult because the financial market was not yet properly developed. Consequently, central bank loans were used to secure funds at first and it resulted in inflation from the increased issuance of currency. It was also difficult to issue government bonds because an increase in issuing of currency caused a higher inflation and increased the nominal interest rate compared to inflation caused by a situation where an increase in fiscal spending affects the aggregate demand. Thus, it was the only option for the government to rely on the central bank loans. This resulted in an increase of the currency later on. The mixture of several factors came out inflationary spiral that became a major cause of the unstable Korean economy. In response, The Economic Planning Board (EPB) prepared the Comprehensive Economic Stabilization

Policy in 1979 to solve the issues of unstable economic growth, but the policy remained incomplete. Furthermore, political and social turmoil including the second oil shock that started in 1978, the Busan-Masan Resistance in 1979¹, the October 26 presidential assassination incident, and the December 12 incident² became an origin of negative growth in 1980 and the economy was in danger of losing all the glorious economic growth it had once achieved. In fact, it posted a negative growth rate in 1980.

The Chun, Doo-hwan government newly emerged and then it started the 1980s implemented macroeconomic stabilization policies which aimed at increasing efficiencies in budget planning by eliminating unnecessary budget expenditures in the fiscal sector. It also tried to stabilize fiscal inflation by reducing the overall fiscal expenditures. For example, it implemented a reform for the entire budget system including an introduction of the Zero Base Budget System, a budget freeze including a defense budget cut amid military confrontation with North Korea, a wage freeze for public servants in the government sector, minimizing the increase of the rice purchase price to eliminate deficit in the Grain Management Special Account, and the introduction of a comprehensive budget planning system.

The reform was so successful that economic growth and price stability continued to the mid-80s. This fruitful result, of course, was not achieved only by introducing a new system. For instance, the Zero Base Budget System abolished the existing practice where budget planning was conducted based on the previous year's budget and set priorities for expenditures. However, the system could not estimate the effects of individual expenditure. For this reason, each ministry and the budget authority had to put an enormous effort to develop an estimation technique. Furthermore, the government had to establish an environment for the budget officials to work in accordance with their conviction without worrying about any political pressures. It also had an obligation to persuade people who had to endure the actual pain of the tight fiscal policy.

The purpose of this study is to explain the process, in which the Korean government successfully transformed unstable economic growth in the 1970s to stable growth in the 1980s, with a focus on the fiscal sector and to learn lessons by analyzing the success factors.

1. It is called "Bu-Ma Democratic Protests", took place between 16 and 20 October 1979 in Busan and Masan (now Changwon), South Korea. Students from Busan University began demonstrations calling for the abolition of the Yushin regime.

2. It secondly occurred in South Korea in 1979 was a coup d'état that would hamper the country's process of democratization. The Coup d'état of December Twelfth or the "12.12 Military Insurrection" was a military coup d'état which took place on December 12, 1979, in South Korea. Finally, it led to the Fifth Republic of South Korea.

Chapter two introduces the financial spending direction in the 1970s and the inflation caused by budgetary deficits. Here we will mainly discuss the government's heavy chemical industry nurturing process, the expansion of the defense budget, and the financial deficit issue caused by the Dual Grain Price Policy. In addition, this chapter reviews the problem that arose from the government that made an effort to cover the fiscal deficits by borrowing from the Bank of Korea.

Chapter three will talk about the introduction process of the economic stabilization policy in the midst of price instability at the end of the 1970s, which was not that successful after all. By looking at it, we can think about the issues that might arise when initiating a new policy or a reform. In addition, we will discuss major content of the stabilization policy in the 1980s and the major events centering on the austerity budget allocation process, after which the achievements of the fiscal stabilization policy will be suggested. Lastly, we introduce the populist policies in the Perón government of Argentina to stress that it was not the authoritarian government with its mighty power that could bring about the stabilized price.

Chapter four introduces one of the greatest assets in the history of the Korean economy, the EPB, including its structure and principles in operation. Here, we can think about the role of the President who could create an environment where the public officials in charge of budgeting were able to work with a sense of mission and belief. Then, considering the fact that developing countries must maintain balance between the basic requirements of democracy and economic growth, we will point out how the authoritarian government in Korea made an effort to win public support: not by an unilateral implementation but by raising public awareness and persuasion in asking for their cooperation.

Chapter five suggests the financial policies and the policy direction behind the success of Korea to provide developing countries with lessons learned.

To recapitulate briefly our study, the introduction of the policy was a mere starting point for the government in Korea in the 1980s to succeed in the austerity policy. The EPB, established back in the 1960s and continued to make efforts under the Park Chung-hee administration played a key role. Korea experienced a number of trials and errors to achieve high economic growth despite its lack of natural resources. It also accumulated great human capital to improve the budgeting system. Therefore, It is more persuasive and desirable for developing countries to focus on how and why Korea introduced new policies and system rather than to show the excellence or strengths in Korea. Lessons learned from trial and error process are valuable assets of Korea which would provide more practical help for the countries in developing stage.

2015 Modularization of Korea's Development Experience
Korea's Fiscal Stabilization Policies
of Transition Period Economic Policy in the 1980s

Chapter 1

Introduction

Introduction

The Republic of Korea achieved rapid economic growth under an outward-looking economic development policy led by the government, from the first Five-Year Economic Development Plan in 1962 to the fourth Five-Year Economic Development Plan in the late 1970s. The Park Chung-hee government implemented all available means from financial/monetary policies to taxation/fiscal policies to achieve its goals. Despite a scarcity of natural resources and a poor industrial foundation, the government aimed to boost its exports and to lay the groundwork for an independent economy with the heavy and chemical industry at its center. As a result of the continued effort in implementing the outward-looking economic development policies, Korea achieved a GDP growth rate of a whopping 14.8% in 1973 and the per capita income of Korea increased by almost 18 times over 20 years, thereby accomplishing the “Miracle on the Han.”

However, there was a downside to the outward-looking economic development policies led by the government. With its “Declaration of the policy to foster the heavy chemical industry” in January 1973, the government began to actively provide the necessary fiscal and financial support. Furthermore, it also provided various supports including policy financing, tax breaks by enacting tax reduction laws, and government-led R&D investment.³ Consequently, these investments and supports put heavy pressure on the fiscal position of the government. For example, low-rate loans through policy financing caused an accumulation of overinvestment and non-performing loans. In particular, then the Park administration actively promoted the fiscal investment and loan system for expanding the industrial infrastructure to promote the capital-intensive heavy and chemical industry. As a

3. 60-year History of the Korean Economy.

result, an excessive increase in money supply led to a high inflation, exceeded 25% in 1974 and 1975.

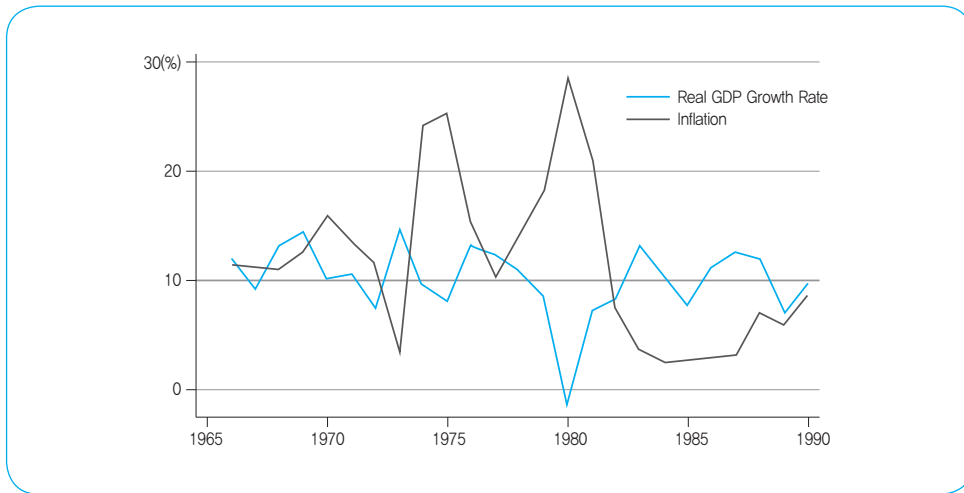
The government, who knew that the scarce financing could only be provided from the government sector, also surely recognized the importance of price stability and tried to implement tight monetary and fiscal policies during the 1960s and the 1970s. Nevertheless, it did not bring actual results and there was volatile price instability due to a high monetary growth rate and fiscal deficit, except during the periods of 1963~1964 and 1970~1971. The price instability was attributed to the political environment in which the first priority was given to achieving economic growth and price stability was merely an accompanying goal.⁴ Therefore, macroeconomic policy instruments could not be used through monetary and fiscal policy and thus an attempt to secure price stability through price regulation was fundamentally limited.⁵ Furthermore, political and social turmoil including the second oil shock that began in 1978, the Busan-Masan Resistance in 1979, the October 26 Presidential assassination incident, and the December 12 incident caused further economic hardship; and in the late 1970s, suspicion about the sustainability of the government-driven development strategy started to increase. All of these issues resulted in negative growth and price instability.

The Chun Doo-hwan government, which began during a difficult macroeconomic period in the 1980s, strongly shifted the political direction from policies that prioritize development and growth to a “policy to lay the foundation for growth with stability.” In the 1980s, the Chun Doo-hwan government adopted a Zero Base Budget System based on stabilization policies and contained prices and factors contributing to fiscal expansion through a budget freeze, freezing the state purchase price of rice, as well as executing wage freeze. Based on these efforts, the government could improve the situation from the recession and the aggravated balance of payments to the stabilized prices.

4. Jung (1986), *40-year History of the Korean Economic Policy*.

5. *60-year History of the Korean Economy*.

Figure 1-1 | Inflation and Economic Growth Rate



Source: The Bank of Korea's Economic Statistics System (<http://ecos.bok.or.kr/>).

The government in the period of economic development during the 1960s and the 1970s and the Chun Doo-hwan government in the mid to late 1980s were both authoritarian government initiated by a military coup. Generally, an authoritarian government is able to implement its policies in an orderly manner based on its powerful authority; however, the government in the 1960s and the 1970s used its authority to prioritize government-led economic growth whereas the one in the 1980s put economic stability led by the private sector first. Although both governments were authoritarian with strong power, the economic development strategies pursued by each government were different.

It is an undeniable fact that the economic growth in the 1960s and the 1970s was truly remarkable. But policy to maintain the higher growth caused an increase in the inflation rate and fiscal deficits, it is casting doubt on the sustainability of Korea's growth. Nevertheless, the stabilization policies of the Chun Doo-hwan government that appeared amid the skepticism achieved an unexpected turnaround and even greater economic growth continued. In aspect of the sound fiscal management, these performance was accomplished not only the improvement of the budget system but also the accumulation of human capital in the process of economic growth. But best of all, an economic bureaucrat shared the goal that should not lose the achievement of amazing economic growth.

The successful Korean story of the stabilization policies in the 1980s will provide great meaning to many policy decision makers in developing countries not only in terms of economic growth, but also in terms of political and social challenges that may occur following economic growth and methods for overcoming those challenges.

This is a further study on fiscal stabilization of the Knowledge Sharing Program (KSP) Modularization Project by Cho and Kang (2013) that initiated a discussion on the macroeconomic stabilization policy of the 1980s including fiscal, monetary, and trade policy. This study will not only evaluate the results from macroeconomic point of view, but it will also discuss the factors behind the fiscal expansion and problems in the 1970s and the budget system reform and other efforts used to achieve fiscal soundness in the 1980s which was an important turning point in the growth of the Korean economy. Moreover, this study will focus on the roles of the President and government officials in charge of the national economy, in relation to the reformation of the budget system and major events in time when the fiscal stabilization policies were carried out. The economic success is partly due to the system, but also depends on the public confidence. In other words, the purpose of this study introduces how to overcome the problem of huge fiscal deficit and how to persuade people about painful policy rather than to acknowledge the budget system in 1980s.

2015 Modularization of Korea's Development Experience
Korea's Fiscal Stabilization Policies
of Transition Period Economic Policy in the 1980s

Chapter 2

Fiscal Management and Associated Limits in the 1970s

1. Rapid Growth and Fiscal Expansion
2. Approach to Cover the Financial Deficit
3. Obsession with Growth-oriented Policies

Fiscal Management and Associated Limits in the 1970s

1. Rapid Growth and Fiscal Expansion

A new military government following the May 16 coup in 1961 founded the Economic Planning Board (EPB) and established the first and the second Five-Year Economic Development Plans.⁶ In the 1960s, which is the same period (1961 to 1971) of the Plans, core goal of fiscal management were to build the industrial infrastructure required for economic growth. Specifically, expanding Social Overhead Capital (SOC) and establishing key industries were the top priorities and these efforts greatly contributed to rapid economic growth. However, the rapid growth in a relatively short period of time caused some problems including inequality between the urban and the rural areas, excessive independence on foreign capital for investment, and a balance of payments deficit.⁷

As a result, the main goal of the third Five-Year Plan was to solve these issues and achieve stable economic growth. At first, more people argued that it was important to overcome the current economic structure where the current account balance would only worsen even if export increased. This was because of the limitations of the economic structure that was centered on light industries that was highly dependent on imported raw materials and materials for facility. To respond to this, the government planned to concentrate its investment into the heavy industries that had a high import substitution effect and this was the most distinctive strategy during that period. Establishing the foundation for the heavy chemical industry was desperately needed not only for expanding domestic demand by

6. The details are provided Han (2014) where he elaborates on EPB's background, formulating Economic Development Plan, performance in the era of high economic growth in Korea.

7. Cha and Kim(1995), *A Half Century of the Korean Economy*.

substituting the imports, but also for increasing the international competitiveness of the export industry.⁸

However, in the 1970s, the world economy severely suffered from two oil shocks and it consequently worsened the domestic economic hardship and jeopardized the growth momentum. To build the construction foundation for the heavy chemical industry in order to lay the groundwork for the economic growth engine and to stimulate the economy, the government took the risk of increasing fiscal investments and loans and rapid fiscal expansion followed.

As a result of the export industry-oriented fiscal management, rapid economic growth could be achieved in the 1970s with a real GDP growth rate of 11.03 percent. However, there were domestic and foreign uncertainties including two oil shocks and early symptoms of real estate speculation on the dark side of external development.⁹ The Korean economy, with a higher inflation rate than that of major advanced economies that faced the oil shocks and economic recession, can be described as an economy with inherent uncertainties during its rapid growth.

Table 2-1 | CPI Inflation Rates of Major Countries in 1970s

(Period Average, %)

| Korea | U.S. | Japan | German | U.K | France | Italy |
|-------|------|-------|--------|------|--------|-------|
| 21.0 | 6.6 | 9.6 | 5.1 | 13.0 | 9.0 | 13.5 |

Source: Cho and Kang (2013).

Furthermore, the government tried to maintain fiscal austerity in 1973 to control the excessive fiscal expansion but the domestic and international environment including the domestic and international economic situation, elections, and natural disasters changed the priorities in budget planning. These changes led to fiscal expansion, aggravation of the consolidated fiscal balance, and a higher tax burden ratio due to the increased fiscal spending that constantly hindered the goal of maintaining fiscal soundness.

8. Cha and Kim(1995), *A Half Century of the Korean Economy*.

9. Cha and Kim(1995), *A Half Century of the Korean Economy*.

Table 2-2 | Fiscal Indicators in 1970s

(Unit: %)

| | 1971 | 1973 | 1975 | 1977 | 1979 |
|---------------------------------|------|------|------|------|------|
| Fiscal Volume Growth Rate | 24.4 | -7.0 | 52.8 | 27.1 | 48.2 |
| Fiscal Volume/GNP | 16.3 | 12.3 | 15.7 | 16.1 | 16.9 |
| Ratio Amount of Taxes | 14.4 | 12.1 | 15.3 | 16.6 | 17.4 |
| Consolidated Budget Surplus/GNP | -2.2 | -1.6 | -4.6 | -2.7 | -1.4 |

Source: 『1991 Fiscal and Policy goal』, KDI, 1991.

The fiscal expansion changed the priorities in budget planning especially for those in defense spending and the agricultural sector. For example, the top priority during the mid to late 1970s under the fourth Economic Development Plan was to strengthen national defense, whereas the top priority in the early 1970s when the third Plan was in place was sound fiscal management and maintenance.¹⁰ As Vietnam became a communist country and as the Korean government had to establish its independent national defense capabilities due to the Nixon Doctrine and the inter-Korean confrontation led to an increase in defense spending and fiscal spending. Industrialization left the agricultural sector relatively lagging behind, thereby causing regional inequality. Furthermore, fiscal spending continued to increase as relevant expenditures for rural area development and the Saemaul Undong, or New Village Movement, was included in the budget priorities accordingly and a dual grain price system was maintained to increase food production.

Table 2-3 | Priorities in the Budget Planning Guideline (1972~1979)

| Priorities Year | 1 | 2 | 3 | 4 | 5 |
|--------------------|-------------------------|---------------------------------|-------------------|------------------------------------|---|
| 1972 | Sound Fiscal Management | Independent Defense | Rural Development | Tax Reform for Lowering Tax Burden | Foundation for the Heavy Chemical Industry |
| 1973 | Sound Fiscal Management | Strengthening National Security | Rural Development | Export Expansion | Foundation for the Heavy Chemical Industry and Fostering the Small and Medium-sized Enterprises |

10. *40-year History of the Korean National Finance: Book Six Chronological Analysis of the Fiscal Management (1991)*.

| Year \ Priorities | 1 | 2 | 3 | 4 | 5 |
|-------------------|---|--|--|--|--------------------------------------|
| 1974 | Sound Fiscal Maintenance | The Heavy Chemical Industry Development | Rural Development | Independent Defense | Welfare Expansion |
| 1975 | Stable Growth Recovery and Employment Expansion | Establishing an Independent Economic Structure | Strengthening National Security | Stabilizing People's Livelihoods and Welfare Expansion | Rationalization of Budget Management |
| 1976 | Strengthening National Security | Enforcement of Official Discipline | Economic Stability Recovery and Continued Growth | Improving the Living Standard and Welfare Promotion | Budget Efficiency |
| 1977 | Strengthening National Security | Social Development | Economic Development | Budget Efficiency | |
| 1978 | Strengthening National Defense Power | Economic Development | Social Development | Development of the Saemaul Project and Traditional Culture | Budget Efficiency |
| 1979 | Strengthening National Defense Power | Stabilizing People's Livelihoods and Environment Improvement | Strengthening Support for Small and Medium-sized Enterprises and Low-income Groups | Education and Technical Development Promotion | Social Overhead Capital Expansion |

Source: The Compilation Committee of 40-year History of the Korean National Finance, *40-year History of the Korean National Finance: Book Six Chronological Analysis of the Fiscal Management*.

2. Approach to Cover the Financial Deficit

2.1. Expansion of the Financial Scale and Increase in Bond Issuance

Right after the Korean War, Korea was left only with a vulnerable level of social overhead capital. Massive financial expense was, therefore, the only way through which economic re-establishment and development could be achieved. A government generally has three ways of financing: 1) to beef up revenues through tax increases; 2) to increase the currency

issuance or direct leverage from the central bank (the Bank of Korea); or 3) to issue national bonds. None of these options were pursued by the Korean government as it did not want to see a tax increase promptly shrink its economy. Korea inevitably faced a rising financial deficit. In the 1970s, in addition to the financial support given to nurture the heavy chemical industry, the government started to expand its financial scale to invest more in the backbone network of industrial sectors, which led to an increase in issuing national bonds. Looking at the government spending(<Table 2-4>), until 1975 the portion taken up by bonds remained somewhat low, approximately five percent.

Table 2-4 | Ratio Bond Issuing to Fiscal Volume

(Unit: Billion won, %)

| Year | Bond Issue (A) | Fiscal Volume (B) | A/B |
|------|----------------|-------------------|------|
| 1970 | 9.4 | 515.4 | 1.8 |
| 1971 | 15.8 | 642.1 | 2.5 |
| 1972 | 30.5 | 846.5 | 3.6 |
| 1973 | 17.4 | 844.7 | 2.1 |
| 1974 | 73.4 | 1418.6 | 5.2 |
| 1975 | 111.6 | 2158.6 | 5.2 |
| 1976 | 292.7 | 2909.7 | 10.1 |
| 1977 | 497.4 | 3660.5 | 13.6 |
| 1978 | 849.3 | 5001 | 17.0 |
| 1979 | 1100.5 | 6210.1 | 17.7 |

Source: *40-year History of the Korean National Finance: Vol 7*.

Because Korean financial market were less developed at that time, the government had to finance at a high nominal interest rate.¹¹ As a result, it decided to take the mandatory bond purchase¹² and the bond acquisition by the Bank of Korea. For an advanced country with a well-developed financial market, issuing bonds could be a useful approach to reducing the government's fiscal deficits.¹³ For Korea, with such rapid economic growth, however, it was

11. Lee and Chun (2003).

12. This refers to the mandatory bond purchasing when registering a newly purchased house or car, taking out a property based mortgage loan or getting various approvals. It is kind of a quasi-tax that the central government or local government issue to raise fund to initiate public projects.

13. In the case of the U.S. between 1960 to 1988, it accounted for about 70 percent while for the U.K, West Germany, and Japan, the net amount of national bonds once exceeded the total financial deficits (40 Years History of the National Finance: Volume 7).

more of a vicious circle where the government issued the bonds and they were promptly acquired by the Bank of Korea, which in return issued more currency, resulting in higher inflation.¹⁴

2.2. Financial Deficit from the Grain Fund and Increased Currency Issuance

Following the expansion of the financial scale to support rapid economic growth in the 1970s, various forms of tax benefits were rendered, including taxation favors such as allowances for depreciation, tax cuts to nurture strategic industries and tax exemptions for exporters and other strategic industries. Financial deficits were exacerbated further with such tax policies and it was difficult to ensure reliable tax revenues no matter how fast the economy grew. The real problem, however, was not the actual size of the financial deficit but how the government was dealing with the deficit itself - borrowing more money from the Bank of Korea.¹⁵ Among other issues, the government disproportionately relied on the Bank to secure funding for grain management.

In an attempt to stabilize farmers' income levels, the Korean government purchased rice and wheat from farmers at prices higher than the market, which was called the dual grain price policy. The grain management fund was used to make up for the loss generated by supporting the dual price system. However, the price of rice in the market showed clear signs of decreasing due to an increasing number of alternative goods from an influx of overseas grains, including wheat flour, as well as an increase in rice yields thanks to improvements in agricultural technology and use of chemical fertilizers.

14. 40 Years History of the National Finance: Volume 7.

15. Cho and Kang (2013).

Table 2-5 | Grain Prices Set by the Government(Won per hop \approx 180ml)

| | | 1972 | 1973 | 1974 | 1975 | 1976 |
|------|----------------|--------|--------|--------|--------|--------|
| Rice | Purchase Price | 9,888 | 11,377 | 15,760 | 19,500 | 23,200 |
| | Resale Price | 9,500 | 11,264 | 13,000 | 16,730 | 18,400 |
| | Difference | -388 | -113 | -2,760 | -2,770 | -4,800 |
| Rye | Purchase Price | 6,357 | 6,993 | 9,091 | 11,100 | 13,000 |
| | Resale Price | 4,300 | 4,800 | 6,000 | 6,900 | 8,320 |
| | Difference | -2,057 | -2,193 | -3,091 | -4,200 | -4,680 |

Source: Cho and Kang (2013) cited.

Table 2-6 | Finance of the Deficit of the Grain Management Fund

(Unit: billion won)

| | 1972 | 1973 | 1974 | 1975 | 1976 | 1972~76 |
|---|-------|-------|------|----------|----------|---------|
| Total | 36 | 50 | 160 | 230 | 250 | 726 |
| BOK Borrowing | 36 | 50 | 160 | 230 | 150 | 626 |
| Long-term | 36 | 50 | 160 | 230 | 130 | 606 |
| Short-term | | | | | 20 | 20 |
| Bond | | | | | 100 | 100 |
| Base Money | 427.5 | 624.1 | 775 | 1,077.00 | 1,437.70 | |
| $\frac{\text{BokBorrowing}}{\Delta \text{Money}}$ [%] | | 25 | 106 | 76 | 42 | |

Source: Cho and Kang(2013) cited, The Bank of Korea's Economic Statistics System (<http://ecos.bok.or.kr/>).

3. Obsession with Growth-oriented Policies

3.1. Nurturing of the Heavy and Chemical Industries

Back in the 1960s, the government focused on light industries that manufactured items at a low cost utilizing an unskilled labor force which was relatively abundant in Korea compared to its low capital equipment to nurture industries. In 1970, however, the government strategically opted for the heavy chemical industry. Due to rapid economic development, the labor-intensive light industry lost its competitiveness.

Ahn and Kim(1995)¹⁶ evaluated that the policy shift in focusing on the heavy chemical industry could be recognized as the adoption of a future-oriented growth strategy considering the fact that, thanks to the industry, Korea enjoyed a rapid acceleration in the manufacturing and export sectors in 1970 and took full advantage of three low phenomena (the low value of the US dollar, a low interest rate, and low oil prices) in the mid 1980s.

Such a change in policy direction, however, can also be seen as a result of changes in the diplomatic and national defense landscape.¹⁷ Internationally, the Cold War was alleviated after diplomatic ties between the U.S. and China were established and the Vietnam War ended. But for Korea, it was a time to prepare for self-defense as the security-related landscape on the Korean peninsula was shifting. The so-called Nixon Doctrine declared in 1970 meant that Korea could expect no more military and economic support from the U.S. including its defense against communized Korea. The following year, the U.S. Army's 7th Infantry Division stationed in Korea withdrew. Therefore, the transition to the heavy chemical industry also aimed at nurturing the defense industry, a core source of self-defense.

On October 17th, 1972, the Yushin Regime (Revitalizing Reforms System) stopped the so-called direct election with martial law. The government was in need of an economic growth strategy for much higher growth than in the past in order to face the strong resistance from the opposition party and also to justify the Yushin Regime and obtain wide public support. At a time when the GNP represented national power, low economic growth would directly compromise the legitimacy of the regime. In a way, therefore, the heavy chemical industry was a politically motivated move to seek a political breakthrough through a higher economic growth.

From a long-term perspective, the strategic nurturing of the heavy chemical industry contributed greatly to substituting imports and promoting exports. But in its initial stages, the huge investment that mainly relied on foreign credit, led to higher foreign debt, and the lack of a specialized labor force caused inflation and failed to increase production.¹⁸

3.2. The Dual Grain Price System

The dual grain price system was a policy designed to increase grain production. It was similar to a subsidy for both farmers and low-income earners in urban areas as the government managed the grain price by purchasing rice at prices higher than the market

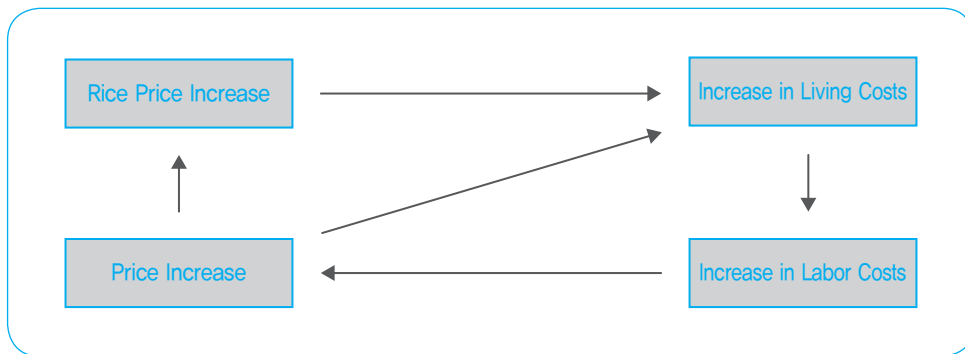
16. Cha and Kim (1995).

17. Cho and Kang (2013).

18. Cha and Kim (1995).

rate and then selling it at prices lower than the market. The general public, who considered themselves the sons and daughters of farmers, supported the policy as well. The National Assembly decided to deal with the inevitable deficit¹⁹ from such grain management with more borrowing from the Bank of Korea. In reality, the dual grain price system was problematic as it distorted the function of price in the market and led to inflation due to the increased issuing of currency. All these factors resulted in the exacerbation of real income for both farmers and urban residents. Every year, the government had to set a higher purchasing price and lower the selling price compared to the year before. The resulting financial deficit was placed on the shoulders of the public.

Figure 2-1 | Relation between Dual Grain Price System and Inflation



The dual grain price system was a complementary policy to the industrialization strategy, intended to resolve the ever-widening income gap between the non-agricultural manufacturing sector, which experienced rapid growth, and the agricultural sector that failed to keep up with the accelerated growth trend. Many have cast doubts on its effectiveness as the income gap remained wide.²⁰

19. *50-year History of Tax system/financial policy and the Assessment* (Korea Institute of Public Finance, 2002).

20. 'Income Distribution and Determinants of Korea (book one)', (KDI, 1979) suggested that according to the 'Income determinants in rural area and the income distribution,' the government statistics saying the rural income had started to surpass that of urban residents since 1974 was far from the truth.

Table 2-7 | The Dual Grain Price System as Viewed in the Media

| Media Outlet | Content of the Report |
|--|---|
| <p>1970. 10. 3 Maeil Business News Korea</p> | <p>Can It be Managed? The Grain Management Deficit and the Grain Fund</p> <p>For the financial sector, grain management related deficits, coupled with the fertilizer account, have long been an obstacle to the fiscal stabilization plan. Until now, the grain related deficit has not been considered as a form of financial pressure as it does not deal with the general account. Instead, the government created the Grain Management Special Account to deal with the accumulation of borrowings from the Bank of Korea, which exacerbated the problem further.</p> <p>As of 1969, the amount of borrowing in the Grain Management Special Account stood at a whopping 29.1billion won, 74 percent of the total government loans from the Bank of Korea. Consequently the BOK had to issue more currency. From 1964 to 1969, the Bank of Korea printed 180 billion won, of which 18.6 billion won (17 percent) was for the Grain Management Special Account. In addition, the price fluctuates even more during the harvest seasons of June to August (summer crops) and November to January (fall grain).</p> <p style="text-align: right;">(Page 8)</p> |
| <p>1972. 7. 25 Maeil Business News Korea</p> | <p>High Rice Price Policy Continues</p> <p>Minister Kim showed his determination to maintain the high rice price policy to encourage farmers to increase production. He said that little was discussed among relevant ministries on the issue of the government purchase price for this year's yields or the amount of purchase. He also confirmed that there was no official suggestion from the IMF Investigation Team to stop the high rice price policy.</p> <p style="text-align: right;">(Page 1)</p> |
| <p>1972. 9. 18 Maeil Business News Korea</p> | <p>High Rice Price Policy Suspended</p> <p>The Korea Development Institute (KDI), the nation's economic policy research institute, proposed a temporary suspension on the high rice price policy to stabilize market prices. According to the relevant authority, in the report recently submitted to high ranking officials and the Economy Planning Board, the KDI pointed out that the government's continued push for the high rice price policy has caused an increase in market prices.</p> <p style="text-align: right;">(Page 1)</p> |
| <p>1972. 9. 29 The Kyunghyang Shinmun</p> | <p>President Park Promised "High Rice Price Policy" to Be Continued</p> <p>On the 29th, President Park Chung-hee said that he would stick to the high rice price policy against all odds.</p> <p style="text-align: right;">(Page 1)</p> |

| Media Outlet | Content of the Report |
|---|--|
| 1972. 9. 30 Maeil Business News Korea | <p>High Rice Price Policy Won by Decision</p> <p>With continued debate among relevant ministries on whether to maintain the high rice price policy, the Ministry of Agriculture seemed to win when President Park said on the 29th that the policy would go on for a while.</p> <p>(Page 1)</p> |
| 1977. 12. 10 The Kyunghyang Shinmun | <p>Vice Prime Minister Nam Put the Brakes on the High Rice Price Policy</p> <p>Nam Duckwoo, Vice Prime Minister and head of the Economy Planning Board pointed out that the high rice price policy reached its limit due to enormous financial pressure and, therefore, he will devise diverse ways to replace the policy and to enhance income in rural areas from next year.</p> <p>(Page 1)</p> |
| 1977. 12. 13 The Kyunghyang Shinmun | <p>"No Imminent Change on High Rice Price Policy"</p> <p>Meeting with journalists on the 12th, the vice President said that he had no intention to disappoint farmers, just wanting to draw a long term vision of my.....</p> <p>(Page 1)</p> |
| 1978. 9. 28 Maeil Business News Korea | <p>Borrowings from The Bank of Korea Stand at 867.5 Billion Won, to Exceed One Trillion Won Next Year</p> <p>Since the initiation of the high rice price policy back in 1972, related deficits have been covered by borrowings from the Bank of Korea which issued more currency. The long-term borrowings from the Bank now stand at 867.5 billion won.</p> <p>(Page 1)</p> |
| 1978. 10. 20 The Kyunghyang Shinmun | <p>Tentative Stay of High Rice Price Policy, 15.4% Increase in Rice Purchasing Price</p> <p>Each year, the government decision on the grain purchase price has been a fight between the basic direction for long-term policy and the reality of the agricultural industry. It seems that the harsh reality of the agricultural area won this time as it was decided that the rice purchase price will increase by 15.4 percent.</p> <p>The long-term grain price policy initiated last year has forced the government to stop the high rice price policy. Due to the combination of the ever changing situation and the political situation, the government was about to retreat from the high rice price policy.</p> <p>(Page 3)</p> |

Source: Naver News Library (<http://newslibrary.naver.com/>).

Consequently, excessive financial support for the export industry, which was the driving force for rapid development in the 1970s, as well as continued price instability were gradually recognized as additional stumbling blocks to economic growth. Despite the increasing voice calling for a change in government policy, the government could go only

so far in accepting such demands. The basic policy directions included the heavy chemical industry-led economic development and the firm ground for self-defense and the dual grain price system to ensure a reasonable income of farmers. However, government officials and politicians were reluctant to speak up regarding the changes in policy direction as such an attempt could be seen as a challenge to the President who constantly pushed a head with a policy of high economic growth and development in rural areas.

Table 2-8 | KDI Policy Recommendations on the Heavy Chemical Industry and Agricultural Sector Policy

Since 1978, KDI recognized the inevitable need to change the policy direction toward stabilization measures to save economy from crisis and suggested that these stabilization measures be implemented strongly in association with issues concerning the heavy chemical industry sector. At that time, then Deputy Prime Minister and Minister of Economic Planning Board (EPB), Shin Hyonhwak and the officers in the planning department at EPB shared the same perception of crisis.

[Omit]

He used to nod his head several times showing his approval for the proposal to change to a stabilization-oriented policy. However, even though he may have agreed with the imperative for a stabilization-centered policy, his face had become more serious over time as he listened to the briefing arguing for stabilization measures. I assumed that it was an expression of agony and inner conflicts that implementing stabilization measures would inevitably slow down the pace of economic growth and our economy at that time couldn't afford to take a hit caused by economic recession, considering the critical nature of internal and external circumstances.

[The then President of KDI, Kim Man-Je][Memoirs of the Economic Brains of KDI (KDI, 2002) p. 212]

[Omit]

"Actually I felt very overwhelmed about having to meet with the President in 1987 because I had to publicly give a briefing regarding the need to slow down the pace of our economy and report it to the President, who was in agony over the challenges that had occurred at home and abroad."

[The then President of KDI, Kim Man-Je][Memoirs of the Economic Brains of KDI (KDI, 2002) p. 213]

"Private distribution organizations were forced to shut down their operation because of this grain management policy. Dr. Pal Yong Moon of KDI and KDI President, Kim, Mahnje, went to the Blue House and suggested a reform in policy to then Senior Presidential Secretary for Economic Affairs, Kim Younghwan because they thought that this grain management policy was not desirable from a long-term perspective. Eventually they got Kim Younghwan to agree to their suggestion and succeeded in securing the approval from the President but this approval was completely invalidated when faced with the fierce opposition of The Ministry of Agriculture and Forestry."

[The Former Research Fellow of KDI, Moon Pal.Yong][Memoirs of the Economic Brains of KDI (KDI, 2002), p. 229]

2015 Modularization of Korea's Development Experience
Korea's Fiscal Stabilization Policies
of Transition Period Economic Policy in the 1980s

Chapter 3

Fiscal Stabilization Policies in the Transition Period

1. Fiscal Stabilization Policies of the Late 1970s
2. Stabilization Tools of the Government in the 1980s
3. Success of Fiscal Stabilization in the 1980s

Fiscal Stabilization Policies in the Transition Period

1. Fiscal Stabilization Policies of the Late 1970s

1.1. April 17 Comprehensive Economic Stabilization Policy (1979)

Economic stabilization generally refers to cooling down an excessive boom through fiscal austerity and stable monetary policy.²¹ However, the economic stabilization policy that was adopted in 1979 had greater meaning beyond the abovementioned general definition and contained a more comprehensive reform. It also included a paradigm shift in growth policy from the development chronicle that had begun in the 1960s. The policies can be described as a great turning point for Korean economic policies since they tried to reduce government intervention and achieve a freer market. Because they included measures that were recognized as “sacred ground,” such as reducing support for exporters, adjusting investment for the heavy chemical industry, and reducing rural housing improvement projects,²² it was a phenomenal event that reversed the political direction of the time.

However, there was a great deal of difficulty in changing policies as the *April 17 Comprehensive Economic Stabilization Policy* (1979) was regarded as a paradigm shift. The Ministry of Commerce and Industry, which was leading the exports, and the Ministry of Agriculture and Fisheries, with its responsibilities to maintain the dual grain price system and protect the rural areas, resisted and the EPB also had inconsistent views from its various departments. All of these proved that it was not easy to revamp the rigid economic structure that had been shaped by the government-led development strategy. Furthermore,

21. Cho and Kang (2013).

22. Ko (2008).

the President did not endorse the policy, not only during the formulation process but also in the implementation phase.

1.1.1. Initiating a Review of the 1979 Stabilization Policy

The former assistant secretary of the EPB, Kang Gyeongsik, recalled that the reason that it was difficult to implement stabilization policies was because it could be regarded as being opposed to the growth-oriented policy direction and therefore he “regarded the task as high risks.” The policies were not something that President Park could easily agree to without hesitating. President Park had devoted all his efforts to stimulating a Korean economy with weak fundamentals and he had great pride in the results that had resulted from his efforts. The world was also amazed by Korea’s economic growth. Therefore, it was not easy for President Park to agree to the fact that it was not appropriate to continue with the current economic growth model and accept a paradigm shift. On March 15, 1979, the President of the Korea Development Institute (KDI), Kim Man-Je, the Governor of the Bank of Korea (BOK), Shin Byung-hyun, and a permanent member of the Economic and Science Deliberation Council, Jang Deokjin, gathered at the Blue House to discuss the problems of the Korean economy and countermeasures without the presence of the EPB officials and the Deputy Prime Minister for Economy Shin Hyun-hwak.²³ Reports from those attendees also concluded that there should be a shift in economic policy to a stabilization policy. Therefore, the Stabilization Policy was publicly announced on April 17, 1979. According to former Deputy Prime Minister, Shin Hyun-hwak, and the former assistant secretary, Kang Gyeongsik, who was in charge of policy at EPB, the Stabilization Policy was the first of its kind to attempt an economic transition and even though the actual content was not much different from the one announced in the new year’s press conference, it had greater meaning as a “policy with Presidential approval.”

23. Minister Shin, who was appointed as the Deputy Prime Minister for economy during a cabinet reshuffle in December 1978, seemed to conflict with President’s political philosophy as the minister suggested the stabilization policy, which he had been preparing from the early 1978 in the EPB, to the President. In late February in 1979, the minister visited the Naval Academy in Jinhae, South Gyeongsang Province, to attend a commissioning ceremony for a second lieutenant and then made a surprise visit to the Changwon Industrial Complex because of its low operating rate. President Park might have thought that there was a need to check the demand for a paradigm shift from the EPB. According to the President’s order, the meeting was not attended by any personnel from the EPB in order for personnel from the BOK, the KDI, and academic circles to be able to have a free discussion. The then assistant secretary of the EPB, Kang Gyeongsik, recalled the meeting held at Cheong Wa Dae on March 15, 1979 as a “judgement by default” for the stabilization policy.

Figure 3-1 | Reporting Newspaper Related to CESP



Source: The Kyunghyang Shinmun (April 17, 1979, page3)

1.1.2. New Strategy towards the 1980s

After the Deputy Prime Minister, Shin Hyun-hwak, was inaugurated, “A new strategy looking towards the 1980s” was prepared and it later became the basis for the April 17 Stabilization Plan. It introduced policy measures aimed at fiscal consolidation implemented by Japan and West Germany, who were faced with transition. It particularly pointed out that Japan utilized public bonds and West Germany banned central bank loans by law. It also argued that it was necessary to learn from those countries about their rapid growth based on stable fundamentals and effort in promoting competition for open markets. On the other hand, examples from Japan including a prolonged price support policy for rice that undermined fiscal function, a food price hike due to excessive import restrictions on agricultural products, and delayed investments for social development that left living facilities vulnerable, were identified as those that Korea needed to avoid. Furthermore, the following tasks were suggested for efficient economic management.

- ① Consolidating principles of fiscal soundness is required to improve fiscal management. Effort in maintaining an adequate level of financial scale and its balance should not only last for one or two years, instead it should continue for a long period.

- ② The tax support system should be rationalized. Imbalanced and redundant taxation should be eliminated and income distribution should be improved. Fiscal spending structures should be revamped to reduce any direct support for economic development as well as to focus on expanding social development and nurturing talented human resources.
- ③ The privatization of government enterprises should be reviewed and implemented decisively. Efficiency needs to be strengthened and the burden on national finance should be reduced through the privatization of financial institutions, government-invested institutions' IPOs, and transforming government enterprises into public corporations.

In terms of fiscal soundness, the first task to maintain an adequate level of financial scale and its balance for a long period of time beyond one or two years is very important. There were many efforts during the 1970s made to achieve fiscal soundness, but it was difficult to maintain the desired fiscal soundness during that period as the cycle of fiscal deficit and surplus continued to repeat. Hence, the attempt to maintain the fiscal surplus can be interpreted as a commitment to achieving fiscal soundness without following the perpetual cycle of deficit and surplus.

The second task of rationalizing the tax support can be evaluated as an effort to correct the irrationality and distorted distribution of resources that existed in tax breaks for fostering the heavy chemical industry, not only in relation to the spending structure but also in the taxation structure.

As government-led economic growth continued and the government directly managed key domestic industries, the efficiency of those institutions decreased and their deficits undermined the government's fiscal status. The third task, therefore, tried to reduce the fiscal burden and strengthen fiscal soundness through the privatization or autonomous management of public corporations.

1.2. The Planning Stages and Afterwards

1.2.1. Policy Making Process

As the government insisted on promoting the heavy chemical industry and supporting the dual grain price system in the 1970s, it is caused not only the fiscal deficit discussed in Chapter 2, but also an increase in prices and nominal interest rates. These problems threatened economic stability behind the rosy facade of rapid economic growth.²⁴

24. Cho and Kang (2013).

The April 17 Economic Stabilization Policy, therefore, was announced and implemented to rectify those issues on April 17. It is noteworthy that the planning for this policy had actually started with the EPB long before Deputy Prime Minister Shin, Hyun-Hwak even took office. By then, no one had noticed that inflation is the enemy of economic growth in Korea's economy.

First, officials from the EPB centering on the Assistant Secretary, Kang Gyeongsik, gathered in the guest house of the Korea Institute of Science and Technology (KIST) to start discussing how to develop “a policy to lay the groundwork for growth based on stability,” shifting from a “growth-first policy” in early 1978. As a result of that discussion, they prepared and reported the current challenges of the Korean economy and relevant measures (Subtitle: Challenges of the transition) to Deputy Prime Minister, Nam Duck-woo. But it was not reported to the President until the cabinet reshuffle at the end of that year. Although the reason that Deputy Prime Minister Nam did not report to the President is not confirmed, it seems that it was not easy to support a policy based on stability while “everybody was striving for economic growth,” according to testimonies of Deputy Prime Minister Nam's successor, Shin Hyun-Hwak, who later became the head of the EPB, and other economic officials in <Table 3-1>. In addition, President Park seemed to greatly oppose the idea of the April 17 Policy as shown in his controversial cabinet reshuffle,²⁵ even though the policy was not implemented due to the October 26 incident.

Table 3-1 | Testimonies of the then Economic Officials

| Officials | Testimonies |
|---|---|
| Deputy Prime Minister Shin Hyun-hwak | Korea's economy developed exponentially until 1978. The growth reached its peak in 1977 and 1978 and numerous side effects followed as a consequence. There was willingness to correct the existing policy direction within the EPB from 1978, but it did not draw any visible results and it was difficult to suggest a concrete policy at that time. No one could present a different opinion when everybody was so busy with the growth-first policy and especially when President Park tenaciously pushed ahead with economic growth. Everybody just drifted with the growth. |
| Vice Minister of EPB Jeong Jaeseok | It took at least three to four months to persuade President Park to change any policies. President Park was particularly upset when it came to reducing the budget for projects to improve the rural areas, which were symbolic projects for him. |

Source: Kang (2010), Kim (1999).

25. Kim (1999).

1.2.2. Backlash and Conflict Among Departments after the Announcement

After the so-called “judgment by default” on March 15, 1979, the President presided over a policy meeting at the end of March and ordered Deputy Prime Minister Shin to prepare a comprehensive measure to change the methods for managing the economy. Although some opposition among different departments existed until the announcement of the April 17 Policy, including the Ministry of Agriculture and Fisheries regarding the dual grain price system and the Ministry of Commerce and Industry for downsizing the heavy chemical industry, the policy could finally be implemented under the leadership of Deputy Prime Minister Shin since it was mandated by the President. However, the President could not aggressively implement the policy since it was reversing his political philosophy and it could also bring about a short-term recession to the economy. Therefore, he could not lend his weight to solving problems caused by the Stabilization Policy. Also, he turned back the previous economic policy by approving the high rice price policy and expanding export financing while Deputy Prime Minister Shin was visiting foreign countries.

“While looking at the export statistics, the President rebuked the fact that he could not just stand there and do nothing when the export growth rate was slowing down. In addition, he added, ‘you need to prepare measures to fix the export growth rate including export financing and Special Adviser Nam will be in charge of this.’ (Testimony from the then Minister of Commerce and Industry Choi Gak-kyu)”²⁶

This confusion regarding economic policies was probably caused by President Park’s ambiguous decision - which was unlikely - to appoint the former Deputy Prime Minister, Nam Duck-woo, as his new Special Adviser for Economic Affairs (“Economic Special Adviser”). In other words, President Park seemed to have difficulty deciding between the suggestion that “the economic policies should be completely revamped” from Deputy Prime Minister Shin of the EPB and the opinion that “it is adequate to fix the problems gradually” from Special Adviser Nam and Senior Secretary for Economic Affairs Seo Seokjun.²⁷ This conflict brought about confrontation between the pro-stabilization group consisting of the EPB, the Ministry of Finance, the KDI, and the Bank of Korea and an anti-stabilization group made up of Cheong Wa Dae, the Ministry of Commerce and Industry, and the Ministry

26. Kim (1999).

27. The April 17 Stabilization Policy could be described as a challenge to the governing philosophy of President Park and at the same time it was a challenge to the economic officials who worked so hard to pursue that governing philosophy. Economic Special Adviser Nam Duck-woo was the Deputy Prime Minister for the economy from 1974 to 1978 and Senior Secretary Seo Seokjun was the vice-captain for the planning group of the Heavy Chemical Industry Promotion Committee in 1973. Hence, they were great proponents of policies for promoting the heavy chemical industry.

of Agriculture and Fisheries. This conflict was shown by the announcement of a policy to expand export financing that fundamentally undermined the essence of the Stabilization Policy while the Deputy Prime Minister was on his overseas business trip.

Table 3-2 | News Articles on Policy Confusion after the Announcement of the April 17 Policy

Minister Lee of Agriculture and Fisheries Continues the High Rice Price Policy [April 6, 1979, Page 1, The Kyunghyang Shinmun]

The government's high rice price policy and policies to expand the state purchase of rice can be interpreted as the government's plan to continue to increase food production centering on a new grain variety, despite policies to reduce the fiscal deficit according to the Stabilization Policy, which has come to the forefront this year.

A Heated Discussion on Economic Policies in Relation to the Changes Made for Policy Direction to "Less Heavy Chemical and More Light Industry" [April 10, 1979, Page 3, The Kyunghyang Shinmun]

The Economic Planning Board (EPB) strongly argued to reduce investments for the heavy chemical industry in order to achieve price stability. However, the Ministry of Commerce and Industry insisted that the government should increase investments for the heavy chemical industry because it plays a critical role not only in relation to policies for industrial development but also as an important export industry.

President Park Denies Any Changes in Economic Policies [April 27, 1979, Page 1, The Dong-A Ilbo]

President Park suggested, "Some says that the policies have been fundamentally changed," and stressed, "but the basic direction of the government's economic policies has not been changed at all and export-oriented growth and the heavy chemical industry are still at the center of our policies. Those assumptions are wrong and completely different from the truth."

The High Rice Price Policy Continues and a Plan to Purchase Rice Based on Market Price is Nullified [May 8, 1979, Page 3, The Kyunghyang Shinmun]

The government decided to nullify its plan to purchase rice based on market price, which had been reviewed at the working level as a solution to the grain management deficit, but instead it decided to purchase rice at a price higher than the minimum production cost as originally planned. On the 7th, the Assistant Secretary of the EPB, Kang Gyeongsik, stated that a working group reviewed a plan to purchase rice based on the market price with the view to reduce the price at which the government is purchasing rice since it is cheaper in the autumn, but the government decided to cancel that plan since it would produce an unfavorable situation to farmers and it will continue with the high rice price policy as announced by the Ministry of Agriculture and Fisheries.

The Stability Policy Got Stabbed in the Back [June 26, 1979, Page 2, The Dong-A Ilbo]

The Stability Policy, a trademark of the EPB led by Deputy Prime Minister Shin, got neglected. The measures to expand export financing decided during the Economic Ministerial meeting on the 25th indicate that the government itself disrupted its own austerity measures that are the symbolic policies of the Deputy Prime Minister.

While announcing the measures, Minister Kim Jaemu said, "The recession caused by the austerity measures occurred too quickly." The measures to expand export financing are interpreted as actions to further highlight some people's argument that although the austerity measures are needed the pace is too fast.

A Discordant Economic Team - Deputy Prime Minister Shin is Actually an Outcast [June 26, 1979, Page 2, The Dong-A Ilbo]

The measures to expand export financing determined during the Economic Ministerial meeting on the 25th were actually prepared without the head of the economic team, Shin Hyun-hwak, while he was on an overseas business trip. This clearly shows that the discord within the economic team has reached its peak.

The Minister of Commerce and Industry, Choi Gak-kyu, reported the current challenges facing the export market to Cheong Wa Dae right after he had returned from Europe on the 15th of last month. President Park accordingly ordered Special Adviser Nam to prepare measures to support the export market even without Deputy Prime Minister Shin present and appropriate measures were prepared after several meetings among relevant ministers. These measures were eventually adopted in the Economic Ministerial meeting and the Deputy Prime Minister ended up only presiding over the meeting as a bystander.

Source: Naver News Library (<http://newslibrary.naver.com/>).

1.3. The Significance of the April 17 Stabilization Policy

1.3.1. Reform Initiated by Bureaucracy

The need for a stabilization policy was not suggested by economic experts or research institutes but by the EPB itself, which legislates economic strategies and policies, after recognizing problems in the Korean economy and proposing associated measures. This means that the Stabilization Policy was not directed by high-ranking officials but was initiated by working-level officials. In other words, this was a bottom-up reform instead of a top-down reform. Typically, the President or the minister orders a review of suggestions from political circles or a party. On the contrary, the Stabilization Policy was actually initiated by the EPB, so it was a reform policy that originated from the bureaucrats themselves. The Stabilization Policy drew a lot of attention, particularly from overseas, including the World Bank, the IMF, Harvard University, and Yale University. The reason behind this attention was that the reform was initiated by bureaucrats who normally would resist reform. They

were more curious about “how bureaucrats became the main players of reformative action” than the actual content of the Stabilization Policy.²⁸

Eisenstadt (1959) explained this in the form of service-oriented bureaucracy, over-bureaucratization and de-bureaucratization among the bureaucrats of newly independent countries. According to Han (2014), EPB tended to be the form of service-oriented bureaucracy, it maintained to utilize practical policy without ideological stereotypes.²⁹

1.3.2. The Originality of the Policy

As Assistant Secretary, Kang Gyeongsik, who participated in the policy making process, mentioned, the Thatcher government of the UK also implemented a similar policy to the Stabilization Policy of Korea, but it was implemented after Korea. Therefore, the Stabilization Policy of Korea can be evaluated as an original policy that did not reference any other foreign policies.

There was no role model to follow while preparing the Stabilization Policy.

...

In February 1979, the reformation carried out by Prime Minister Margaret Thatcher of the UK was introduced in a daily newspaper in Korea. Deputy Prime Minister Shin read the article and said, “Look, the UK is also implementing a similar policy to ours.” In fact, Prime Minister Thatcher also knew that she was implementing a similar policy to the Korean one at that time. Soon after, President Reagan of the US also started a reformation in a similar vein to the Stabilization Policy. However, no one in Korea had even heard of the word “supply-side economics” when the Stabilization Policy was drawn up. No cases of the US or the UK were studied or reviewed when the Stabilization Policy was in the planning stage.

Source: Kang Gyeongsik, 2010, Things that a State Should and Should Not Do

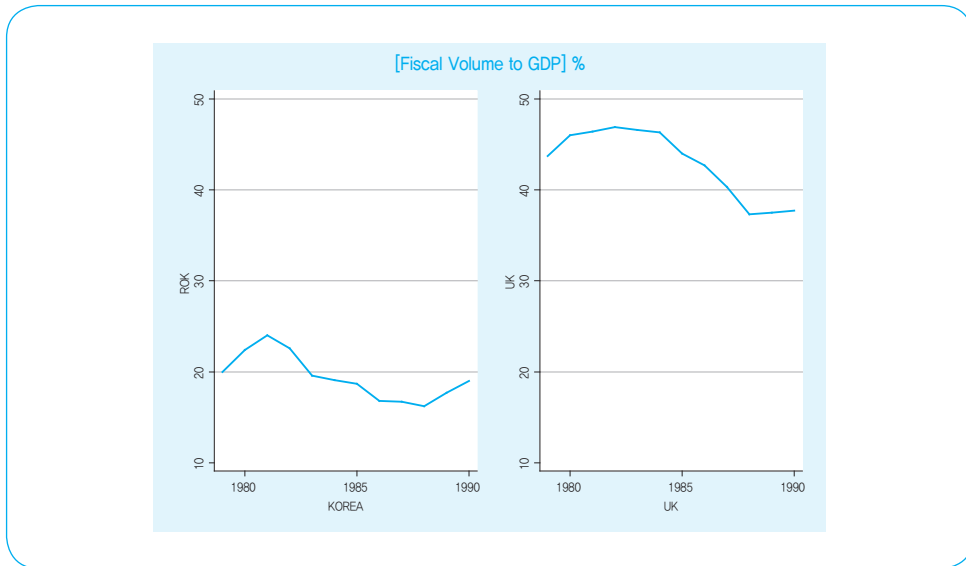
Margaret Thatcher, who held the position of prime minister in the UK for 11 years from 1979 had unswerving faith and principles towards conservatism and is well known for carrying out an economic reform for what is known as the “British disease” including the 1978 fiscal crisis. The details of the reform carried out by Prime Minister Thatcher

28. Kang Gyeongsik (2010).

29. The government officials working at the EPB possessed dedication with goal of their county's modernization. Also, agency was free from the influence of other interest groups. In institutional viewpoint, EPB officials were not tied up by the strict regulations and had room to fully exhibit their creativity and flexibility [Han, 2014].

included the privatization of state enterprises, deregulation, fiscal spending control, small government, markets with free competition, and the standardization of union activities, and these were quite similar to the content of the April 17 Stabilization Policy and the tight fiscal policy ([Figure 3-2]) implemented in the 1980s in Korea. Furthermore, the two governments both tenaciously carried out their policies despite various issues.

Figure 3-2 | Ratio Government Expenditure to GDP (Compared Korea to UK)



2. Stabilization Tools of the Government in the 1980s

Fiscal stabilization policies of the 1980s refer to the policies implemented after 1982 which was approximately one year after the President took office. In terms of aggregate demand control, the Stabilization Policy was based on a tight monetary and fiscal policy. In 1981, when the Stabilization Policy was in full swing, the government had to issue government bonds with high interest rates since tax revenue decreased from sluggish growth and reduced income. The EPB decided to shift to tight fiscal policy and pushed ahead with budget reform to increase the efficiency of the budget execution after recognizing that fiscal expansion would cause inflation.

Budget reform to achieve fiscal soundness in the 1980s aimed to increase efficiency in the fiscal sector and focused on reducing the fiscal deficit. Since fiscal management in the early 1980s basically focused on recovering growth potential and maintaining stability,

the budget reform also aimed to achieve efficient management of the budget. This was particularly well elaborated in the mid-term fiscal planning system in 1982, the Zero Base Budget System in 1983, and the budget freeze in 1984.

2.1. Zero Base Budgeting System

2.1.1. The Process of System Reform

The government in the 1980s introduced the Zero Base Budget (ZBB) in 1983 to reform the budget system. During the budget planning stage in 1983, the government reassessed all budget activities from a zero base and determined the necessity of individual activities and their priorities. The existing appropriation method, in which a budget is allocated based on the previous budget, was avoided and this groundbreaking system concentrated on the maximization of budget savings and increasing investment efficiency. It was possible for the budget to increase by 20 to 30 percent every year due to high inflation and rapid economic growth in the 1970s and the individual ministry could not provide the exact level of budget required in the future. Therefore, the budget for a new year used to be calculated based on the previous budget and any additional demand, thereby increasing the possibility of causing waste in the budget. Hence, the government needed to reassess the budget system from a zero base to increase budget efficiency as part of the tight fiscal policy.

“The main departure of the zero-based budgeting system from the past was incorporating value-judgment to prioritize government spending, contrary to value-neutral accounting based budgeting that extrapolated past spending. Another major difference was the discontinuous nature of the zero-based budgeting system, where the old ways of budgeting reviewed only the new projects and programs for feasibility, whereas the zero-based budgeting system reviewed everything from scratch, which allowed for cutting the budget relatively easily.” (The then head of the Budget Office Cho Gyeongsik)³⁰

The Zero Base System applied to budget planning in 1983 is shown in <Table 3-3>. The details included a review of the existing budget units and planning guidelines, a reassessment of the priorities for budget activities, and the identification of factors causing waste and inefficiency.

30. Cho and Kang (2013).

Table 3-3 | Zero Base System applied for the 1983 Budget

| Types of Budget | Application of Zero Base System |
|--|--|
| Uncontrollable Expenditures (Defense expenditure, Grants) | <ul style="list-style-type: none"> - The budget size is recognized - The details of the budget are reviewed to cut expenditures where possible to pass them on to other main activities |
| Administration Expenditures | <ul style="list-style-type: none"> - The amount requested by each government office is disregarded and the same standard is applied for each government office - Inequality among the ministries caused by following the previous year's budget planning is solved - All information expenditures are revoked, except for information expenditures for relevant management and investigations and they are appropriated as special official expenditures. |
| Subsidies, Contributions, Funds | <ul style="list-style-type: none"> - A proportional increase from this year's budget is avoided - Criteria for budget reduction is prepared and applied to all relevant organizations |
| Project Expenditures | <ul style="list-style-type: none"> - Priorities are reorganized to divide policy-related activities and miscellaneous activities - A deliberation process for miscellaneous activities is changed from ministerial deliberation to joint deliberation |

Source: The Compilation Committee of 40-year History of the Korean National Finance, *40-year History of the Korean National Finance: Book Three Relevant Korean Laws and Key Policy Data* (KDI, 1991).

ZBB planning requires extra time and effort from the budget authority and government ministries and it is difficult for the budget authority to determine an appropriate budget for individual ministries because each ministry has more information on their own budget. Furthermore, because budget planning is only one of many processes of political agreement to determine where to use national resources, there is possibility of reduced efficiency compared to the time and effort put in. For these reasons, the ZBB system was not an easy task to implement without the commitment to stabilization from the government in the 1980s and justification for budget reform.

“This was budget reform. I was not proposing to reduce and adjust the entire budget but I suggested reducing budget items that are non-essential and wasteful from current project expenditures. Official expenditures were also reduced based on new criteria. The Budget Office and the EPB started to act first by reducing their own budgets. When a particular ministry opposed some cuts, the amount cut from the budget of the Budget Office and the EPB was provided. If I remember correctly, there was a ministry where their budget for foreign inspection and various services was reduced by almost 80 %. The total amount of budget cut was almost 239.4 billion won. Reducing more than 200

billion won of current expenditure was a remarkable effort considering the total budget size. Each and every ministry strongly resisted during the budget reform process. I told the Deputy Prime Minister, Kim Jun-seong, that I could personally give a briefing at a cabinet meeting. I explained the purpose and the details of the budget reform as well as what a ‘Zero Base Budget’ was and why we needed to adopt this system.” (The then head of the Budget Office Cho Gyeongsik)³¹

The government in the 1980s had an unwavering commitment to budget cuts and this was clearly shown when it was emphasized in various meetings that the purpose of the budget reform was to eliminate any waste and inefficiency in the budget to eventually increase investment efficiency. The government’s political will was too strong so it applied the ZBB system, which had been introduced in January 1982, to the 1982 budget that had already been passed by the National Assembly.³² There was an angry backlash even within the executive branch since it had to review again the budget that had already been passed by the National Assembly. However, this was a demonstration of how strong the government’s will was in the 1980s to secure fiscal soundness through budget reduction.

2.1.2. Budget Structure of the Pre-post Introduction of the ZBB

The budget structure of the pre-post introduction of the ZBB could be confirmed through ratio sector expenditure by function of GDP (<Table 3-4>). Defense had been decreased from 5.85% in 1980 to 3.99% in 1987, lowered 1.86%p. Economic project had been decreased from 3.54% in 1980 to 2.55% in 1987, lowered 0.99%p, whereas, Education and Social expenditure slowly decreased in 0.26%p, 0.1%p.

Table 3-4 | The Ratio Public Sector Expenditure by Function of GDP

| | Defense | Education | Social Welfare | Economic project |
|------|---------|-----------|----------------|------------------|
| 1973 | 3.33 | 2.17 | 0.54 | 2.6 |
| 1974 | 3.77 | 1.98 | 0.6 | 2.64 |
| 1975 | 4.21 | 2.15 | 0.68 | 3.83 |
| 1976 | 4.88 | 2.36 | 0.69 | 3.69 |

31. Kim (1999).

32. “I met with President Chun Doo-hwan after I was appointed as the head of the Budget Office in January 1982. President Chun said, ‘The national finance is in a total mess. It seems like only some powerful ministries are gaining weight while those weak ministries are skin and bones. This is not right. Although the budget passed the National Assembly, I need you to get each ministry to prepare their budget all over again and reorganize the national budget as precisely as possible (Testimony from the then head of the Budget Office Cho, Kyongshik) [Kim (1999)].”

| | Defense | Education | Social Welfare | Economic project |
|------|---------|-----------|----------------|------------------|
| 1977 | 5.13 | 2.46 | 0.68 | 3.37 |
| 1978 | 5.23 | 2.36 | 0.8 | 2.9 |
| 1979 | 4.83 | 2.6 | 0.96 | 4.36 |
| 1980 | 5.85 | 2.78 | 1.18 | 3.54 |
| 1981 | 5.42 | 2.86 | 1.07 | 3.03 |
| 1982 | 5.58 | 3.36 | 1 | 2.83 |
| 1983 | 4.97 | 3.18 | 0.98 | 2.6 |
| 1984 | 4.51 | 2.91 | 0.91 | 2.67 |
| 1985 | 4.36 | 2.86 | 0.97 | 2.87 |
| 1986 | 4.25 | 2.72 | 1.07 | 2.57 |
| 1987 | 3.99 | 2.6 | 1.08 | 2.55 |

Source: *40-year History of the Korean National Finance: Vol 4, 5.* and The Bank of Korea's Economic Statistics System (<http://ecos.bok.or.kr/>).

Likewise, the growth rate of defense and economic project was lower than the economic growth rate, whereas the growth rate of social and education was reduced to less than defense and economic project.

2.1.3. The Introduction of the Budget Deliberation Council

The reason each ministry opposed the ZBB system and the reason they merely followed the previous year's budget when it came to planning the budget for the next year was because clear principles and standards did not exist for budget planning. Therefore, a government body, which could deliberate on and discuss the budget for each ministry, was necessary to effectively execute budget reform.³³

According to this institutional need, the then head of the Budget Office, Moon Heegap, established the Budget Deliberation Council in 1982 for 1983 budget planning to be operated as a consultative body within the Budget Office during budget planning as a means of reviewing the appropriateness of a proposed budget.

33. In order to increase the technical efficiency in budget management, which is one of the most important tasks of the fiscal management, maximization of efficiency is required: 1) in the planning and execution stage of the budget; and 2) in the audit process to control inefficiency in budget management including budget planning, execution, and audit. It is imperative seek measures: 1) to have deliberation during budget planning to eliminate any project which might cause waste of budget; and 2) to conduct a performance management for each project and to utilize the private sector during budget execution. Furthermore, measures to control waste and inappropriate use of budget by ensuring external audit function including the Board of Audit and Inspection and internal audit function within each ministry (2010, *60-year History of the Korean Economy*, p. 431).

Before introducing the Council, each budget proposal for an individual division in charge of each ministry within the Budget Office went through a hierarchical approval process such as Deputy Director → Head of Division → Director → Chief Directorate-General for Budgets → Head of the Budget Office for review and approval. The Chief Directorate-General for Budgets and the Head of the Budget Office were in charge of comparing different projects in various sectors and setting the priorities for budget distribution. On the contrary, under the Budget Deliberation Council, all personnel with a position of head of division and above gathered together to determine the priorities of budget distribution among different projects through a collective decision-making process. The Council was presided over by the Head of the Budget Office and participated in by the Chief Directorate-General for Budgets and Directorate-General for Budgets by sector, all heads of divisions, and deputy directors from Budget Coordination Division and each division for an individual ministry. A chief official of a division in charge of a particular ministry would explain his or her opinion on the budget proposed by a ministry and then the participants decided whether to reflect that opinion to budget planning or not after a discussion and review.

The (then) Head of the Budget Office, Moon Heegap, who first introduced this system, explained the reasons for its introduction as follows.³⁴ First, a forum was needed for all relevant personnel for budget planning to gather to forge a consensus on budget reform and the budget freeze by dramatically cutting unnecessary budget items. Second, in order to collectively respond to various external pressures including those from responsible ministries about the budget cuts, collective responsibility and anonymity were essential for a particular budget cut. For this reason, the Budget Deliberation Council, with collective action, was more effective than individually making decisions by one division in charge of each ministry.

Third, it was important to correct any imbalances that existed in budgets among the ministries and at the same time to recheck the investment priorities by deliberating all budget activities from a holistic view instead of from the perspective of an individual ministry. A new budget deliberation method was required to effectively address issues including reorganizing budget distribution by categorizing projects into “projects to discontinue”, “projects to downsize”, “projects to maintain”, and “projects to reinforce” as well as rectifying imbalances among the ministries caused by an expense allocation system based on individual government offices in which administration expenses are allocated based on one set of standards for each bureau and the departments of central government

34. The reasons for introduction are cited again from *60-year History of the Korean Economy*, p. 431.

offices. Fourth, it was necessary, through general deliberation, to strictly stop increases in preferred budgets for expenses including so-called “sacred ground items” such as expenses for activities that are inherent to the ministry’s budget, overseas travel expenses, and special official expenses. Fifth, a more democratic process was needed for budget planning since it was there to decide where and how to spend taxes paid by citizens. Budget adjustments made by an individual division within the Budget Office was closed and had a high chance of leaning towards favoritism, but the Budget Deliberation Council could be more democratic because it is open and various viewpoints and opinions can be reflected in discussions.

Table 3-5 | Comparison Table for before and after the Introduction of the Budget Deliberation Council

| Classification | Before | After |
|----------------------------------|---|--|
| Decision Making Process | Hierarchical approval process | Consensual process based on types of committees |
| Financial Management | Decentralized management by each division (Generally, a budget for each division is distributed in a lump sum first and is distributed again to different projects within the division) | Centralized management by the Budget Coordination Division (The Council distributes budgets directly for different projects) |
| Budget Adjustment | Various standards exist | Common standards are applied by the Council |
| Anonymity of the Decision Makers | Not guaranteed | Mostly guaranteed |

Source: Re-quotation of Ban(2003), p. 154.

The system of the Budget Deliberation Council spoke for concerns in the Budget Office about the EPB, who had to carry out a tight fiscal policy including a budget freeze in the early 1980s. It has been noted that the Council played a critical role in reexamining the investment priorities in a holistic view, eliminating imbalances among the ministries, and reducing uncontrollable expenditures in addition to forging a consensus for budget cuts and responding to external pressure. “It was also noted that the Council greatly contributed to eliminating political factors in the budget decision-making process, establishing an open, democratic, and rational organizational culture in the Budget Office, and providing a learning environment for chief officials of the Budget Office to make decisions and explain them in a rational manner.³⁵

35. Re-quotation: Ban [2003], *60-year History of the Korean Economy* (2011).

[Moon Heegap] Improving the budget deliberation method - “There should be no such thing as sacred ground in budget planning.”

“There should be no such thing as sacred ground in budget planning. No budget can be regarded as sacred ground. Whether it belongs to Cheong Wa Dae or any other ministries, all budgets must be allocated in balance according to the same standard among the ministries and it should be approved through the budget authority’s deliberation. There should not be any secrets behind any budget. At the time, there was no budget sanctuary apart from the budget for the Agency for National Security Planning and all proposed budgets underwent deliberation in order to eliminate inefficient and wasteful factors.

To establish such an environment for budget planning, we, the Budget Office, needed to change our methods of budget deliberation first. Before the Budget Deliberation Council was established, for example, a person in charge of the Ministry of Defense would only take care of the defense budget and the budget for police would be taken care of by one responsible division with a hierarchical approval system made up of a person in charge, a junior official, a deputy director, a head of division, and a director. This practice was not right. To solve this problem, the Council was established to make the high-ranking officials of the Budget Office sit down together to discuss budget planning with the same set of standards. It enabled everybody, including the head of the Budget Office, directors, heads of divisions, and deputy directors to screen the budget with the same standards in the planning stages.

We tried to build a system where all relevant personnel get together to spend even a sleepless night to discuss how an individual ministry planned their budget instead of having a discussion for the sake of formalities. As a result, the overall budget could strike a balance by fixing each other’s problems or reflecting one’s own problems.

That system has been continued until today.”

(The former head of the Budget Office)

Source: Lee and Chun (2003).

2.2. The Budget Freeze in 1983

2.2.1. Budget

The government in the 1980s froze the budget, wages for public servants, and the government-purchase price of rice for 1984 to the same level as in 1983. Although the inflation rate, which exceeded 20% in the late 1970s, decreased to a single digit number in the early 1980s, the government had to take the extreme measure of a budget freeze, which was a de facto budget cut, to accelerate price stability.

The reason for pushing ahead with the budget freeze despite strong opposition from the political circles and government ministries was that the government was confident enough to implement the relevant policy by witnessing a single digit rate increase for the consumer and the producer price indices in 1982 (7.2 %), which was a double-digit number in the early period of the administration (<Table 3-6>). Furthermore, the budget freeze was an attempt to mitigate any opposition that might occur if financial support for the rural areas, including the high rice price policy, which impeded price stability, was reduced. Just like the 1970s, financial support for the agricultural sector to help establish self-sufficient food production was the main cause of inflation in the 1980s. The dual grain price system, in particular, accumulated a deficit in the Grain Management Special Account and this was rectified by increasing the issuing of currency which, in turn, resulted in a situation where the government had to increase the rice purchase price for farmers every year for them to cope with increases in the cost of living and farming. Therefore, the government in the 1980s mitigated political pressure and showed its strong commitment by presenting an idea of reducing financial support for the agricultural sector and stabilizing the prices at the same time. As a result, the budget freeze enabled an indirect fiscal surplus that could be used to repay the BOK loans.³⁶

Table 3-6 | Inflation (1975~1986)

(Unit: %)

| | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|-----|-------|-------|-------|-------|-------|-------|-------|------|------|------|------|-------|
| CPI | 25.30 | 15.30 | 10.10 | 14.50 | 18.30 | 28.70 | 21.40 | 7.20 | 3.40 | 2.30 | 2.50 | 2.80 |
| PPI | 26.50 | 12.10 | 9.00 | 11.70 | 18.70 | 39.00 | 20.40 | 4.70 | 0.20 | 0.70 | 0.90 | -1.50 |

Source: The Bank of Korea's Economic Statistics System (<http://ecos.bok.or.kr/>).

Someone say that the budget freeze was possible because the government in the 1980s was authoritative, however, the government's commitment to fiscal soundness should be praised. Even though the government might seem to be authoritative because the President, the head of the executive branch, acted as a protector against opposition from the National Assembly regarding austerity measures and empowered the practical leader of the central budget authority (the head of the Budget Office) to fight against influence exercised by political circles; the basic driving force was a political will to achieve fiscal soundness. Especially, a stronger backlash from the ministries was inevitable when the government's budget actually

36. *60-year History of the Korean Public Finance* [Jaegyonghoe (A society for retired economic officials – translator) and Yewoohoe (A society for government budget officials – translator), 2011].

decreased while the economy continued to grow. Also, for the ruling Democratic Justice Party (DJP)³⁷, freezing the budget for 1984 was a political misrule since the general election was scheduled for 1985. Thus, the ability to push ahead with the budget freeze despite these issues tells us that President Chun had a very strong commitment to the Stabilization Policy and budget officials could carry out the budget freeze based on the President's commitment.

In addition, the defense budget was also cut according to the budget freeze. The defense budget was very rigid since the country was faced with the exceptional situation of military confrontation with North Korea. Not surprisingly, the decision caused a huge backlash from the military. The defense budget was especially sensitive because it had to maintain the principle of "6% of GNP" after President Jimmy Carter demanded to increase the proportion of the defense budget in GNP from 5% to 6% for reasons including the withdrawal of the USFK during his visit to Korea in June 1979. The budget authority cut the defense budget practically by allocating the construction budget for roads surrounding military camps into the defense budget. By doing so, the authority proved that the policy goal of price stability is more important than the defense budget, which is normally ranked high in budget priorities, and shows that any budget can be subject to cuts unless a compelling reason for a particular budget item is provided. As a result, this worked as strong support for implementing the ZBB. The first budget freeze in history was particularly more difficult to implement because the economy in the 1980s was also growing as fast as that of the 1970s and uncontrollable expenditures including the defense budget, labor costs, and grants took more than 60% of the total budget. The then Senior Secretary for Economic Affairs, Kim Jae-ik was planning to start the budget freeze from 1982 but it was not successful due to opposition from the then Head of the Budget Office, Cho Gyeongsik. Kim later succeeded in freezing the expenditure budget for 1984 after gaining the approval of the President.

As a result, the expenditure budget was frozen but the revenue budget increased by 4.2%, thereby bringing 550 billion won of surplus to the 1984 budget. Considering that the total amount of the budget for 1984 was about 11 trillion won based on general accounting standards, it is possible to understand that the budget-saving effect directly gained from the budget cuts was quite significant. These savings helped greatly in strengthening fiscal soundness by using them to repay the debt caused by the accumulated deficit in the Grain Management Special Account and fertilizer account in the agricultural sector. In other words, the spending of the government was frozen and the savings from that freeze were

37. The Democratic Justice Party (DJP) was the ruling party of South Korea from 1980 to 1998. It was formed in 1980 as the Democratic Republican Party and was the political vehicle for Chun, Doo-Hwan. When 1979, Park Chung-hee's assassination, Chun, Doo-Hwan of the party created it the 'Democratic Justice Party' in 1980.

used for repayment of debt. To emphasize the saving mentality, the government expressed the savings from the budget cuts to improve the consolidated balance.³⁸

[The Head of the Budget Office]

Two Brigadier Generals of the Joint Chiefs of Staff barged in the office of the Head of the Budget Office, Moon Heegap, and yelled at him. "How dare you break the '6% of GNP' rule for the defense budget? If Kim Il-sung invades us and our country becomes full of commies, will you take full responsibility for it?" "What are you talking about? Do you think soldiers are the only ones who care about this country? You must also know that pouring all our budget into defense expenses and neglecting welfare policies will definitely turn our country into commies!" Moon raised his voice even louder against those furious generals. (Reference: Lee Jang-gyu, You are the President of the Country of Economy)

Moon cut the defense budget from the 1985 budget that belonged to the Fifth Republic, when the military had even greater influence. Even the budget officials could not touch the defense budget because it remained sacred, but Moon had the nerve to cut it. The defense budget was meant to remain at 6% of GNP according to the agreement made between President Jimmy Carter and President Park in 1979. According to that principle, the defense budget would have had to increase dramatically and therefore, it was impossible to plan the budget. Moon persuaded the President and got approval so that he did not have to comply with the rule of "6% of GNP" for the defense budget. The President encouraged Moon and said, "I am well aware of the difficulties you are going through, so do not worry about anything else but do what you believe you must do." Those two generals who yelled at Moon later were demoted.

The post of the Head of the Budget Office, who was a gatekeeper for the national treasury, was regarded as one of the most important roles in public office. This was because the person in this role was actually the Chief Financial Officer of the country who plans the budget and also oversees the execution of the budget. The Head of the Budget Office was among the two most powerful posts out of the top five heads of Office and Bureau (the Budget Office, the Finance Bureau, the Public Security Bureau, the Economic Planning Bureau, and the Rural Policy Bureau) in Korea in the past. Since the Head of the Budget Office held the key to the national treasury, he always played the villain who cut the budgets for the ministries. The Head's power was so strong that he or she could change the fiscal spending plan that had already been publicly promised by the President, if the Head thought it was not appropriate.

Source: March 2, 2009, Column Horizon, The Hankook Ilbo.

38. *60-year History of the Korean Public Finance* (KDI, 2011).

2.2.2. Wages for Public Servants

The budget freeze carried out by the government was possible thanks to the public sector that led by example. As a result, it had a great ripple effect on other sectors including the private sector. The government tried to induce private enterprises to contain their wage increases by freezing wages for public servants and new employees. At the same time, it also tried to educate people through policy advertisement that everyone must endure pain together because price stability could bring improved quality of life when considering the cycle of a wage increase → inflation → decrease in a real income. In addition, the wage increase control policy eventually helped freeze the purchase price of rice.

2.2.3. The Government Purchase of Rice

It was strongly claimed under the influence of political logic that the purchase price of rice should always increase greatly regardless of fiscal soundness. The annual rate of increase for rice purchase prices was 25% in 1980, 14% in 1981, 7.3% in 1982, 0% in 1983, 3% in 1984, and 6% in 1985. This shows that the rice purchase price, which was under the influence of political logic, started to successfully be controlled in line with the policy goal of price stability.

The official and legal methods for setting the rice purchase price changed twice after 1961,³⁹ but the principles for determining the price can actually be divided into before and after the launch of the Fifth Republic. Until 1980, the power of the President was too strong,⁴⁰ so the purchase price was actually decided by the President. In other words, the rice purchase price was mainly determined by the executive branch and policy coordination was conducted quite smoothly toward the direction that mostly reflected the opinion of the Minister of the Agriculture and Fisheries⁴¹ since the President had a strong commitment to the high rice price policy. The rate of increase, therefore, was set high every year. As shown in <Table 3-7>, the average rate of increase in the 1970s was 22%. However, the rates of increase in the 1980s all reduced to a single digit and became stable, except for in 1981.

39. Kang et al (2008).

40. Kang et al (2008).

41. The Ministry of Agriculture and Fisheries naturally prefers policies that increase income in the agricultural sector and provide incentives to farmers, instead of policies that aim the price stability, reduction of grain management cost, and improved welfare for the people.

Table 3-7 | The Rate of Increase for the Rice Purchase Price

(Unit: %)

| | 1968 | 1970 | 1972 | 1974 | 1976 | 1978 | 1980 | Average |
|-------|------|------|------|------|------|------|------|---------|
| 1970s | 17.0 | 35.9 | 13.0 | 38.5 | 19.0 | 14.2 | 25.0 | 22.0 |
| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | Average |
| 1980s | 14.0 | 7.3 | 0.0 | 3.0 | 5.0 | 6.0 | 6.0 | 7.2 |

Note: 1) The rate of increase is from the previous year.

2) The average shows the annual average rate of increase for the relevant period.

Source: Kang et al(2008), *Policy Decision Making Process during the Rapid Economic Growth of Korea- The EPB and Policy Enforcement Organization*.

However, it was not easy for the government in the 1980s to reduce the rice purchase price at first. In 1981, the EPB proposed an increase of 10 percent for the rice purchase price based on research conducted by the KDI considering the wage increase for urban workers, inflation, and the deficit in the grain management funds. However, it was faced with many difficulties after the Ministry of Agriculture and Fisheries proposed a rate of 20 percent to improve the aggravated trade conditions between agriculture and the industries and to increase the income for farmers, and the opposition party proposed to increase the price by 30 to 45 percent. The ruling DJP, in particular, opposed not only the original rate of 10 percent proposed by the government, but also the revised rate of 12 percent and the final rate of 14 percent which was chosen.

Regarding the fact that Deputy Prime Minister Shin Byung-hyun changed his original position, where he strongly insisted that he would never change the rate from 10 percent, the members of the National Assembly demanded an apology from the Deputy Prime Minister for insulting the authority of the National Assembly; but compared to the wholesale price increase of 11.3 percent and the consumer price increase of 13.8 percent, a 14 percent increase in the rice purchase price could reduce the deficit in the Grain Management Special Account and could provide an opportunity to bring the rate of increase for the rice purchase price down to a single digit from 1982.

Table 3-8 | News Articles on the Purchase Price of Rice in 1981

Deciding the Government-purchase Price of Rice is Expected to Be Very Difficult [September 15, 1981, Page 1, The Dong-A Ilbo]

Decision on the government-purchase price of rice seems to be faced with more difficulties this year. This is because there is a high possibility of fierce conflict between the EPB who worries about wage increase, inflation, and widening of the deficit in the Grain Management Special Account and the Ministry of Agriculture and Fisheries who needs to consider the farming costs and the farmers' desire to increase production.

One of the officials from the Ministry said that the rate should at least be at the 20 percent mark to secure the farming costs for farmers.

KDI, the Dual Grain Price System Needs to Be Phased Out and the Rice Purchase Price Should Only Rise by 10 % [October 7, 1981, Page 5, The Dong-A Ilbo]

Korea Development Institute (KDI) suggested the rice purchase increase rate of 10 percent this year to the government. It also pointed out that the dual grain price system caused the grain management deficit of 435.8 billion won last year and it led to the increased issuance of currency and inflation. If the rice purchase price is increased too much, it will reduce the real income for farmers due to inflation and eventually this will hinder economic stability. KDI, therefore, argued that the increase of purchase price should be limited to 10 percent to stop those side effects. It also claimed that the dual grain price system should be phased out.

The DJP Proposed an Adequate Level of Increase for the Rice Purchase Price to the Government in the Executive Meeting of Government and Party [October 8, 1981, Page 1, The Kyunghyang Shinmun]

It is known that the DJP requested the government to increase the rice purchase price to a certain level despite some difficulties to maintain the economic boom in the rural areas considering the increase in farming costs. The government is known to have declined the proposal by the DJP and claimed that it was difficult to greatly increase the purchase price under the current fiscal situation.

The Democratic Korea Party Urges 45 % Increase for the Rice Purchase Price [October 13, 1981, Page 1, The Kyunghyang Shinmun]

On the 13th, The Democratic Korea Party (DKP) held a executive meeting and gathered its views to claim that the rice purchase price for this year should be 45 percent higher than that of last year.

A Counterattack against Policies to Contain the Purchase Price of Rice [October 13, 1981. Page 5, The Kyunghyang Shinmun]

The Ministry of Agriculture and Fisheries ordered the Rural Economic Institute to prepare an acceptable rate of increase that can best reflect farmers with appropriate measures for advertisement.

This movement can be interpreted as a counterattack against people who claimed that the rate of increase should be limited to 10 percent.

The People Demand a 30 % Increase for the Rice Purchase Price [October 23, 1981, Page 1, The Kyunghyang Shinmun]

The Korean National Party (KNP) held an executive meeting on the issue of the rice purchase price at noon on the 23rd and decided to urge the government to increase the rice purchase price by 30 percent from last year and to purchase the entire amount of rice that farmers demand.

No More Than 12% Increase for the Rice Purchase Price [October 28, 1981, The Dong-A Ilbo]

The Deputy Prime Minister and the Minister of the EPB, Shin Byung-hyun, stated that the government could increase the rice purchase price by a maximum of 12 percent and it is difficult to raise that rate from there at a breakfast meeting joined by party executives including the Secretary General of the DJP, Kwon Jeongdal. The Secretary General Kwon mentioned that 12 percent was not enough for the DJP to accept and requested the Deputy Prime Minister to again reconsider a further increase. Kwon provided the details of the meeting as such and mentioned that there would be no further negotiation and the decision to increase the price more than 12 percent now depends on the political determination of the high-ranking government officials.

The Government Decides to Increase the Rice Purchase Price by 14% This Year [October 30, 1981, Page 1, Maeil Business News Korea]

The controversial purchase price of rice has been set to increased by 14 percent from the previous year. The Minister, Goh Kun, stated that this year's rice purchase price was set higher than production costs although it is far less than the level that farmers wanted and it was possible because of the government's strong will for price stability.

Source: Naver News Library (<http://newslibrary.naver.com/>).

Although it was not easy for the government to implement policies for reducing the fiscal deficit as shown in the news articles, the government organically contained the increase of the budget, wage for public servants, and the rice purchase price, thereby laying the groundwork for fiscal soundness.

Table 3-9 | News Articles on Budget Freezes, Wage Freezes, and Government Purchase Price of Rice Freezes in 1983

Political Party on Frugal Spending to Join Effort with Government Budget Freezes [July 19, 1983, Page 2, The Kyunghyang Shinmun]

On the 19th, the Central Standing Executive Committee of the Democratic Justice Party (DJP) decided to save the party's expenditures as much as possible in response to the government decision to freeze budgets. As part of such an effort, the DJP required its representative members, the secretary-general, standing advisors, the vice secretary-general, and secretaries of public research centers to return their party-owned vehicles to the party and purchase them at their own expense.

The party also ordered an upcoming Deogyusan camping trip to be held in the most modest manner and required members themselves to prepare their own meals and snacks for the event, thus serving as exemplary cases.

First Surplus Government Budget Proposal Confirmed [September 22, 1983, Page 1, The Kyunghyang Shinmun]

The Economic Planning Board (EPB) announced that the top priority in 1984 would be to fully secure a solid foundation for our economic stability and this should be backed up by government fiscal plans. To that end, it stated that it froze the next year's budget at this year's level and prepared budgets to reduce the government bond issuance of general accounts, stopped taking out loans from the Bank of Korea for the grain fund and fertilizer accounts, made up for the shortfall in loans of fund management special accounts with the support of general accounts, and dramatically improved the unified fiscal balance.

Dream of High Yields Fade Away Against Government Stability First Policy - Government-purchase Rice Price/Volume Freezes and Challenges [October 19, 1983, Page 3, The Dong-A Ilbo]

This year's government rice procurement volume and prices appears to remain the same as last year's level. At the beginning, the government considered purchasing an additional 1 million suk (5 million bushels) at the request of farmers. However, it found it hard to surpass last year's level when taking into account the current fiscal conditions and the government storage capacity of grain. When a wide range of economic policies, such as the next year's budget and public officials' wage freezes, is seeking to stabilize the economy it would be difficult to show the flexibility only for the government grain purchase price and its volume. It remains doubtful whether the General Assembly's argument will be strong enough to win over the government's determination for stability.

Public Investment Institutions Also Froze Next Year's Budget [November 3, 1983, Page 1, Maeil Business Newspaper]

According to the Economic Planning Board (EPB) on the 3rd of November, a total of 24 public investment institutions, which received over 50% of their investments from the government, have also decided to apply the principle of an expenditure budget freeze and are working on the process.

Wage Freezes at Government-run Banks Next Year [December 23, 1983, Page 2, Maeil Business Newspaper]

Government-own banks, including the Bank of Korea, decided to freeze wage increases next year under the government's wage moderation policy. Furthermore, private banks, which had once planned to increase wage rates under the wage liberalization policy, saw their bank balances deteriorate, leading them to join this movement. Along with the government decision to freeze the wages of public servants, it has also set a policy that would restrain wage increases of the management at public enterprises in line with that of public officials.

Source: Naver News Library (<http://newslibrary.naver.com/>).

2.3. Medium-Term Fiscal Management Plan

The medium-term fiscal management plans refer to a system in which resources and distribution directions are planned according to three to five-year medium-term plans so as to overcome limitations of conventional one-year fiscal plans. Medium-term plans aim to improve the effectiveness of one-year budgeting systems.⁴² In terms of fiscal soundness, the budgeting process can be consolidated through a goal management approach in this new system. Especially, such medium-term systems help the government gain trust from both the public and the political realm over its policy efforts. Advanced nations such as the U.K and Germany adopted such systems a long time ago. In Korea, as well, the Economic Planning Board (EPB) has strived to establish medium-term plans since 1982.⁴³

Since the 1960's, Korea had established and operated five-year economic development plans. Between these five-year plans and yearly budgets, fiscal and institutional discrepancies existed, leading to mismatches between plans and actual budgets. These economic plans were more comprehensive than fiscal plans in that they involved all kinds of policy measures including government, private, financial, trade & foreign exchange, and industrial policies. Once a plan is set, its basics would remain unchanged during the planned years unless special circumstances arise. Thus, if the plan were not backed by proper funding, it would create a gap between the plan and the yearly budgets. Looking into the operation history of five-year plans, unlike the fiscal policies that were treated as part of macro planning such as fiscal savings and fiscal scale, the yearly budget needs were not reflected in micro investment planning. All this triggered structural disparities between the five-year plans and the yearly budgeting.

42. Ban (2003).

43. Cha and Kim (1995).

To address this gap issue, the five-year plan introduced an Overall Resource Budget (ORB) to serve as yearly plans. However, economic operation plans were devised based on macro planning and sectoral policies, and they were prepared after the passage of the budget. Thus, budgeting directions could not be given beforehand. For these reasons, medium-term fiscal plans were adopted in 1982.⁴⁴

With this new approach, resource allocation directions are presented beforehand from the macro perspective as they are prepared before March when the yearly budgeting guidelines are given. Based on such information, every agency first draws up and submits yearly budget proposals and the budget administration fine tunes the proposals. The government has made efforts to establish this medium-term plan system since 1982. However, the system has not been effectively operated. For 20 years, the government announced basic directions only once under Kim Dae-jung's presidency and the contents were insufficient.⁴⁵ Nevertheless, the scheme was meaningful in that it offered opportunities to the government to review fiscal management directions over the medium to long term, and the plans were used internally by the government that sought to maintain fiscal soundness.

2.4. Unified Budget Introduction

In 1979, Korea adopted a unified budget that included legal budgets such as general and special accounts, and funds according to the IMF recommendations. The decision aimed to analyze the fiscal effects on the public and enhance the effectiveness of the policy making by connecting fiscal plans with the public account.⁴⁶ To determine the effect that the national fiscal state has on the macro-economy, the entire budgets in fiscal plans need to be considered. This approach has benefits as it helps a government to see its national fiscal scale, funding, and fiscal impact on the economy and the public in a more systematic manner when compared to the central government budgets which center mainly around the general account.⁴⁷ Thus, the system laid the groundwork for Korea to understand its fiscal activities more comprehensively while managing its legal budgets all together.

The unified budget system expands the scope of fiscal rules in which expenditures should be kept in line with revenues. During the 1970's, based on the general accounts, it appeared that fiscal soundness was maintained except for two instances of fiscal deficits in

44. *40-year History of the Korean National Finance: Book Six* (1991).

45. Ban (2003).

46. Lee and Chun (2003).

47. *40-year History of the Korean National Finance: Book Six* (1991).

1972 and 1975. In terms of the unified fiscal balance including special accounts and funds, however, the government's budget was in the red during the entire 1970's; for instance, -1.0% of the GDP in 1970, and -4.6% of the GDP in 1972 ([Figure 3-5]). The new budget system is a system that offered more fiscal soundness by allowing the principle of austerity to be applied not only to the general accounts but also to the special accounts and public enterprise accounts. In addition, it enabled counter measures catering to each sector of the fiscal deficits to be put in place.

3. Success of Fiscal Stabilization in the 1980s

3.1. 1983 Budget Cut through Zero-Based Budgeting

Efforts were made to improve the content of defense expenditures and government subsidies while maintaining the existing allocation principles. For example, defense expenditures were planned reflecting the result of the inventory inspection and the self-budgetary reform of the Ministry of Defense. Among various projects of the Ministry, major ones had to readjust their budgets according to the priority and importance of the project while the rest reduced the budgets on average by 11% to the levels of 1982.⁴⁸ Furthermore, the government first applied the Zero-Based Budgeting (ZBB) system in 1982. In 1983, to make up for the weaknesses of the ZBB, standards for administrative expenditures were established and the public operating expenditure system was introduced, as well as reinforced inquiry standards for investment businesses. Consequently the austerity budget was implemented. In 1983, the budget for each expenditure item experienced a reduction ranging from 10 to 50 percent compared to that of 1982 (<Table 3-10>) and the annual expenditure budget increased by only 8.8% compared to the main budget of the previous year (11.8% to the supplementary budget).⁴⁹

48. Kang (1983).

49. *40-year History of the Korean National Finance: Book Six* (1991).

Table 3-10 | Budget Cutting by Means of ZBB (1983)

(Unit: million won, %)

| | 1982 | 1983 | Reduction Cost [%] |
|-------------------------------------|---------|---------|--------------------|
| Expenses (Foreign) | 13,681 | 11,789 | 1,892 (13.8) |
| Service Charge | 13,394 | 6,498 | 6,896 (51.5) |
| Current Subsidies to Private Sector | 163,194 | 135,862 | 27,332 (16.7) |
| Asset Acquisition | 31,641 | 26,146 | 5,495 (17.4) |

Source: *40-year History of the Korean National Finance: Vol3.*

Meanwhile, in 1983, the government allocated the budget with the two conflicting issues that needed to be solved. On the one hand, it had to curb financial expansion to lay a firm foundation for price stabilization; while on the other hand, in order to inject vitality into the contracted domestic economy, investing much more in public projects was a must. The government decided to achieve both the price stabilization base and the economic boost harmoniously by developing the ZBB further. Administrative expenditures were curbed except for the areas directly related to business and the livelihood of the public. While the public investment projects were launched as planned, new projects were limited strictly following their priority. Entering the year of 1980, despite the unclear prospects for tax revenues, the government reduced the corporate tax and income tax rate to around 20 percent to ease the tax burden. In 1983, it cut the rate further to 14.4 percent, thereby boosting the domestic economy.

Table 3-11 | Budget Growth Rate and Tax Burden Rate

(Unit: %)

| | 1960s (1962~69) | 1970s (1970~79) | 1980 | 1981 | 1982 | 1983 |
|--------------------|--------------------|--------------------|------|------|------|---------------|
| Budget Growth Rate | 28.9 | 28.1 | 28.4 | 21.2 | 15.8 | 8.8 (11.8) |
| Taxes Burden Rate | 37.6 | 33.0 | 22.0 | 24.7 | 16.0 | 14.4 |

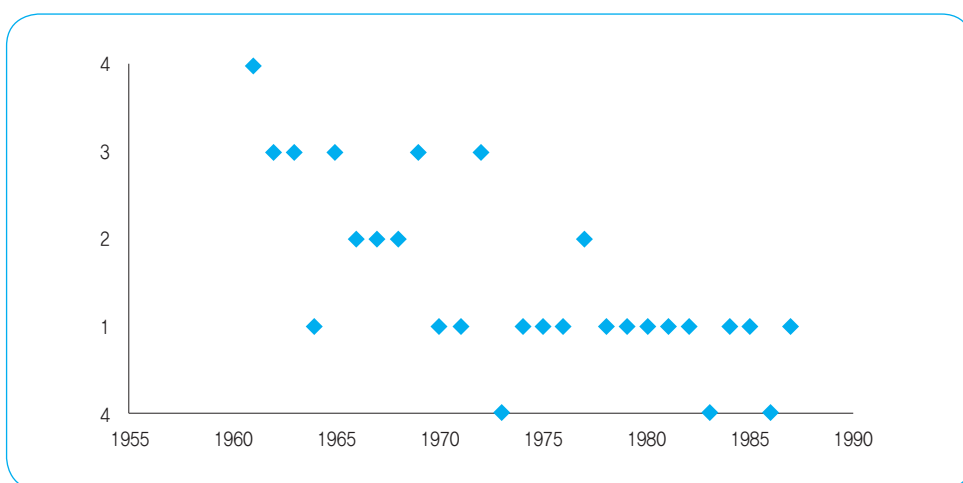
Note: Including Supplementary Budget in parenthesis.

Source: Kang (1983).

3.2. Reduction in the Compliance of the Supplementary Budget

In the 1970s during 10 years of rapid growth, there were as many as 12 supplementary budget allocations, while under the Roh TaeWoo administration, a supplementary budget was allocated seven times. Compared to two administration, the Chun, Doo-Hwan administration seemed to have a modest number of the compliance of supplementary budget during its seven-year regime: one reduced supplementary budget (1982) and four increased supplementary budgets ('81, '84, '85, '87). In 1984 and 1987 the supplementary budgets were secured from the annual budget surplus and used for disaster response expenses, focusing on the earliest redemption possible. In 1985, the government used the annual budget surplus from the previous year as the only source for the supplementary budget. The government successfully maintained fiscal soundness by implementing a reduced supplementary budget for the first time.

Figure 3-3 | The Number of the Compliance of Supplementary Budeget (each year)



Source: 40-year History of the Korean National Finance: Vol4.

3.3. Self Restraint of Government related to Monetary Expansion

Fiscal soundness improved significantly due to efforts of the government. The consolidated budget deficit reached a record high in 1981 and 1982. Since then, however, with increased tax revenues and improved management of the grain fund, the financial deficit started to decrease in a gradual manner. In 1987, Korean's balance of the consolidated budget turned in the black.

There are several ways the government changed the major means to cover the financial deficit. First, in the 1970s the biggest problem was the government's borrowing from the BOK. It resulted in the increased issuance of currency, which soared to 526 billion won in 1982 before it started to go down. Then, in 1984, the government implemented the budget freeze policy. The surplus from tax revenues was used to pay back the debt to the BOK. In addition, in the 1970s, as a similar measure to borrowing, the government issued national bonds to sell directly to the BOK. The total amount of the national bonds exceeded 1 trillion won in 1981 but went down after 1983. The financial deficit reduced further when from 1984 to 1986 the government paid the debt in national investment securities and grain fund bonds.

Table 3-12 | Consolidated Budget Deficit in 1980s

(Unit: hundred million won, %)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 |
|---------------|--------|--------|--------|--------|---------|---------|---------|---------|
| Deficit | 11,737 | 21,109 | 22,221 | 9,506 | 9,229 | 7,133 | 649 | -2,597 |
| Domestic | 8,560 | 15,779 | 15,463 | 5,517 | 6,134 | 2,727 | 2,109 | -2,699 |
| BOK Borrowing | 2,650 | 5,260 | 1,964 | 2,453 | -13 | -65 | - | - |
| Bond | 2,742 | 10,927 | 11,885 | 3,029 | -1,636 | -4,179 | -310 | 7,991 |
| | (23.4) | (51.8) | (53.5) | (31.9) | (-17.7) | (-58.6) | (-47.8) | - |
| Etc | 3,168 | -408 | 1,614 | 35 | 7,783 | 6,971 | - | -10,690 |
| Abroad | 3,177 | 5,330 | 6,758 | 3,989 | 3,095 | 4,406 | -1,460 | 102 |

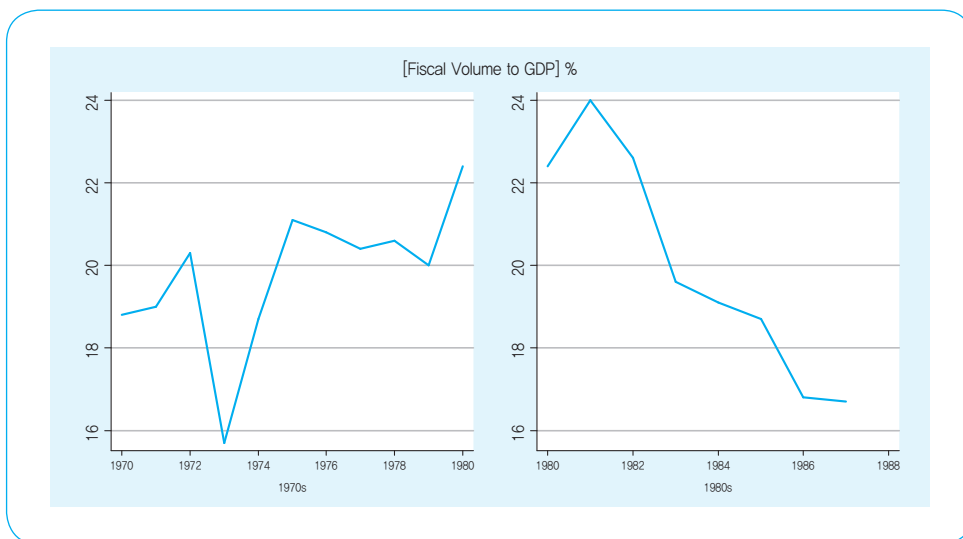
Note: Ratio bond issuing to consolidated budget deficit in parentheses.

Source: *40-year History of the Korean National Finance: Vol 7*.

3.4. Reduction in Public Expenditures and the Achievement of Fiscal Profit

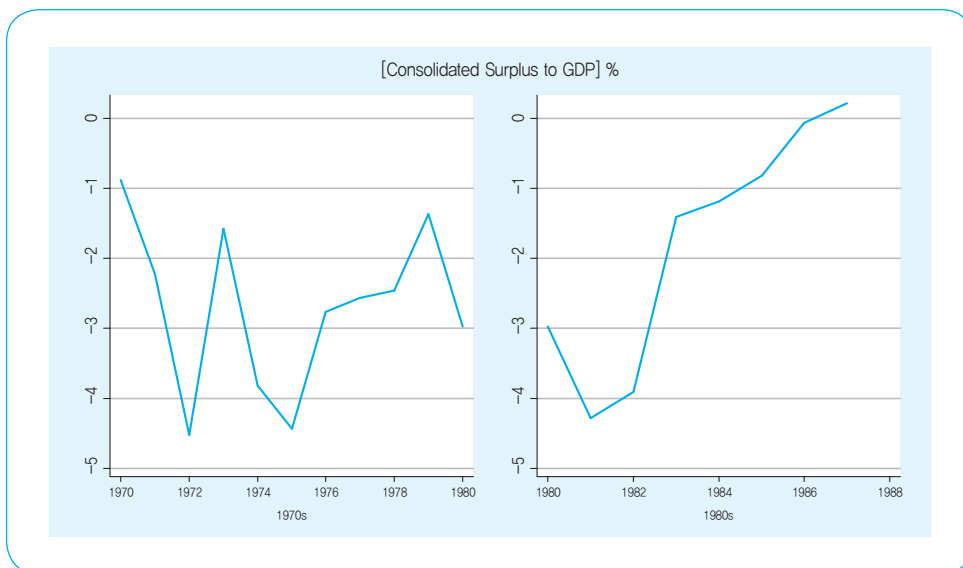
The government spending to GDP ratio increased from the mid-1970s to the early 1980s but from 1982, the ratio continuously went down. As a result, the government was able to decide to turn its fiscal expansion into the austerity budget ([Figure 3-4]). From the perspective of the consolidated budget balance, the government constantly decreased the fiscal deficit to GDP ratio from 1980 to finally achieve a fiscal balance surplus in 1987 ([Figure 3-5]).

Figure 3-4 | The Government Spending as percent GDP (Compared 1970s to 1980s)



Source: The Ministry of Strategy and Planning (<http://mosf.go.kr>).

Figure 3-5 | Consolidated Budget Surplus as a percent GDP (Compared 1970s to 1980s)



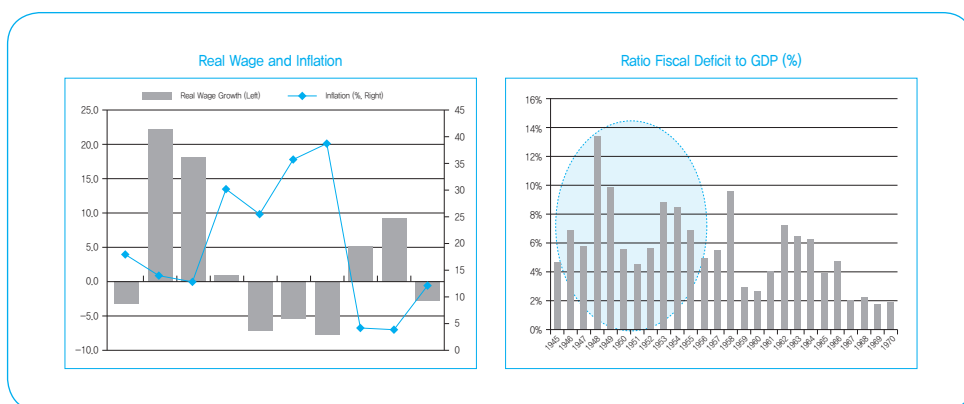
Source: *40-year History of the Korean National Finance: Vol 7* and The Bank of Korea's Economic Statistics System (<http://ecos.bok.or.kr/>).

3.5. Comparison to Authoritarian Regimes in Latin America

It can be argued that the fiscal achievements in the 1980s were only possible under an authoritarian government. To see if such undervaluation is justified, we need to compare the case of Korea to the fiscal management measures carried out under other authoritarian regimes. The authoritarian regimes in Argentina under Juan Perón and in Peru under Fujimori practiced populist policies. President Perón came to power in 1946 based on his individual popularity and support from industrial workers who were in conflict with agrarian landlords. He implemented various policies such as a wage increase for workers through cooperation with labor unions, expansionary fiscal policy to solve the wealth distribution issue, job creation by expanding the public sector, as well as the nationalization of banks, railroads, and universities. However, his policies caused a high budget deficit due to the excessive pursuit of the wealth distribution goal for workers, the strong supporters of his regime. As a result, the real wage growth rate was 20% during the first two years and inflation reached 38.7% in 1952 leading to workers' demand for higher wages.

In this regard, it is not reasonable to say that the strong power possessed by authoritarian regimes was the only driving force behind the success of stabilization policies. Korea's fiscal stabilization in the 1980s was successful because it included the right combination of an appropriate philosophy from the administration, the willingness of public officials to buy in, and the process of persuading the public to bear the burden.

Figure 3-6 | Macroeconomic Indicator of Peron Regime in Argentina



Source: Reme, Galatee (2010) Hwang et al (2011) cited.

2015 Modularization of Korea's Development Experience
Korea's Fiscal Stabilization Policies
of Transition Period Economic Policy in the 1980s

Chapter 4

Success Factors of Fiscal Stabilization in the 1980s

1. The Role of the Economic Planning Board (EPB)
2. The Role of the Supreme Leader
3. Communication with the Public

Success Factors of Fiscal Stabilization in the 1980s

1. The Role of the Economic Planning Board (EPB)

1.1. Technocrats during the Transition Period

1.1.1. Shin Hyun-hwak and Kang Gyeongsik

According to Kang Gyeongsik, who was then the Assistant Secretary of the EPB, ‘the Comprehensive Measures for Economic Stabilization on 17 April 1979’ was started when the report titled [Current Issues of the Korean Economy and Policy Measures] was submitted to Vice Prime Minister Nam Duck-woo. With the subtitle, ‘Tasks during the transition period’, this report made it clear that a major turn-around from the previous policies was necessary, along with changing the way of thinking, as the Korean economy was at a transitional period. The report pointed out that prices were the most urgent issue: a lack of supply in agro-fishery products and housing/construction materials caused inflation; the grain fund deficits, increased issuance of money in the foreign sector, and a lack of financial savings created excessive demand, increasing inflationary pressure; and the labor shortage and soaring living expenses raised pressure on wage growth. All these factors created the vicious cycle of inflation.

If the report had only been used internally in the EPB, it would not have led to the government-wide fiscal stabilization efforts. Fortunately, thanks to the work done by the new Vice Prime Minister, Shin Hyun-hwak, various policies emerged based on the report. Vice Prime Minister Shin had put forward stability policies in the midst of a number of advocates for rapid growth under the development oriented administration of Park Chung-hee. Shin

continued strongly pushing the necessity of downsizing the heavy chemical industry.⁵⁰ He also insistently demanded to reduce the scale of projects improve the housing conditions in farming and fishing villages even when the President expressed negative opinions about Shin's suggestion.

1.1.2. Kim Jae-ik and Moon Heegap

After the leadership change from President Park Junghee to President Chun Doo-hwan by military force, Kim Jae-ik, who had worked for the EPB, was appointed as the Senior Secretary for Economic Affairs. Gaining President Chun's trust, he was able to implement economic stability policies on a large scale. The government carried out stability policies as it realized that, in order to differentiate itself from the former administration, the mishaps experienced by the former government should not be repeated again. It was undeniable that Secretary Kim played a critical role with his clear and simple logic in persuading the President to have confidence in promoting stability policies.

Indeed Kim Jae-ik was a failure among the government officials before he became an economic tutor to Chun Doo-hwan. Since being appointed as the Director of the Economic Planning Department of the EPB by Vice Prime Minister Nam Dukwoo in 1976, Kim experienced a series of failures and frustrations in spite of ceaseless efforts to change his novel ideas into policies. He was like a lonely white heron, bullied by other officials.

Source: Lee Chang-gu (2014).

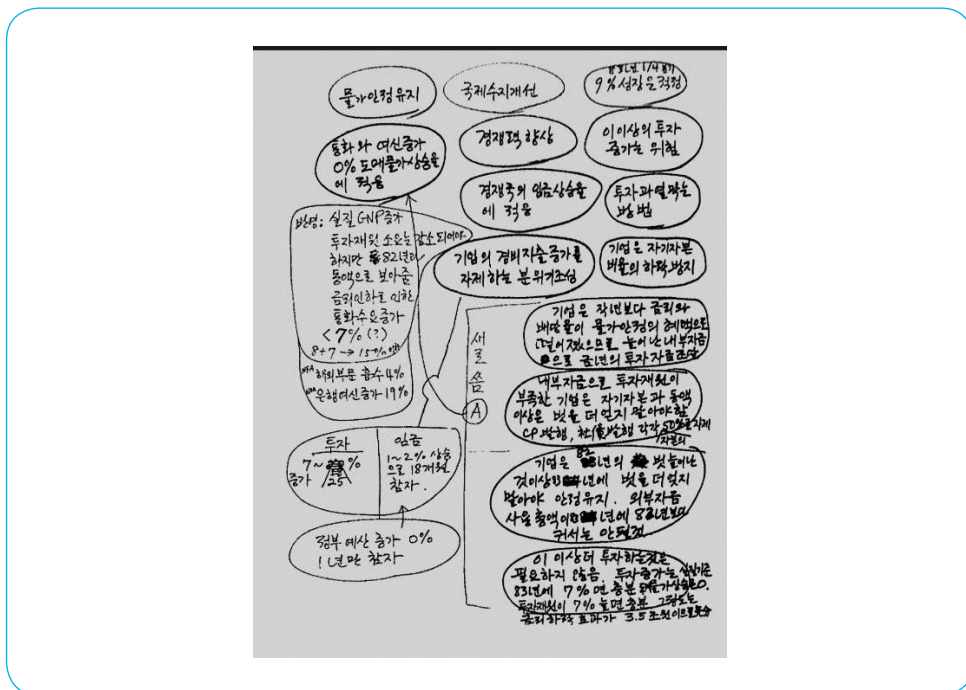
Kim Jae-ik believed that the bad practices of government spending should be corrected to achieve real price stability. That is why, when he was a member of the National Security Council, he attempted to insert a new provision into the Constitution to ban the government from borrowing money from the Bank of Korea (BOK). It was such a revolutionary idea to remove the fundamental reason behind the BOK increasing the issuance of currency by prohibiting the government from borrowing the money from the BOK in the first place.

As an alternative to borrowing from the BOK, he suggested a budget freeze; by freezing the budget to the level of the previous year, the increase in tax revenue could be the surplus to pay back the loans to the Bank of Korea.

50. Such firm stance made President Park think about a cabinet reshuffle. (Lee Chang-gu, 1991).

In the process of the budget freeze, Senior Secretary Kim had disputes with Cho Kyongshik, the Head of the Comprehensive Budgeting Department, who strongly believed that surmounting budget issues such as investment in social overhead capital (SOC) and the defense budget made a budget freeze impossible. Kim persuaded the President to replace Kyongshik with Moon, Heegap, together with whom he pushed forward the budget freeze policy. The new Head of the Budgeting Department successfully stabilized the fiscal conditions: road-related budgets were reduced to secure the defense budget to account for at least six percent of the total amount of the national budget; the ZBB and the Budget Deliberative Council were introduced. The whole process was not easy. A Brigadier General of the army once threatened Mr. Moon with a revolver because of the defense budget reduction. In 1948, with the general election ahead, the ruling Democratic Justice Party complained about freezing budgets. Moon responded to such rejections by actively participating in policy forums hosted by the press and other debating forums nationwide to elaborate on the budget freezing system and problems raised by the high rice price policy. By doing so, he tried to build a consensus with the public as well as with public officials and academics on why the budget freeze policy was inevitable.

Figure 4-1 | Senior Secretary Kim's Memo



Source: Lee, J.K (1991).

1.2. Legacy of the Government with Rapid Growth

1.2.1. Horizontal Debating Culture in the Economic Planning Board (EPB)

In the 1980s, the austerity fiscal policy and price stability seemed to be possible due to the continuing role of the EPB, which had been in charge of investments and financing for each economic sector in the 1960s and 70s to achieve rapid economic development. In particular, the introduction of the zero-based budgeting system to implement the austerity fiscal policy was such a huge change that it brought about strong resistance from every Ministry even under an authoritarian government. Therefore, for a soft-landing of this policy, such resistance needed be dealt with using logical persuasions based on rationality rather than authoritarian power. In the 1980s, the EPB had a unique organizational culture to encourage discussions, and adjusted budgets only through the Budget Deliberative Council. Furthermore, even under the military regime, not a single person with a military background was appointed to the EPB, and the Head of the Comprehensive Budgeting Department was appointed within the EPB. Such an open and democratic organizational culture contributed to achieving fiscal stability.⁵¹

The Budget Deliberative Council had the function of containing budget plans from different projects. In other words, to secure the planned budgets of own project is to cut the budgets of other budget planning officer, this process formed competitive structure. Under this backdrop, establishing a culture of horizontal discussion was helpful to see whether to spend their budgets and their to be valid enough or not.

1.2.2. Screening on the Investment Project

The purpose of screening the investment projects was to identify the most cost-effective projects. The government initiated the screening process in 1962 when the 1st Five-Year Development Plan was implemented. At that time, however, the screening techniques and methodologies were at their infant stages and the process was more like a quality evaluation to determine the extent to which a project would contribute to the policy purpose. Kim Jaehyung (2013) said that in the 1960s, the standards to screen investment projects were neither systematic nor quantitative enough to clearly determine the validity of projects.

Entering into the 1970s, however, more sophisticated screening systems were introduced as the scale of the investments grew much larger thanks to the rapid economic development

51. Ban (2003).

of Korea. Especially by the time the 2nd Economic Development Plan was established, government officials completed a training course for competent screening of investment projects offered by the Economic Development Institute (EDI) of the World Bank.⁵² It was a great opportunity for Korean government officials to be able to carry out the screening with advice from advanced foreign agencies or experts. In addition, they adopted the screening methodologies developed in advanced countries and revised them to create manuals⁵³ catered to the situation in Korea or to use them as a tool to determine the validity of projects related to the foreign loans.⁵⁴ Although the screening process was temporarily suspended around 1973, the government implemented the system in earnest in 1973, realizing that such a process should be put in place to re-evaluate the economic issues and economy-related policies.⁵⁵

According to Kim (2012), although the EPB worked hard to strengthen its screening function for investment projects, it basically followed the techniques and the methodologies established by the World Bank, failing to develop them further to cater to the situation and the economic model of Korea. Having said that, we need to give EPB credit since, thanks to its efforts, the screening system took firm root as an ordinary part of the process. This means the government agencies started to acknowledge that in order to receive their budgets, they should prove that the budget would be executed in an autonomous and effective manner. Going further, since 1982, each Ministry has been obliged to write and submit “an action plan for major tasks” based on the major work plan, the instructions from the President, and election pledges. The budget execution status needed to be reviewed and analyzed every quarter and the results were submitted to the EPB, which in return readjusted the plan in a comprehensive manner. For those projects lagging far behind their goals, the EPB analyzed the reasons and came up with measures to solve the problems.

1.2.3. The Principle to Limit Expenditures within the Scope of Tax Revenues

When we spend money, after considering the amount of money coming in, it is called revenue budgeting; and when we secure revenues after considering the amount of money to spend, it is called containing revenues within expenditures. In textbooks in Korea, it is taught that households should keep the rule of the revenue budgeting while the government must

52. *60-year History of the Korean Economy (2010)*.

53. The manual was written and distributed three times in 1970, 1972, and 1973. It helped to raise the level of understanding over the techniques and methodologies used to screen investments. In addition, not only the public but also the private sector showed improved capabilities when it comes to planning investment projects [Kim (2012), p. 22].

54. Kim (2012).

55. Kim (2012).

contain the revenues within expenditures. Things are different in reality. The government of Korea, except for during the Asian Financial Crisis, seemed to follow the principle of revenue budgeting. That was largely because in the 1980s, the EPB, which was responsible for budgeting, had to consult with the Ministry of Finance, which was responsible for the tax revenues, first to finalize the annual national budget allocation. In detail, the EPB identified all the demands requiring expenditures for the coming year while the Ministry of Finance screened projects using the national budget considering projected tax revenues. Revenue budgeting was considered a kind of a tacit principle to follow. For example, when the Blue House wanted to carry out a project, the first thing to consider was the possibility of securing tax revenue and the goal of the economic growth rate. Because increase in a number of projects is necessary to raise tax on firms and people. In general economy, raising taxes have a negative effect of growth. In a way, revenue budgeting was a tool to maintain fiscal soundness as expenditures within revenues is always accompanied with the possibility of a tax rate increase, thereby preventing deficits.

2. The Role of the Supreme Leader

2.1. The Continuation of the Policy

The political turmoil that started on the 26th of October in 1976 led to the incident on December 12th, followed by the Democratic movement on May 18th of 1980. The administrations in the 1980s centering on the new military regime could have tried a variety of radical policies thereby differentiating themselves from the previous ones in the 1970s and gaining legitimacy for the regime. Especially, repeating the economic strategy focusing on rapid growth must have been quite tempting as former President Park Jung-hee successfully employed the strategy before. Instead, however, the governments in the 1980s opted for economic stabilization policies, which had been put on the back burner in previous administrations. Thanks to such an economic paradigm shift, the governments could minimize possible economic turmoil.

Although not directly related, back in November 1979, the first President of the KDI, Kim Manje, tried to learn lessons from Spain and Portugal, which experienced a shift in economic policy direction after the collapse of their authoritarian regimes. There is not much left in the KDI archive, but according to a retrospective,⁵⁶ the KDI focused on political and economic changes in Spain that experienced extreme turmoil after the dictatorship,

56. Jung (2002).

which started in 1939 and continued for 36 years, finally collapsed. Following the death of the dictator, Franco, Adolfo Suárez from the Union of the Democratic Centre won the election and passed the Moncloa Pact. The Pact was meant to avoid a revolutionary reform, which could be carried out to deny the economic achievement from the dictatorship and to choose a gradual change in the economic and social policies beneficial to the nation and the public. The KDI believed that the case of Spain had implications for Korea. Considering the domestic circumstances after the incident on October 26th, if the regime change represented the cancelation of the ongoing economic policies, the public would bear the national loss and the burden from it. Therefore, the KDI argued that the existing economic framework should be maintained and, applying the same logic, the suspended 5th National Development Plan be put back on track.

The economic stabilization policy was once announced back in the 1970s but it failed, only bringing about confusions in policies among Ministries and strong resistance. This was mainly because the stabilization policy was not the one that could expect short-term achievement or support. Especially for the supreme leader who took office backed by military force, it must not have been easy to choose the stabilization policy failed by the previous government over the tempting populist policies and other policies with possible short-term achievement. Countries around the world have much to learn from the Korean administrations in the 1980s that made far different choices to those suffering from a fiscal crisis due to fiscal populism.

2.2. Followers of the Stabilization Policy

As mentioned earlier, the stabilization policy was able to proceed in a consistent manner thanks to Senior Secretary for Economic Affairs Kim Jae-ik, who served as the economy tutor of Security Commander Chun Doohwan and later successfully persuaded President Chun with his clear logic. He was often called an idealist since his ideas and policies were considered very unlikely and rarely put into practice; when it comes to policy implementation, it was very difficult for him to obtain others' confidence beforehand and people were always ready to go against his ideas. The budget freeze policy caused strong resistance from all of the Ministries and the wage freeze of the public servants sapped morale from public organizations. In addition, both the ruling and opposition parties opposed his policies because of the upcoming election and the farmers who strongly went against the limits on the increased rate of the government's grain purchase price.

Kim Jae-ik: If you promise one thing, then I will faithfully serve you as the Senior Secretary for Economic Affairs. Will you support my economic policies even when it's obvious that they will face strong opposition from people?

Chun Doo-hwan: You don't have to worry about that. You are the President when it comes to the economy.

Source: Lee Jangkyu (1991, p. 8).

In this respect, the willingness and the belief of the President, who pushed the stabilization policy, should be highly regarded⁵⁷ and even the military sector could not look down on the EPB, especially the budgeting office, as the President himself appointed and supported the officials for Economic Affairs.

Consequently, in the early 1980s, fiscal soundness was improved significantly due to various policies including the wage freeze for public servants, the deterrence of the government grain purchase price, defense budget cuts, ZBBS. The EPB pushed forward efforts for budget reform and fiscal soundness. The EPB as the national budgeting organization must have a centralized authority. Through reasonable decision making process, they must persuade or overwhelm against Ministry. Otherwise, budgeting organization compromise with the strong resistance that might arise among relevant Ministries and interest groups protecting their vested interests. Therefore, budgeting organization might choose a incrementalism that increase above the previous years' budgets.⁵⁸

2.3. Gwa-Mool-Tan-Gae (過勿憚改)⁵⁹ of the President

Back in 1982 when Major Yi Ung-pyong defected from the North, President Chun announced a plan to increase the pay for pilots as he believed in strengthening national defense and pilots who played a key role in national defense deserved to be compensated better. The budgeting authorities, however, opposed such hasty decision, persuading the President by saying that an increase in pay for the pilots was likely to lead to an increase

57. The decision of President Chun led to a radical transition from the state-oriented economic structure to the private-oriented one. It was only possible thanks to the confidence of the leader of the administration. It is all the more clear considering the fact that President Park failed to make the stabilization policy move forward for several years. The true determination of the leader is the first step for any great idea or policy which can lead to a fruitful result in reality (Kang, 2010).

58. Ban (2003), When the relevant Ministries, interest groups, or the political sector are too powerful, there is no other implement a budget reform.

59. A Chinese proverb that means "Should not be afraid to correct mistakes."

in all payments for the Special Forces including those for parachutists, explosive exports, and the UDT.⁶⁰ It was not easy for the President to admit his mistake and listen to opposing opinions, however reasonable the budgeting authorities' opinion was, because many leaders would have considered such advice as an insult to their sense of pride and the authority of the President.

President Park Jung-hee, whose regime continued for a full 17 years, showed a high level of understanding when it came to state affairs and was always very cautious, making few mistakes. Conversely, President Chun, when he first took office, had little knowledge about the economy as he came from a military background. He stopped ongoing projects after listening to the opinion of budgeting authorities. Some might say that such abrupt cancelations could be criticized as a lack of consistency from the government, and without consistency you cannot reinforce confidence in policies. But the President does not have to be adamant about an undesirable policy only to safe face.

3. Communication with the Public⁶¹

Unlike the administrations in the 1970s, the governments in the 1980s knew that any economic policy should be introduced with a proper explanation of its validity so that the public could be in support of the policy.⁶² When first implemented, however, such a public awareness system was not systematic enough. At its initial stages, on every approval documents was the order from the President, which was perceived as an absolute mandate to run the national economy and decide everything. But soon enough, the government recognized that such a unilateral method of communication would not work and devised measures to promote government policies cooperating with the media and national research institutes.

60. Lee and Chun (2003).

61. Kim et al (2015) elaborates the promotion, purpose, effect, and implementation process of the economic education in 1980s and 1990s.

62. Cho and Kang (2013).

Table 4-1 | News Articles on the Government's Economic Policy Promotion

The EPB Launched the Department of the Economic Promotion Planning [1982.01.08 1st page of Dong A Newspaper]

The EPB launched the National Economic Promotion Planning Team to raise public awareness on economic policies.

All Government Officials Planned to Complete Economic Education by February [1982.12.22 1st page of Maeil Business News Korea]

The government will carry out a three-stage economic education program targeting as many as 0.86 million government officials including all staff members of affiliated organizations. This education course, starting the 22nd of December and ending in February next year aims to help public officials better adapt to the fast changing economic landscape at home and abroad as well as realize the economic realities and the public economy in the 1980s.

Source: Naver News Library (<http://newslibrary.naver.com/>).

Economists belonging to national research institutes traveled nationwide to compile in-depth reports on the nation's economic status and made documentaries based on the reports, thereby raising public awareness on the economy and asking for public cooperation and understanding regarding the stabilization policies.⁶³

In addition, public officials joined live TV programs for policy debate in which they had heated discussions with college students, citizens, and even one-time anti-government activists, all of whom were highly critical of the government. Many government officials participated in the TV debate program and President Chun was also very interested in the program. He watched the program by himself and commented on it. The TV debate helped to significantly raise public awareness and it was necessary. The stronger the opposition and resistance from interest group on policies like the wage freeze, the more desperate it was for the government to have the support and understanding of the public.⁶⁴

There is also criticism that it was the authoritarian government's way of disguising its policy promotion with its control over the media in the 1980s. People criticize that for a good policy, the adjustment of financial demands from a number of social groups is necessary but an authoritarian government is unable to reconcile such an adjustment process and therefore communication with the public must be inadequate.

63. Jeong Inyeong (2002).

64. *60-years History of the Public Finance in Korea* (2011).

We should not overlook the fact, however, that in the 1980s, the government did its best⁶⁵ to explain the policy directly and distributed the related information understanding that it was the best way to manage the opposition from the public. The government in the 1970s used media outlets to deliver policy information to the public.

65. Reviewing the data prepared by the Economic Education Team, the President asked his security staff if he understood. It is to prepare the information easy to understand for the public, which was far different from the traditional way of promotion and highly regarded of [Kim(1999), p. 309, 311].

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of Transition Period Economic Policy in the 1980s

Chapter 5

Implications

Implications

Considering the political, economic, and social landscapes at the end of the 1970s and early 1980s, the changes in the major economic policy direction were only natural just like a car slows down before making a turn. To change the economic policy that lasted almost 20 years, however, was not as simple as making a turn. Therefore, we need to take a closer look at the policies implemented at that time and the behavior of the policy makers who implemented the policies. Korea was able to achieve high economic growth in the mid-1980s because the transition from expansionary fiscal policies into the austerity ones helped eradicate the chronic occurrence of price instability.⁶⁶ This research paper is not meant to deliver the measures and institutions adopted by Korea for the austerity fiscal policy in the 1980s to developing countries. It is wrong to encourage them to apply what Korea did in the past, because even Korea no longer uses such policies as its economic structure became much more complicated and the financial systems have evolved significantly. Nevertheless, there are some things that developing countries can learn from the case of Korea. It is undeniable that in the early 1980s in the midst of the economic crisis caused by the previous administration, along with the political and social turmoil, the government carried out the austerity fiscal policy, resulting in stabilizing prices and bringing about an economic boom

66. Some pointed out that in the 1980s, the spending cut of the Korean government brought about price stability and economic boost while lacking in the investment in the SOC and failing to better response to the economic fluctuation.[*60-year History of the Korean Economy* (2010) p. 406, *60-year History of the Korean National Finance* (2011) p.153].

in the mid-1980s. Based on the efforts made by the government and institutions, we can draw the following implications for the development of developing countries.⁶⁷

The Confidence and Sense of Mission as Public Servants

Each member of the policy making bodies should not pay too much attention to their external reputations or evaluations. In the 1970s, even when facing huge economic challenges due to inflation and the oil crisis, government officials failed to push forward the stabilization policy because they feared the reaction of the President. There were, however, some economic officials who realized that the hard-won economic achievement in the 1960s and 1970s could come crashing down overnight. If you are locked in a system only in pursuit of a short-sighted reputation and evaluation, you will never find ways to overcome these challenges. Korea, especially, was facing many challenges in the 1980s. The government took power using military force and due to the confrontation between the South and the North on the Korean Peninsula, the government needed to keep the defense budget at more than six percent of the GNP as promised to the U.S. In addition, with the introduction of the ZZB, there were more problems to be solved. The bureaucrats always resisted newly adopted policies. All of these challenges could turn into serious obstacles to the budget system reform. In authoritative regimes, the regime could easily push forward a policy using military power but in any democratic country these days, flexible and diverse views should be respected to the extent that everyone takes responsibility for their actions. That means personnel responsible for budgeting should have a strong sense of belief and duty and be brave enough to say “no” to irrational ideas including populist or showcase policies.

The Government should set a Good Example for the Public

The government in the 1980s successfully solved the fiscal inflation issue with the budget freeze and the wage freeze of public servants, showing the sacrifice needed to lead the public by example. The austerity policy carried out by the government inevitably contracted the economy, from which the private sector had to suffer the most. Therefore, the government had to show the sacrifice first for the companies and households to follow. Even if the government worked hard, the budget freeze would end up a failure only to bring about economic contraction if companies did little to save raw materials and maximize

67. Cho and Kang (2013) suggests the implications in the perspective of financial policy as below: 1) The channel through which the government borrows money from the central bank to cover the financial deficit should be cut; 2) The amount of budget should be according to the achievement for the projects; and 3) There should not be any special accounts. They should be consolidated to the general accounts, subject to the public monitoring on the government spending. This report suggests implications from the perspective of policy management.

business efficiency and households did not save much, failing to create industrial capital. The austerity policy must be started with the government's action to share the pain so that the private sector will do its best to follow the policy.

Reinforced Communication with the Public

It is undeniable that the rapid economic growth in the 1970s was attributable to President Park Jung-hee who took the initiative to carry out various economic development policies based on his strong convictions. The government in the 1980s, however, did not apply the same approach for economic development. Among many changes, it is notable that policy promotion to the public was no longer a one-way delivery to the public. It was transformed into a type of public education where the public could enhance their economic-related knowledge and the government could listen to the real opinions of the public. In a highly-advanced information technology era, one-way communication from the government could face strong public resistance. The government should build a strong sense of trust with the public by offering as much information as possible and improving the quality of its statistics.

Enhancing Assessment Capacity for Improving the Legitimacy and Efficiency of Distribution of Resources

The biggest challenge in allocating a tight budget in the 1980s was to screen the projects submitted by each government ministry and establish the budget proposals. Even with the Zero-Base Budgeting, estimating the implications of each project was not an easy task. Continuous efforts were required to enhance the investment appraisal capabilities since screening results might lead to complaints of the ministry whose project proposal got rejected as a result of an assessment and the resistance of local residents who have an interest in a project in question. Even an authoritarian government may mobilize the political tools to reverse the results of the appraisal because ministries under the authoritarian government have the same goal to pursue the projects continuously. Therefore, reasonable and objective standards for evaluation on each project should be adopted to respond to any types of political actions.⁶⁸

68. You can refer to KSP modularization project, led by Kim [2012] that explained the process and contents of structural reforms conducted by the Korean government in an attempt to effectively manage the public investment projects and analyzed the factors behind their success. Especially it provides the lessons that developing countries can learn from regarding the inefficiency of public investment management and the reforms and the adaption of the institutions.

To Admit when Making Mistakes and Righting the Wrong Promptly

In the year of 1980, President Chun took office with little knowledge about the national economy. When an austerity budget was being allocated, he approved government projects without sufficient discussion with the officials responsible for economic affairs. When a project was later found to be problematic, he admitted his faults and corrected the problem in a swift manner, without thinking of his pride or authority. If the President approves projects after they were rejected by the budgeting authorities, it remains elusive for the budgeting authorities to be able to maintain efficient financial management. If a national leader sits back and does nothing over a bad policy in order to save face, it can cause serious economic issues.

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