PART 2

EXPORT-ORIENTED

GROWTH

2. Export-Oriented Growth of Korea: A Possible Path to Advanced Economy

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EXPORT-ORIENTED GROWTH OF KOREA: A POSSIBLE PATH TO ADVANCED ECONOMY*

Within a quarter century, Korea transformed itself from a typical backward economy into one of the so-called NICs. This paper overviews the development mechanism of Korean economy since the early 1960s, examines the NICs phenomenon, and deduces possible lessons for other developing countries that might be willing to emulate the Korean experience in some way. [100]

1. INTRODUCTION

Within a quarter century, Korea transformed itself from a typical backward economy into one of the so-called NICs. Perfectionists might argue, in retrospect, that Korea could have achieved more ideal growth, avoiding the various undesirable distributional side-effects and concomitant social unrest observed in the country today. It is about time, however, to recapitulate the so-called NICs phenomenon and examine what lessons can be deduced for other developing countries who seem to admire the Korean experience as a model to emulate, at least in some way, if not in its entirety.

The main objective of this paper is to overview the development mechanism of the Korean economy since the early 1960s. Section 2 delineates the implications of *infant-industry promotion* in a developing country that pursues industrialization as a means of building an advanced economy. Section 3 summarizes the well-known characteristics of export-promotion-oriented (EP) and import-substitution-oriented (IS) regimes. Section 4 briefly summarizes the export-oriented high growth in Korea and Section 5 delineates the development mechanism which maintained such dynamism and high growth. Section 6 identifies some favorable elements that were conducive to the high growth performance of Korea, Section 7 examines the extent of market intervention by the Korean government, and Section 8 describes the progress of import liberalization in Korea. The final section gives concluding remarks.

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2. COMPARATIVE ADVANTAGE AND PROMOTION OF INFANT INDUSTRIES

Infant industries may be defined as *production activities* in early (infant) learning stages of trial and error which generate, for a limited period of time, substantial external economies that will accrue, mostly with some time lag, to those who are not the initial undertakers of such production activities. An industry stops being an infant industry when it stops generating external economies. Infant industries may also include exporting activities themselves because the activities of procuring commodities in domestic markets and selling them in international markets can generate substantial, time-limited external economies.

The case for time-limited government intervention during the early stage of such production activities is based on the possibility that the positive externalities generated from those activities may be large enough to more than recover the losses that the country suffers during the initial period of low returns.

On the basis of the Heckscher-Ohlin theorem, one may assume that a resource-poor developing country has a comparative advantage in labor-intensive production activities vis-à-vis advanced countries. If we further assume that the benefits associated with the production activities of infant labor-intensive industries (and/or exporting activities) mainly take the form of external economies, however, the so-called comparative advantage expounded by the Heckscher-Ohlin theorem becomes merely a potential advantage. Unless the government intervenes with tax-subsidy measures to take care of such external economies, this potential advantage will remain potential and will not materialize in the actual export pattern.

The promotion of infant industries is justified in principle by economic theories. Now the question in real world is how to promote them. For instance, the government may promote infant industries through outward-looking export-oriented growth strategy or through inward-looking import-substitution growth strategy. If the government decides to adopt the former approach, the promotion of infant exporting (sales) activities has to be included. Otherwise, domestically produced labor-intensive commodities may prevail in domestic markets but will not be sold in foreign markets. If the latter approach is adopted, however, then there is no need to promote infant exporting activities, because there is no plan, from the beginning, to sell them in international markets. In such a country, export marketing may stay in the infant stage indefinitely. In this case, even if by chance the country happens to produce some labor-intensive commodities at low cost, they are unlikely to be exported, because the people would not know how to sell them abroad. Keesing (1967) and Bhagwati and Krueger (1973) argue that such a country would, in fact, never be able to produce labor-intensive commodities at low cost. The potential comparative advantages will stay buried deep under the surface so that even very keen foreign buyers would fail to notice anything worthwhile for purchase from the country.

3. ADVANTAGES OF EXPORT-ORIENTED GROWTH

It is believed that under an EP regime, international competition forces domestic entrepreneurs to pay close attention to the possibilities of innovation and speeding up learning processes (see Keesing, 1967 and Bhagwati & Krueger, 1973). Exporting firms must face price and quality competition in international markets and consequently the survival and success of each exporter depend on active absorption of up-to-date production techniques and adaptive innovations based on imported technologies. Furthermore, the EP strategy naturally enables an economy to take full advantage of scale economies. Even when the initial markets are found at home, the physical layout of manufacturing activities is designed to permit ready exploitation of scale economies and an easy transition into export markets.[1]

Both the EP and IS regimes may be characterized by a mistrust of laissez-faire and free trade. International trade conventions, however, do not tolerate an extreme abuse of export subsidies, and hence arbitrary government intervention is more restricted in the EP regime. Apart from realistic exchange rates, EP can be sustained mostly by subsidies. Since the costs of excess export promotion are more visible, there are built-in forces against excessive EP. The costs of IS are borne by firms and consumers within the country and, hence, no obvious internal or external pressures emerge as rapidly when incentives are biased excessively toward IS.[2]

In a developing economy, import demand may mostly reflect locally

[1]Keesing (1967) notes that, under the IS regime, every industry is spurred to demonstrate its need to be sheltered from the cruelties of foreign competition, and eventually the country ends up with a system allowing each industry protection according to its inefficiency.

[2]In an IS regime, government officials have the power to remove or enhance domestic monopoly positions of firms and hence the firms can be subject to intolerable intervention in their decisions. But in an EP regime officials simply do not have the same degree of power over firms that are engaged primarily in export markets (see Keesing, 1967).

unattainable natural resources, skills, and technology. There may be a lack of substitutability of local resources for foreign-supplied resources, and hence even with an ample supply of domestic savings, the inability to pay for needed imports may severely limit economic growth. In such cases, an EP regime is believed to relieve the foreign exchange constraint on growth more readily than an IS regime. Furthermore, any industry which is promoted to become an export sector can automatically substitute its products for imports, but the reverse sequence does not readily follow.

Entrepreneurs in an export-oriented developing country learn at an early stage to cater to the discriminating tastes of the affluent consumers of developed countries, which encourages the entrepreneurs to seek front-line production technology with imagination and managerial acumen. As a result, the ability of these entrepreneurs to respond to new challenges and to transform themselves to meet the changing business environment is continuously cultivated and strengthened. The innovative entrepreneurial class produced under an internationally competing EP regime is believed to be more conducive to generating sustained high economic growth in the long run than the lackadaisical entrepreneurial class produced under an IS regime based on monopolistic rents. That is, the IS regime generates wrong kind of learning effects in the form of external diseconomies that lead entrepreneurs to overestimate the real rates of return on IS activities.

According to Corden (1971), opening up an economy to trade generates *static* efficiency gains which are very similar to *once-and-for-all* technical progress in raising the absorption-possibility frontier of a country at the given factor supplies.[3] Furthermore, given a constant propensity to save, the static efficiency gains will induce the rate of capital accumulation to rise and consequently will raise the growth rate of the economy. This effect might be described as the *induced growth gains* from trade. If investment goods were mostly imported, then the induced growth gains will also include reduced prices of investment goods. On the other hand, the opening-up to free trade may raise the rate of growth of an economy not only through static efficiency gains and the associated induced growth gains, but also by directly raising the country's propensity to save (see Hong, 1988).

In a macroeconomic framework of analysis, a country's chronic trade

[3]Should we postulate instantaneous structural adjustment, the static efficiency gains would materialize instantaneously. The opening-up of a semi-autarkic economy to semi-free-trade, however, may occur over an extended period of time. Then the static efficiency gains from the opening-up to free trade may materialize year after year over a long period of time.

deficit may be interpreted as reflecting the country's aggregate habitual overspending. Then one may well expect to cure the inveterate trade deficit by cutting back aggregate spending in relation to national income. However, if the quality of the country's products is so poor and their production costs so high that the country cannot sell all the surplus products (which are generated by a cut in spending) at international markets, then the unconsumed portion of national products will simply result in unintended inventory accumulation or a recession with nationwide excess capacity. That is, even with an increased rate of domestic savings, the failure to sell unconsumed products abroad would still result in a trade deficit that matches the unrealized sales (or unexpected lack of sales) abroad.[4] On the other hand, an EP regime can liberate the country's economy from the yoke of Keynesian unemployment because, unlike an IS regime, it can enjoy a virtually infinite effective demand for its products in international markets, and hence it can always enjoy nearly full employment, unless there is a world-wide recession. A small export-oriented country may be able to sell any amount of commodities it produces; that is, the supply capacity of the country will likely be the only constraint on the sales of its products.

4. EXPORT-ORINENTED HIGH GROWTH

The five-hundred year old Choseon dynasty was annexed by Japan in 1910, and Korea was subjected to the Japanese colonial rule until 1945. In its early phase of the colonial rule, Japan concentrated on exploiting Korea's traditional primary resources. Japan was content with taking rice and other primary products from Korea and selling all kinds of manufactured products, including various textile products, to Korea.[5] In the latter years of the colonial period, Japan had attempted to convert the Korean peninsula into a logistical base for the creation of the so-called Greater East Asia Co-

[4]One may now argue that devaluation might cure the problem. Such a view relies on the assumption that domestic prices are stuck at too high a level (i.e., resisting downward pressure) vis-à-vis foreign prices in the sense that exports are not selling as well as expected and markets are out of line. Exchange-rate changes, however, can in general only change prices of broad classes of importables in relation to exportables. We cannot rely on an exchange-rate change to sell specific commodities in foreign markets. Furthermore, the exchange-rate change in a small open economy may more likely be offset by an equi-proportionate inflation.

[5]Mason, et al. (1980: 246) note that "from 1910 to 1920, manufacturing activity was actively discouraged and new corporations were formed only with [colonial] government approval."

prosperity Sphere. As a result, there emerged a few light and heavy industries as well as some social overhead capital facilities in Korea. The handful of heavy industrial facilities and electrical power plants that emerged during the colonial period, as well as the important mineral deposits, were mostly located in the northern part of Korea. The southern part was dominated by agriculture and the manufacturing activities of a few light consumer goods. The Korean economy, which was initially designed as a colonial economy dependent on Japan and then further crippled by the separation of the North from the South in 1945, found itself fully engaged in reconstruction work in the wake of the Korean War (1950-53).

Korea in the 1950s, with a per capita GNP of less than $600 (in 1988 dollar prices) and more than two-thirds of its population engaged in the primary sector, possessed all the familiar characteristics of an extremely underdeveloped economy. With the energetic execution of export-oriented growth strategy since the early 1960s, however, annual commodity exports expanded from less than $30 million (of mostly primary products) in the 1950s to $60 billion (of mostly manufactured products) in 1988, and the growth rate of the Korean economy jumped from about 4 percent per annum on average in 1953-61 to about 8 percent in 1962-66 and to about 9 percent in 1967-88. The commodity-export/GNP ratio increased from less than 1 percent in 1960 to about 35.2 percent in 1988. Per capita GNP amounted to about $4,040 in 1988.[6] The proportion of persons employed in the primary sector declined from about 64 percent of total employed persons in 1963 to about 20 percent in 1988 (producing 10.8 percent of GNP), while that in the manufacturing sector expanded from about 8 percent to 27 percent (producing 31.6 percent of GNP in 1988). During 1963-88, the “gross” unemployment rate declined from 16.2 percent to 3.5 percent.[7]

Within a quarter century, Korea transformed itself from a typical backward economy to one of those so-called “NICs.” Following one more thrust and another quarter century, Korea may find itself transformed into a newly advanced economy.

[6]Average annual real wages in manufacturing declined from about $1.7 thousand in 1957 to about $1.5 thousand in 1966 in 1988 dollar prices, but then started to rise rapidly thereafter to become about $6.5 thousand in 1988. The real wage rate increased by about 7% per annum on average during 1967-88.

[7]“Gross” unemployment includes those who are employed for less than 18 hours a week, who amounted to 8.01 percent of total economically active population in 1963 and 1.0 percent of them in 1988.

5. DEVELOPMENT MECHANISM

A. The Mechanism of High Growth

Scitovsky (1985) observes that "all too often the industrialization of traditional agricultural societies merely transformed their failure fully to utilize man's latent energies — the so-called disguised unemployment — into open, urban unemployment, which is more painful and objectionable in social and human terms." On the other hand, excessive social welfare systems that have been enforced in many developed countries seem to have seriously reduced incentives to work and save, and furthermore weakened the traditional value given to harmony and cooperation among the members of families and of various social groups such as firms. Galenson (1981: 71) also emphasizes the fact that "there is no simple one-to-one relationship between investment and growth rates. . . high investment can be frustrated by erroneous policies in other respects."

The enormous potential in the energy and intelligence of human beings can be nullified and wasted by institutionalizing a system that would severely repress man's latent energies, or let each individual energy offset each other, or channel individual energies into the least productive activities. For an economy to achieve sustained high growth, it has to institutionalize a system that can, first, maximize the energy and effort of each individual member of the society, second, channel the individual energies into the economic activities most productive for the society as a whole and, third, maintain an autogenous dynamism.

This chapter contends that the economic success of Korea during the past 30 years has been due to the government's ability to (1) fortuitously or consciously identify the most productive forms of economic activities for the nation's economy, (2) institutionalize a system that maximized the energy and effort of each individual member of the society and channeled these mobilized energies into the clearly identified most productive and most dynamic activities and (3) maintain the new system, with continuous improvement, over a long enough period of time to bear tangible results.

For a resource-poor underdeveloped economy having one of the highest population densities in the world, the most productive economic activity is obviously international specialization in labor-intensive manufacturing based on the Heckscher-Ohlin theory of trade. Since export activities based on static comparative advantage also generate, as a byproduct, various dynamic learning effects, the static efficiency gains are augmented by dynamic learning gains. Due to externalities, however, these potential (static or dynamic) gains normally can not be realized without government intervention.

Of course one may not be able to say that the Korean government could, from the beginning, envisage all these possible gains from specialization and executed premeditated intervention into the market system. More likely, the government initially promoted *foreign exchange earning* activities from a sheer necessity to acquire scarce foreign exchange without knowing anything about the long-term consequence of such efforts. At any rate, the government was wise enough to recognize immediately unexpected gains in the form of massive employment opportunities created by labor-intensive export production activities, enhanced national output based on improved overall allocative efficiency, scale economies arising from mass production for the world market, and the tremendous learning effects arising from *forced* international competition in terms of quality, unit price, and marketing. As a result, a rather simple policy to promote *foreign exchange earning* became the august *export-oriented growth strategy.*

B. Concentration of National Energies: Export First

The ideology of “Export First” was established in the later part of the First Five-Year Economic Development Plan (FYEDP) period (1962-66) and was officially recorded in the Second FYEDP document (see p. 118). It was understood to imply that, apart from investment in a few key import-substituting industries and SOC facilities, all the efforts of the government would concentrate on the direct promotion of export expansion. The government mobilized four major policy tools — preferential tax system, preferential subsidy system (such as preferential rationing of bank loans and foreign exchange), discretionary trade system and administrative support system — to reward those who contributed to export expansion. As far as export activities were concerned, the government maintained a free trade system: the exporters were free to import any intermediate and investment goods needed for their production activities. The restrictive import system was applied only to consumer goods and materials imported for production activities oriented toward domestic consumption. Wealth accumulation through export activities was open to any one with potential entrepreneurial capabilities. Furthermore, those who contributed to export expansion were assured to be honored publicly, and export activities were elevated to the rank of patriotic activities.

The military government which was established in 1961 fully committed itself to the cause of industrialization and to breaking the vicious circle of poverty that had prevailed in the country for hundreds of years. Economic development was to be the principal outlet for the nation's energies and became the raison d'etre of the authoritarian regime of Chung-Hee Park (1961-79). Economic development was to be achieved through the promotion of key import-substituting industries, promotion of agriculture, investment in SOC facilities and, above all, the promotion of export expansion. To achieve the first three objectives, the government had to acquire investment fund and distribute them to selected projects. For the sustained expansion of exports, however, the government had to develop an outward-looking mentality and an export promotion system and had to firmly incorporate them into national economy.[8]

By the mid-1960s, government leaders and associated technocrats apparently had become fully convinced that the expansion of manufactured commodity exports was the only means available for Korea to achieve rapid industrialization and to take advantage of its only plentiful resource, labor. Though this course was chosen by the government, individual entrepreneurs were to be the vehicle for the actual execution of such industrialization efforts. As a result, it was decided that the only respectable entrepreneurs were those who contributed to export expansion, which would be the only way to contribute to the "fatherland."

Everybody was encouraged to join the export-oriented manufacturing activities which were almost non-existent in Korea prior to the 1960s. The government utilized a fairly objective measurable performance test (i.e., gross export performance) and various objective rewarding devices. Wealth accumulation through export expansion was admired and encouraged, while wealth accumulation through production activities aimed for only domestic consumption was despised. The small number of big businessmen who had already established themselves through the import-substituting activities of the 1950s were initially rather skeptical of the wisdom of export expansion efforts as a means of furthering their wealth accumulation and were apprehensive of the new system. However, there emerged a group of entrepreneurs who quickly established themselves in the new system, fully taking advantage of the new rules of the game. Some of the old big businessmen hesitated too long and ultimately perished, while the remaining ones changed their mind and joined the bandwagon. Since the export-drive was an open entry system, it fully mobilized the potential entrepreneurial

[8] It was recognized by the late 1960s that the development of the agricultural sector also needed more than investment funds, and as a result the so-called *New Village Movement* was introduced as an engine of rural development.

resources of the country.

The hitherto unemployed and underutilized human resources, i.e., unskilled labor, educated and talented labor and those with entrepreneurial potential, were channeled into export activities, and rewarded with employment at rapidly rising wage rates, with cumulating wealth and expanding business empires. The raw resources that were scattered throughout the country were organized and channeled into export expansion, industrialization and modernization. The plans for investment and production were masterminded by the government but were ultimately executed by the individual entrepreneurs. The masses were receptive to the whole scheme. The Korean government created an environment in which private incentives maximized the energies and efforts of individuals and also created a system that channelled the mobilized energies into the most productive activities.

C. Administrative Support for Export Promotion

In many underdeveloped countries, the most insurmountable obstacle to productive economic activities is often the existence of despotic bureaucrats. In Korea however, at least as far as export activities were concerned, the bureaucrats were by and large far from parasitic but were, rather, enthusiastic helpers.

Government bureaucracy has traditionally reigned over the common people and businessmen in Korea. Bureaucrats were the links between the government and the nation's labor force and businessmen. Although it has been criticized for corruption and superficial efficiency, the Korean bureaucracy has indeed been an effectively functioning institution, and the bureaucrats have energetically carried out the wishes of top decision-makers. The core of bureaucrats consisted of those who were dedicated to attaining the recognition of distinction and promotion, and the less ambitious bureaucrats were driven by this core group in the direction set by the top decision-makers.

Most Koreans would agree that the Korea's successful export-oriented growth was due in large part to President Park's leadership, determination and devotion to the cause of "nation-building by export." Since the president emphasized export promotion with such intensity and zeal, the relevant ministers, especially the Minister of Trade and Industry (MTI), were expected to show no less enthusiasm for the cause. The MTI declared export targets at the beginning of each year. If there appeared any possibility that the target would not be fulfilled, the MTI officials as well as other officials related with export administration worked to expedite the administrative process, to strengthen existing export support schemes, to innovate new subsidy measures, and to exert irresistible pressures on businessmen to accelerate exports even though it might entail losses. If all such efforts failed to achieve the target amount, MTI officials even tried to adulterate export statistics.[9] Such over-enthusiasm for export expansion apparently caused some losses, but it has kept fuelling the export-oriented growth process in Korea (see Hong, 1979: 58-59).

An indispensable prerequisite for successful export-oriented growth is the actual implementation of the strategy to obtain the intended effect. For one thing, the potentially despotic bureaucracy has to be converted from a handicap into an advantage to economic development. The low level bureaucrats in any country have a tendency to take administrative orders from the top decision makers ignoring the spirit underlying the orders. Therefore, in order to ensure the actual implementation of intended policy measures, Korea's top decision makers established a monitoring system that could help continuously solve the implementation problem. The system included a continuous contact and feedback mechanism between the top decision makers and the representatives of private entrepreneurial decision makers such as the Monthly Expanded Meeting for Export Promotion, and also continuous efforts to convert bureaucrats into enthusiastic assistants of export-oriented economic growth.

Officials in ministries related to economic affairs supervised private entrepreneurs and helped them to acquire investment funds, import necessary plant facilities and input materials, and expand exports. After retirement, many of these officials found themselves in the private sector serving those same private entrepreneurs and blending into the managerial class of the economy. Since most of these officials had to retire at an early age, it was often in their own interest to take good care of some prospective business employers while they were in a position to do so.

6. SOME FAVORABLE ELEMENTS

A. Abundance of Daring Entrepreneurs

[9]This tradition continued even after the Park era. For instance, the ship repairing business expanded rapidly since 1982, and the Korean government included all ships for repair in its (customs clearance) trade statistics. The repaired ships amounted to about $0.4 billion in 1981, $1.5 billion in 1983 and as much as $3.2 billion in 1985. The government at last decided to delete ship repairs in 1986 in order to restore public confidence in its trade figures.

The absence of capable indigenous entrepreneurs is often believed to be one of the most important causes of economic backwardness of a country. In Korea, a surprisingly plentiful supply of people with daring entrepreneurship appeared as soon as there appeared the somewhat exaggerated profit signals in export activities. Even more surprising was that many of these daring ones turned out to be really capable entrepreneurs. The business achievements of those successful entrepreneurs that appeared in Korea in the 1960s and 1970s are comparable to or might even excel any other group of successful entrepreneurs that appeared during a comparable short span of time in modern capitalist economies. The personal history of some of the present-day business leaders in Korea might be comparable to the feats of Andrew Carnegie, Henry Ford, Alfred Krupp, Konosuke Matsushita, etc.

The supply of entrepreneurship in a society does not seem to be fixed. The art of entrepreneurship can be learned. The developing countries seem to have enormous unexploited entrepreneurial resources which are wasted because of blatantly obstructive government interferences. Once the government provides an attractive outlet such as export expansion, people can quickly master the art of entrepreneurship. Somewhat exaggerated profit signals, market principle and competition may enable the mobilization of entrepreneurial potential of a country.

In the early phase of outward-looking growth, Korea's export activities depended heavily on subcontracting and consignment work for foreign corporations, U.S. mass buyers, Japanese general trading companies, joint ventures and foreign direct investment (FDI) firms. As time passed, however, the native entrepreneurs and trading companies learned the art of global marketing, and hence merged their production and sales activities. FDI firms were constrained by minimum export requirements and local-content requirements; and majority stock ownership by foreigners was discouraged whenever possible. Unlike Singapore, Korea has encouraged indigenous entrepreneurship over foreign entrepreneurship in undertaking the export-oriented growth.

Korean entrepreneurs learned that generous subsidies and other promotional schemes would be provided for production activities which the government wished to support, such as export activities, while various disincentives would be applied to non-favored activities. In the late 1970s, most of Korea's big businessmen, who had accumulated wealth from the production and export of light industrial products, willingly started to invest in heavy and chemical industries because the government wished to promote them as the new generation of major export industries. Compared to some advanced countries such as the present-day U.S., shifts from old, declining sectors to newly emerging ones seem to have caused relatively less friction and resistance in Korea. This was because in most cases the initiatives for such shifts were undertaken by the very entrepreneurs who had been engaged in the declining sectors.[10]

In Korea, a successful big business group usually owns, possibly as a result of scale economies in financial operations (or due to the snowballing effect of wealth accumulation), a large number of firms involved in various activities extending from exclusively import-substituting production to exclusively export-oriented production. As the emphasis of the government shifts from, say, the simple labor-intensive manufactures to the skill-intensive and more capital-intensive manufactures, the business group begins to adapt to this shift by investing in a new set of projects, reducing the relative scale of existing production activities and reshuffling workers accordingly. If such an adjustment does not occur, the chances are good that it will soon no longer be a successful business group in the Korean economy.

The ability of Korean entrepreneurs to adapt to changing economic variables and to venture into new activities has been a necessary ingredient for Korea's rapid economic growth. The mobilization of such entrepreneurship, however, was possible only through insititutional reforms enforced by the government.

B. People and Materialism

One might argue that the fundamental source of Korea's rapid growth can be traced to the strong material desires of the Korean people. Through domestic and international mass communication media and through various forms of direct contact, first the urban and then the rural people of Korea became aware of the material affluence of advanced countries. The traditional Confucian or Buddhist value system was rapidly destroyed. Conspicuous consumption became a fashion. The materialistic illusion of people seems to have reached its zenith: happiness is identified with material

[10]In a country where the entrepreneurs of declining industries and those of rising industries are more or less separated by the lack of mobility or imagination or by tradition or habits, structural adjustment causes much more friction and resistance on the part of the declining industries whose survival is at stake. If the leading entrepreneurs of a country remain rigidly entrenched in a particular set of industries regardless of the changes in comparative advantage and government policies, the shifts in industrial structure and resource allocation are more difficult than in a country where the same group of entrepreneurs are involved in both the declining and the rising industries.

affluence, or at least material deficiency is equated with misery. One may then conclude that, with the vast majority of people being intoxicated by such strong material desires, it would be rather strange if such a country does not achieve rapid economic growth, unless the government intentionally or unintentionally designs and institutes a frustrating economic system such that the energy of every person offsets each other (say, a selfcontained counteracting system).

Another basic source of Korea's rapid economic growth seems to be the Korean people's intense enthusiasm for education. Throughout the five-hundred year Confucianist Choseon dynasty, education symbolized the ruling class. With the introduction of a mass education system, anyone could emulate the traditional nobility. There has been an outpouring of zeal for formal education in Korea ever since the end of the Second World War, which apparently was conducive to generating a vast pool of literate workers by the 1960s and to fostering higher-level human capital formation in the following periods.

One remarkable characteristic of present-day Korean society is extreme social mobility. The ruling noble class of the Choseon dynasty was uprooted during the Japanese colonial period (1910-45). The traditional landlord class disappeared after the land reform that was enforced immediately after the Second World War. Furthermore, the entire society was shattered and reshuffled by the Korean War (1950-53). The period 1953-60 is often identified as the import-substitution-oriented period for the Korean economy, but it was too short a period to generate powerful vested interest groups entrenched in highly protected import-competing industries.

On the other hand, the most openly heard self-criticisms against the present-day Koreans are excessive individualism and the lack of professionalism, craftsmanship and lifelong devotion to any objective. If there is any grain of truth in these self-criticisms, it may have to be regarded as a temporary phenomenon of 20th-century Korea reflecting the lasting mental effects of the humiliation inflicted by the Japanese colonial rule, the separation of the northern part of Korea from the southern part since 1945, the devastating Korean War, and the haunting fear of another invasion from the North. However, the other side of the coin may present the strength of the contemporary Koreans: aggressiveness, an inclination toward (even the all-or-nothing type of) risk-taking, freedom from the self-imposed restraints of convention, a frontier spirit, and so on. Apparently these types of *animal spirits* cannot prevail indefinitely. As time passes, the scars that were inflicted on Koreans during the first half of the 20th century will be healed and the Korean people will recover their more conventional mentality. In the meantime, such an aggressive mentality together with high social mobility can be conducive to rapid economic development, more than offsetting the real or imagined shortcomings pointed out in the self-criticisms.

In a sense all the necessary ingredients for an economic *take-off* were present in Korea by the time President Park took authoritarian power. He then ruthlessly applied the *carrot and stick* method: generous rewards for export-oriented production activities coupled with a heavy-handed suppression of every other imagined or real distracting activity such as the pursuit of political democracy. The political outlet was blocked by the stick, and the only major outlet left for the people was the pursuit of material affluence within the sphere of government-promoted economic activities. However, for a people heavily infected by materialism, it was not extremely difficult to comply with the system.

C. The Balancing Forces

What businessmen want might be the same anywhere in this world: less taxes, absence of labor union problems, lower and less rapidly rising wages, low financial costs and protected domestic markets.[11] The leading businessmen in Korea as a group exercise significant influence on the government and it is only natural that they should always try to influence the government to get more of what they want.

In addition to the businessmen, there have always been very vocal (and quite heterogeneous) groups of quasi-intellectuals which also seem to have exerted some influence, though quite erratically, on government decision-making. These groups have maintained extremely critical attitudes toward almost every government policy. These quasi-intellectuals do not seem to have fixed ideas but ideas which change over time: arguing the virtue of self-sufficiency while the government pursues international specialization, preaching the minimization of dependence on foreign factors *à la* dependency theories while the government promotes export expansion and foreign capital

[11]For the influential big business groups in Korea which used to receive preferential treatment in credit rationing, there may be another dream: continuous preferential treatment, but in the name of *market principle*, without any further government interference in their investment and other decision-making activities. However, as far as the exchange rate policy is concerned, the big businessmen seem to have been divided into two different groups: a group which has heavily financed its investment activities with foreign loan funds, wishing to have an overvalued domestic currency, and the other group, engaged in export production activities and without heavy foreign borrowing, wishing to have an undervalued domestic currency.

inflow, proposing a more equal distribution of income and wealth while the government ignores equity problems, arguing for more expensive agricultural price support policies while the government tries to reduce those price supports, arguing the need to promote capital goods sectors as early as in the mid-1960s when Korea was expanding its labor-intensive consumer goods exports, arguing the need for balanced growth between agriculture and industry while the government emphasizes industrialization, arguing for the promotion of Western-style labor union movements and minimum wage legislation while the government wanted to have only a nominal labor union presence and to let wages be determined by supply and demand, arguing the need for more protectionist policies and import-restriction-cum-domestic-price-control instead of import liberalization, and so on. The Korean government could not really ignore all these critical opinions. Instead, many, if not all, of these ideas became consciously or unconsciously to be reflected in policy-making. After all, what we call "the Korean government" in abstract is far from a group of people with homogeneous opinions and beliefs.

Whenever the government tried to compliment itself for Korea's "successful" economic growth, these groups insisted that life in rural and urban slum areas had become much more miserable than before and that the rich had become excessively rich in the midst of mass poverty. These groups seldom seem to believe in any kind of published statistics and seem to rely mostly on their own personal experiences, intuition, inspirations and beliefs. Not infrequently their ideological background appears to be the Marx-Lenin-Mao line of socialism, Latin American dependency theory, liberation theology and belief in the superiority of an import-substitution-oriented semi-self-sufficient economy. Pushed to the extreme, the influence of these groups could have been destructive, but so far in Korea they seem to have served the government leaders as a source of reflection, humility, and relentless dynamism.

7. MARKET SIGNALS VS. GOVERNMENT INSPIRATION

One of the most conspicuous aspects of the Korean government was the relative youth of its top decision-makers. On the positive side, this youthfulness enhanced the government's dynamism; once a desirable policy was conceived, it was immediately enforced, and once the newly enforced policy started to reveal serious problems, it was immediately abandoned. The negative side of such flexibility was the waste resulting from too frequent use of the trial-and-errors process. On balance, however, flexibility, hindsight and adaptability seem to have contributed positively to rapid economic growth. After all, the Park regime, which initiated the First Five-Year Economic Development Plan without any idea as to the merits of an outward-looking growth strategy, established an "Export First" strategy with only a few years of development experience and, once convinced of its merits, adhered to the strategy.

There seems to have always been a latent aspiration in the minds of government officials that was to assume a more active and direct role in promoting the specific "key," "basic" or "heavy and chemical" industries. Instead of passively following market signals, the government officials wanted to select such industries with their own hands for the sake of their imagined merits in "strengthening the industrial foundation" of the Korean economy or for the sake of "leveling-up" the commodity composition of outputs and exports, whatever these expressions mean to the individual user of such expressions. The projects to be selected by the government were imagined to be associated with substantial external economies, and hence market mechanisms were not expected to realize the desirable allocation of investment funds for them. The government therefore intervened, without any objective measures of performance and of optimum magnitude of support. Furthermore, the "right" entrepreneurs who were to undertake the selected projects were also chosen by the "infallible" government.

With the beginning of the 1970s, the government started to enlarge its scope of selecting prospective industries beyond its traditional boundaries (i.e., cement, fertilizer, oil refinery and steel mill). Furthermore, the government began to assign the selected projects at an increasing rate to hand-picked entrepreneurs who turned out to be largely the proven winners in the export contests of the 1960s and partly a small number of political favorites not proven in any objective fashion. The export-promotion regime began to move away from the open-entry system, and the objectivity of the system started to erode rapidly. This led to the consolidation of the first generation winners, the concentration of wealth, and the establishment of a small number of big business groups.

Since the investments were increasingly undertaken not on the basis of direct market signals but rather on the basis of the inspirations of top decision-makers, the businessmen who were entrusted to undertake the actual investment activities could not be blamed for the possible poor performance in their assigned projects. Whenever a major failure occurred, the government-operated banking system had to assume full responsibility, defraying the losses which seigniorage and inflation taxes. The entrepreneurial risk was highly socialized and transferred to the general public. The rent income of the selected businessmen rapidly increased. And yet, the concentration of economic power in the hands of a small number of selected big business groups was justified in terms of the real or imagined scale economies.

The share of big firms (employing more than 500 workers) in total manufacturing value added increased from 37 percent in 1966 to 56 percent in 1977-81, and their share in total manufacturing employment increased from 26 percent in 1966 to 44 percent in 1977-78.[12] By the mid-1980s, the share of small firms (employing less than 300 workers) in total commodity exports of Korea amounted to only about 22 percent while that in Taiwan amounted to about 65 percent.[13]

Since GNP and real wages kept increasing rapidly in the 1970s, the undesirable distributional effects arising from the concentration of economic power could have been ignored. Since 1967, the unskilled labor force was rewarded with semi-full-employment and rapidly rising real wages.[14] By the 1970s, there was no more massive disguised unemployment in the traditional sectors which could be transferred to the expanding industrial and service sectors. The talented and educated workers were rewarded with rapidly rising efficiency rents and enhanced power in private business organizations. The chosen entrepreneurs were generously rewarded with snowballing business empires and rapid wealth accumulation. Entry into the ranks of the big business groups became tightly restricted.

Until the early 1970s, Korea's export-oriented growth strategy implied the promotion of various labor-intensive commodity exports. With the steady rises in real wage rates, the intensifying protectionist policies of developed countries, and the expected competition from the cheap labor of less-developed countries such as China, the Korean government recognized, as early as the beginning of the 1970s, the need to move its industrial structure away from the simple labor-intensive consumer good sectors and towards more skill- and capital-intensive sectors. In January 1973, President Park

[12] Due to the rapid rates of capital deepening in big firms, their share in employment started to decline since 1978, falling to the 35 percent level by 1986.

[13] Ministry of Trade and Industry, *Plan for Trade Sector*, in Korean, p. 34, March 1986.

[14] According to Korean manufacturing census data, although the total number of workers employed in manufacturing establishments with 5 or more workers increased from about 0.26 million persons in 1958 to about 0.57 million person in 1966, there was no increase in the real wage rate during 1958-66. This period may correspond to what Lewis calls the stage of infinite supply of labor at subsistence wage rate. During 1968-79, however, the number of workers employed in the manufacturing sector expanded by 9.5 percent per annum and the real wage rate (applying the GNP deflator) increased by about 6 percent per annum on average.

officially announced the Promotion of Heavy & Chemical Industrialization at his New Year's press conference. The selected sectors were the manufacturing of steel, non-ferrous metals, machinery, ships, electronics products and pertrochemicals as well as armaments.

In the late 1970s, the "Export First" policy came to include the vigorous promotion of heavy & chemical industries as well as shipping, armament plants and overseas construction sectors. However, the selection of new "winners" was largely made by the top decision-makers of the government while the actual execution of investment was delegated to the small number of chosen entrepreneurs. By the late 1970s, the mobilization of the labor force and investment funds had largely been carried out through the chosen big business groups. By the beginning of the 1980s, however, this investment decision-making system started to yield an alarmingly large number of failures. The reaction of the government was to divorce itself from the investment decision-making process. The professed government policies after the mid-1980s were to restrain the excessive concentration of production activities in the hands of a small number of big business groups and to "dig out" prospective winners among the small and medium-size firms. The export-oriented growth strategy of the Korean government in the 1980s apparently changed its emphasis, at least in terms of the slogans flooding the mass media, toward the promotion of "small & medium-sized firms," "skill- and technology-intensive industries," "machinery & parts industries," "frontier high-tech industries," and "R & D and technical progress."

In the 1960s and 1970s, it was the government that initiated export promotion and it was the government that promoted investment in heavy & chemical industries. In the 1980s, it was still the government that initiated the promotion of machinery & parts industries, small-scale industries, and R & D for technical progress. By the 1980s, however, the well-established big business groups began to invest heavily, on their own initiative, in the areas of basic electronics, automobiles & parts, and down-stream petrochemicals. That is, the big business groups became capable of making major investment decisions at their own risk and capable of raising a large proportion of the required investment funds by themselves.

Throughout the past 30 year period, Korean government has tried to take advantage of the merits of a competitive market mechanism as much as possible, though it has not hesitated to intervene heavily whenever it wanted to. In short, Korea has maintained a kind of "bounded market economy" in which the allocation of resources is heavily dictated by the government intervention and manipulation of market mechanism.

8. IMPORT LIBERALIZATION AND OPEN COMPETITION

During 1962-83, the export expansion of Korea was not accompanied by any extensive import liberalization. The government instead instituted a half-open economy by maintaining a semi-free-trade regime for export activities on the one hand but, on the other hand, providing protected monopolistic positions in captive domestic markets for the sectors that had scale economies. The threat to allow imports if the domestic prices of the protected industrial products went too far out of line had often been used to hold down domestic prices to near international levels and also to give less distorted profits signals to the entrepreneurs. Since 1984, the government has turned such random threats into a more systematic timetable for import liberalization.

Until the mid-1970s, Korea's industrial production and exports were dominated by final consumer goods whose production depended heavily on imported intermediate and investment goods. Hence market protection mostly entailed import restrictions on consumer goods at the expense of final consumers. This protection, as it turned out, was not fatal to the growth performance of the economy. After all, the quality of Korea's consumer goods rapidly and continuously improved because the lack of domestic competition was compensated for by the cut-throat competition in international markets. After the mid-1970s, however, the government designated a host of very capital-intensive heavy & chemical industries as a promising new generation of infant industries. Thus they were protected by severe import restrictions, and at the same time promoted as export sectors. Since Korea was not expected to gain comparative advantage in the production of many of these intermediate and investment goods for some time, there arose pressures for import liberalization and pressures for the Korean government to search for measures other than import restrictions to promote infant (intermediate and investment goods) industries, not so much to enhance consumer welfare, but to enhance the production efficiency and the international competitive power of Korean industries in general.

The newly established intermediate and investment goods industries had to supply most of their products to other domestic industries that were engaged in production for domestic as well as foreign markets. These end-users of domestically produced intermediate and investment goods, however,were better organized than consumers in general to mobilize a concerted effort against the protection accorded to the producers of intermediate and investment goods. Sellers' domination and uncontested protection rents tended to disappear in these sectors because their existed an equally (or more) powerful group which stood to benefit by eliminating import restrictions and allowing international competition. The export producers, in particular, wanted to acquire the intermediate and investment goods needed for their export production activities from the lowest-cost and highest quality sources, whether of domestic or of foreign origin.

During 1984-88, the Korean government raised the import liberalization ratio to 95.4 percent (from 80.4 percent in 1983). The simple arithmetic average tariff rate declined from 23.7 percent in 1983 to 18.1 percent in 1988. Breaking the tradition of chronic balance of payments deficits, Korea achieved a current account surplus of $4.6 billion in 1986 and the surplus, mostly arising from the U.S. market, increased to about $14 billion by 1988. U.S. pressure on the Korean government to completely open-up its domestic market grew immensely. Under ever-escalating threats from the U.S. government, the Korean government earnestly started dismantling non-tariff invisible trade barriers in 1988. The overall import liberalization ratio is scheduled to grow to 97.3 percent in 1991. Korea's domestic market for manufactured products is to be completely opened by 1991 and the average tariff rate is scheduled to be reduced to the OECD level by 1993. Even the import liberalization ratio for agricultural and fishery products is scheduled to increase from 71.9 percent in 1989 to 82.5 percent in 1991, leaving only 264 items subject to import restriction (based on a 10-digit Harmonized system classification).

Most developing countries, by pursuing import-substitution-oriented growth strategies, do not allow open international competition either in domestic markets or in foreign markets. Japan has encouraged its industries to engage in fierce international competition in foreign markets but has not until recently allowed an open international competition in its domestic markets. Korea, by pursuing export-oriented growth strategy, has encouraged its industries to participate in open international competition in foreign markets. Furthermore, by drastically liberalizing manufactured imports during the period 1984-89, Korea has also allowed open international competition in its domestic markets. At a relatively early phase of growth (compared to Japan), Korea has decided to promote its infant (intermediate and investment goods) industries thought tax-subsidies only, allowing international competition in open domestic markets.

The evolution of Korea's import-restriction system suggests that an EP regime is much more conducive to early import liberalization than an IS regime. Due to enhanced foreign exchange earning ability and export-oriented industrial characteristics, once domestic savings cease to impose a severe constraint on growth, an EP regime can afford to reduce or dismantle its import-restriction system much more rapidly than an IS regime. At any rate, the adverse efficiency impact of protection in an EP regime is much less serious than in an IS regime because the firms at least have to compete in the international market.

9. CONCLUDING REMARKS

Broadly speaking, there have been two different approaches in analyzing "the NICs phenomenon" that may be defined as "the transformation of an economically backward society into an advanced one in relatively short span of time." One approach emphasizes the non-reproducible character of the NICs phenomenon.[15] This approach gives credit to a NIC's uniqueness (say, of the experience of Japan) in terms of culture or racial elements, or the specificity (say, of the experience of Korea) in terms of a massive foreign aid program, successful land reform or extraordinarily large military establishment that cannot be easily repeated elsewhere.[16] The other approach stresses the commonality in the merit of "outward-looking" and "export-oriented" policy measures based on static and dynamic comparative advantages. This approach emphasizes the general applicability of the strategy of export promotion of labor-intensive manufactures in resource-poor developing economies in their early phase of growth.

Our approach is rather to focus on the basic nature of the mechanism of sustained high growth in the export-oriented developing economy. We contend that the outward-oriented growth strategy is more than a simple unbiased trade regime with minimal or neutral government interventions. That is, we contend that, due to externalities and the associated market failures, the latent comparative advantage in labor-intensive manufactures

[15]The approach that emphasizes the limited relevance of NICs experience "is congenial to those who wish to promote the cause of increasing international aid or of introducing land reforms in other developing countries." It is also comforting to those who find outward looking economic policies "unpalatable on political or ideological grounds because these policies rely too much on the use of the market mechanism and private enterprise and entail too great an involvement with foreign trade and foreign investment." Quotes are from Myint (1981: 110).

[16]By being engaged in a real battle for survival against communist North Korea, Korea could not postpone comprehensive land reforms. Furthermore, in order to maintain its huge military establishment, Korea has spent an average of more than 5 percent of GNP (taking about a third of government expenditures) per annum on defense. As far as foreign aid is concerned, quite a few developing countries received amounts of foreign aid similar to those Korea received in the 1950s.

would not assert itself in a developing economy, particularly in its early phase of growth, simply by the removal of trade distortions.

Korea, like many other developing countries, had a vast supply of educated, hardworking human resources. With these resources, Korea instituted a controlled but competitive market system that maximized the energy and effort of individual citizens and implemented policies and regulations that channeled the individual energy into the most productive activities for the nation's economy: i.e., outward-looking, export-oriented activities. As a result, the Korean economy integrated itself into the world economy, taking full advantage of its abundant human resources. With a tolerably correct system and with a tolerably correct set of policies, Korea captured a singificant portion of international markets. As Korea's exports expanded rapidly, its foreign exchange earning and the productive employment of its human resources expanded rapidly. Most important, there were tremendous dynamic learning effects arising from international competition.

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