THE RUSH TO DEVELOPMENT

ECONOMIC CHANGE AND POLITICAL STRUGGLE IN SOUTH KOREA

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CHAPTER 1

ACKNOWLEDGING THE PRIMACY OF STATE INTERVENTION

South Korea's reputation for economic success is based on a record of sustained economic growth and industrialization which few countries can match. Making this record even more impressive (and South Korea an even more attractive model for other countries), is the fact that before the early 1960s South Korea was itself a poor country on the verge of becoming poorer. As a way of introducing the South Korean experience and providing background for the discussion to follow, I offer below a brief overview of South Korea's industrial transformation.

U.S. advisors to the newly established South Korean government began with high hopes for the country's future. Tony Michell, an economist who has worked as a consultant for the South Korean Economic Planning Board and has written about the country's economic rise for the International Labor Organization, describes early U.S. thinking as follows:

> From 1949 onwards the United States encouraged the idea that the Republic of Korea could become a model of capitalist development, it would be successful not only economically but also socially and would provide objective proof that capitalism is more effective than socialism.[1]

But by 1960 most U.S. policymakers were prepared to give up on South Korea, calling the country a "hopeless case."[2] South Korea was then still largely a rural and agriculturally based country. Only 24.4 percent of the population of 24.9 million lived in cities of over 50,000 people. Agriculture accounted for almost 40 percent of Gross Domestic Product (GDP) and employed approximately two-thirds of the work force. The population was also poor. Designated as a low income country by the World Bank, South Korea had a per capita income of $82 (in 1960 prices), approximately the same as estimates of the Japanese per capita income in 1868 (also in 1960 prices).[3] This per capita income placed South Korea below Ghana, Senegal, Liberia, Zambia, Honduras, Nicaragua, El Salvador, and Peru.[4]

South Korea's economic weakness at this time is probably best highlighted by the country's international trade position. Imports of goods and services equaled 13 percent of Gross National Product (GNP), while exports of goods and services were equal to only 3 percent of GNP. Moreover, reflecting South Korea's limited industrial base, almost 90 percent of exports were primary commodities: agricultural, forestry, and fishery products (56 percent) and fuels, minerals, and nonferrous metals (30 percent).[5]

The country's large trade deficit was covered and economic growth was sustained only because of massive U.S. aid which financed approximately 70 percent of South Korea's total imports between 1953 and 1962.[6] With the U.S. government determined to reduce its aid to South Korea, it is not surprising that most U.S. economists had a pessimistic view of South Korea's economic future. South Korea's situation had been even more discouraging when compared with developments in North Korea, which had, at that time, grown rapidly.

Beginning with Park Chung Hee's May 1961 military coup, however, South Korea's economic conditions began a dramatic turn around. Within twenty years, according to World Bank rankings, South Korea rose from a low-income country to the top third of all middle income countries. Its per capita income in 1980 had risen to a level three times the average of the above-mentioned four African countries and more than two times that of the four Latin American countries.[7]

The following tables, drawn from World Bank data, help illustrate the enormity of this economic achievement.[8] Table 1.1 shows South Korea's rapid growth in production. We can see that its rate of growth of production in all categories was significantly faster than the average rate of growth for all middle income oil importers. Table 1.2 shows the enormous impact this growth had on the industrial structure of the South Korean economy. In fact, by 1980 South Korea had

TABLE 1.1
Growth of Production
(by percent)

	Middle-income oil-importing economies	*South Korea*
GDP		
1960-70	5.8	8.6
1970-80	5.6	9.5
Agriculture		
1960-70	3.5	4.4
1970-80	2.8	3.2
Industry		
1960-70	7.8	17.2
1970-80	6.6	15.4
Manufacturing		
1960-70	7.5	17.6
1970-80	6.2	16.6
Services		
1960-70	5.7	8.9
1970-80	5.7	8.5

Source: *World Development Report*, 1982.

a structure of production close to that of the average for all middle-income oil-importing countries. Not surprisingly, such changes also affected the occupational status and geographic location of the great majority of South Korean citizens. Table 1.3 highlights the rapid employment shift out of agriculture and into industry. Table 1.4 shows the resulting urbanization of the population.

Exports of manufactures were the driving force behind South Korea's rapid industrial transformation. The country's export success is highlighted by the comparative figures presented in Table 1.5. The shift in the composition of trade to manufactures can be seen in Table 1.6. Finally, Tables 1.7 and 1.8 show that even though South Korea's economic performance slowed in the 1980s, it continued to exceed the average gains made by both middle- and upper-middle income countries in production and exporting.

By 1985, South Korea had, as shown in Table 1.9, achieved a

TABLE 1.2
Structure of Production:
Distribution of Gross Domestic Product (by percent)

	Middle-income oil-importing economies	South Korea
Agriculture		
1960	23	37
1980	15	16
Industry		
1960	32	20
1980	37	41
Manufacturing		
1960	23	14
1980	23	28
Services		
1960	45	43
1980	48	43

Source: *World Development Report*, 1982.

level of per capita GNP greater than that of the four larger non-East Asian "newly industrializing countries" (NICs) and considerably above that of the average for middle-income countries. In fact, South Korea's GNP in 1985 was larger than that of half the members of the Organization for Economic Cooperation and Development (OECD), the influential grouping of the twenty-four most advanced capitalist countries.[9]

While South Korea's overall level of development is still below that of most OECD member countries, its relative international standing in terms of GNP, industrial production, and trade volume is now widely recognized. As a result, the OECD is actively considering South Korea for membership. If the offer of membership is made, as many expect it to be, and accepted, South Korea would become the organization's first new member since 1973.[10]

The economic record presented above, although one-dimensional and one-sided, shows why so many analysts and government leaders consider South Korea to be a model of successful development. Equally significant, the great majority of these analysts and

TABLE 1.3
Structure of Employment:
Labor Force Distribution (by percent)

	Middle-income oil-importing economies	South Korea
Agriculture		
1960	59	66
1980	42	34
Industry		
1960	16	9
1980	22	29
Services		
1960	25	27
1980	36	37

Source: *World Development Report*, 1982.

TABLE 1.4
Urbanization

	Middle-income oil-importing economies	South Korea
Urban population as percent of total population		
1960	37	28
1980	50	55
Average annual growth rate		
1960-70	4.2	6.4
1970-80	3.8	4.7
Percentage of urban population in biggest city		
1960	28	35
1980	28	41
Percentage of urban population in cities of over 500,000		
1960	36	61
1980	48	77

Source: *World Development Report*, 1982.

leaders are convinced that South Korea's success is due to the government's faithful application of free-market, free-trade policies. Because this interpretation of the South Korean experience is almost universally accepted—and wrong—I conclude this chapter by presenting and then refuting conventional market-based explanations for South Korea's economic accomplishments.

The Conventional Wisdom: Market Power

Most economists attempt to explain South Korea's achievements by comparing the common economic policies and success of South Korea, Taiwan, Singapore, and Hong Kong with the common economic policies and difficulties of Brazil, Mexico, Argentina, and India. The four East Asian NICs are viewed as countries that have grown rapidly because they followed a strategy of export-led development based on free-market, free-trade policies. The non-East Asian NICs, on the other hand, are considered to have failed to develop because they adopted an inward-looking, import-substitution industrialization strategy, based on state regulation of domestic and international economic activity.

For example, after examining "why the economic fortunes of Latin America and Asia have diverged so dramatically," the *Far Eastern Economic Review* concluded that:

> there is now a near-universal realization by Latin Americans themselves that their problems were rooted in a tolerance of high inflation, their championing of import substitution rather than export-led growth [as in Asia], and the adoption of a large role for the state.[11]

Before critically examining this conventional wisdom, we consider an influential study, *Adjusting to Success: Balance of Payments Policy in the East Asian NICs*, by two well-known economists and international advisors, Bela Balassa and John Williamson. This study, which compares the performance and policies of the four above-mentioned East Asian NICs with those of the three Latin American NICs and India, finds that the East Asian NICs have far out-performed the other countries in both GNP and per capita GNP growth rates. Moreover this success was associated with extremely rapid export growth.

TABLE 1.5
Growth of Merchandise Trade:
Average Annual Growth Rate of Exports (by percent)

	Middle-income oil-importing economies	*South Korea*
1960-1970	7.1	34.1
1970-1980	4.1	23.0

Source: *World Development Report*, 1982.

TABLE 1.6
Structure of Merchandise Exports:
Percentage Share of Merchandise Exports

	Middle-income oil-importing economies	*South Korea*
Fuels, minerals, metals		
1960	14	30
1979	10	1
Other primary commodities		
1960	10	56
1979	20	10
Textiles and clothing		
1960	16	8
1979	8	31
Machinery and transport equipment		
1960	29	—
1979	29	20
Other manufacturers		
1960	31	6
1979	33	38

Source: *World Development Report*, 1982.

TABLE 1.7
Growth of Production:
Average Annual Growth Rate (percent)

	Middle-income economies		*Upper-middle-income economies*		*South Korea*	
	1965-80	*1980-87*	*1965-80*	*1980-87*	*1965-80*	*1980-87*
GDP	6.2	2.8	6.7	3.4	9.5	8.6
Agriculture	3.4	2.5	3.4	2.6	3.0	4.4
Industry	6.0	2.9	5.8	3.7	16.5	10.8
Manufacturing	8.1	3.0	9.2	4.1	18.7	10.6
Services	7.3	3.1	8.2	3.8	9.3	7.7

Source: *World Development Report*, 1989.

For example, the East Asian NICs' share of third world exports of manufactures rose from 23.8 percent in 1963, to 45.9 percent in 1973, and to 53.5 percent in 1984. Over the same period, Latin American NICs registered only a slight gain from 7.8 percent to 12.2 percent. India suffered the biggest single decline, with its share of exports falling from 19.5 percent in 1963 to less than 3 percent in 1984. South Korea's record perhaps best illustrates the export-led rise of the East Asian countries. In 1963, South Korea accounted for only 1.1 percent of all third world exports of manufactures, a level exceeded by all of the non-East Asian NICs. By 1984, however, South Korea had an export share of 18.1 percent, placing it far ahead of all those countries it had previously trailed, and second only to Taiwan which had an export share of 18.8 percent.[12]

What determined the economic success of the East Asian NICs and the failure of the others? According to Balassa and Williamson, it was differences in policy choices by the respective governments. In short, the former countries were practitioners of neoclassical thinking—reliance on free markets and free trade—while the latter were committed to statist policies. More specifically, the following policies are seen by the authors to have been critical in accounting for the differences in economic performance:

1. East Asian governments neither promoted or discriminated against export activity. "In contradistinction to most developing countries, including the large Latin American countries (with the partial exception of Brazil) and India, the East Asian NICs have not discriminated against exports. Rather, on the average, they have provided similar incentives to sales in foreign and domestic markets."[13]

TABLE 1.8
Growth of Merchandise Trade:
Average Annual Growth Rate of Exports (by percent)

	Middle-income economies	*Upper-middle-income economies*	*South Korea*
1965-80	2.4	1.0	27.2
1980-87	5.5	5.6	14.3

Source: *World Development Report*, 1989.

TABLE 1.9
GNP Per Capita
(in current U.S. dollars)

	1980	*1983*	*1985*	*1987*	*1989*
Argentina	2390	2070	2130	2390	2160
Brazil	2050	1880	1640	2020	2540
India	24	260	270	300	340
Mexico	2090	2240	2080	1830	2010
Middle-income economies	1580	1310	1290	1810	2040
South Korea	1520	2010	2150	2690	4400

Source: *World Development Report*, various issues.

2. East Asian governments created a stable economic environment. "The stability of policies in the East Asian NICs meant that exporters could make plans for the future with confidence."[14]

3. East Asian governments limited their interference in economic activity. "More generally, the scope of administrative controls was much more limited in the four East Asian NICs than in Latin

America and, even more, India. In the latter case, there were pervasive controls on investment, prices, and imports, and decisions were generally made case by case, thereby creating uncertainty for business and opportunities for corruption, which has remained comparatively limited in East Asia."[15]

4. East Asian governments did not allow the creation of powerful trade unions or become involved in excessive labor market regulation. "In contrast, labor unions were powerful and labor markets extensively regulated in Latin America (rather less so in Brazil) and in India."[16]

5. East Asian governments refrained from overregulating capital markets. "Capital markets, too, were freer in the East Asian NICs than in Latin America and in India."[17]

6. Finally, East Asian governments followed conservative, anti-inflationary fiscal policies. "Fiscal policy presents another contrast between East Asia and Latin America. Fiscal prudence has augmented domestic savings, has avoided a need to resort to the inflation tax, has contributed to the maintenance of moderate but positive real interest rates, and has dampened the sort of fears that helped fuel capital flight in Latin America."[18]

If one principle stands out in the above presentation of policy differences between countries, it is the role of the state. In East Asia, states are alleged to have confined their activities to creating an attractive and stable business environment for entrepreneurs. Supposedly free capital and labor markets gave these entrepreneurs the ability to respond to international market signals, thereby enabling each country to take advantage of its international comparative advantage and begin a process of sustained export-led industrialization. In the case of the less successful NICs, states are said to have attempted to shape and control economic activity to the detriment of their respective economies.

This belief that the economic record shows that success depends on the free workings of market forces as opposed to active state planning and economic intervention is held by the great majority of economists. For example, in a comparative study of Japan and the Asian NICs, E. K. Y. Chen argues that in all of them, "State intervention is largely absent. What the state has provided is simply a suitable environment for the entrepreneurs to perform their functions."[19]

The economic experience of the East Asian NICs is also advanced to discredit those who would support socialism over capitalism as the preferred engine of growth for the third world. Mainstream economists have mistakenly confused Marxist theories of imperialism with the position that third world economic problems can be completely explained by the degree to which a country is integrated into the global capitalist system. This position was at one time popular in many countries, especially in Latin America, where many intellectuals believed that sustained growth and industrialization was impossible as long as a country remained part of the international capitalist trading system.

On the ideological defensive for much of the 1960s and 1970s, mainstream economists now confidently argue that the historical record summarized above proves this anticapitalist position, and thus the Marxian critique of capitalism, to be false. The Latin American NICs and India (and to an even greater extent the former socialist countries of Eastern Europe) pursued development through active state policies designed to limit the role of domestic and international market forces. Their economies have performed poorly. The East Asian NICs pursued development by freeing up market forces to participate more effectively in the world capitalist system. Their economies have grown rapidly. End of argument.

The ideological importance of the East Asian success is real. Drawing strength from their economic record, free-market theorists are battering down all opposition. If free-market policies are at the heart of the East Asian success, then, according to these theorists, any country willing to embrace similar policies can also expect to enjoy success. As Donald Keesing, writing in a World Bank working paper, makes clear:

> application in new settings of the combination of what is now known and recommended—particularly in countries well along in the process of development—gives very encouraging results, even if it does not turn other countries into success stories on the same scale as Korea.[20]

There seems to be an amazing consensus concerning the reasons for economic success and failure. Yet, as we will see next, this received wisdom, which identifies economic success with free-market, free-trade policies and economic failure with active state economic intervention, seriously misrepresents reality. The following brief overviews of the role of the state in South Korea and Taiwan show that while both countries have export-driven economies, in neither country has the decision to focus on exports or the allocation of capital to sectors or firms primarily been market determined; economic activity in both countries has largely been planned and driven by a powerfully organized state apparatus.

In fact, based on the experiences of these two powerful East Asian NICs, it is more likely that the economic problems of Latin America and India are the result of insufficient or ineffective state regulation of capitalist activity rather than overly aggressive state intervention. This is an especially important conclusion in light of current developments in Eastern Europe and the countries of the former Soviet Union, where many policymakers advocate dismantling all state controls over credit allocation, trade, and investment in order to follow what they incorrectly believe to be the East Asian path to success.

The Challenge to Conventional Wisdom: An Overview of the State in the South Korean Economy

In South Korea, as in Taiwan, the state, rather than market forces, has played the central role in structuring the economy and shaping growth. As Alice H. Amsden effectively demonstrated in her book, *Asia's Next Giant: South Korea and Late Industrialization*, South Korea is a country "that grew very fast and yet violated the canons of conventional economic wisdom."[21] Amsden's important contribution to the literature on South Korean development was to show that the major post-1961 investment and resource allocation decisions that powered South Korea's industrial transformation were made by the state, not private entrepreneurs, and in response to state-formulated growth priorities, not profit-maximizing market signals. Furthermore, production itself was highly centralized as a result of state policy and organized by a few large family-owned conglomerates called chaebol.

Control over the country's financial system has been the single most important factor enabling the state to successfully direct the economy. One of Park Chung Hee's first acts after taking state power in 1961 was nationalization of all major commercial banks. Government planners were then able to use their control over both the allocation and cost of capital to direct firm activity into areas considered strategic for industrial development.

By the mid-1960s, the government decided upon exports as a priority activity for all firms. This emphasis was hardly a response to an individual firm's profit-maximizing behavior. As Byong-Nak Song, an economist with experience at both government planning agencies and research institutes, explains:

> Under the government export promotion strategy, "survival of the fittest" among competing firms was not determined in the marketplace, but through discretionary government actions. "Fitness" was judged in terms of the ability to expand exports, rather than based on profitability. If determined "unfit," firms were likely to face bankruptcy. Such firms were under constant threat of tax investigations and other punitive sanctions. On the other hand, firms that efficiently used their government-backed loans to expand exports were implicitly considered fit and favored with even further support.[22]

The government's commitment to exports did not, however, signify a commitment to free-trade principles. The state made regular use of a variety of techniques to control and limit imports. For example, all importers had to be licensed by the government, and permission to import was usually granted only under terms that specified type and quantity of product and often restricted the country of origin. Even goods listed as "automatically approved" for import were subject to a maze of special laws, regulations, and hidden taxes which the government used to restrict their entry. The effectiveness of these controls is highlighted by the fact that in 1990 less than 3 percent of South Korean imports could be classified as luxury goods.[23]

Equally important, government export promotion was undertaken as part of a comprehensive effort to promote national industrial development. While most international development experts routinely advise countries that they must choose between either an export-oriented or import-substitution-oriented development strategy, South Korea has used both strategies simultaneously. The government regularly targeted new areas for development by encouraging the establishment of domestic firms to replace imports. These new firms were protected by both trade restrictions and strict limits on foreign direct investment and, when judged capable, were required to export as well as meet domestic needs.

An excellent example of this development approach was the government's 1973 program to establish new heavy and chemical industries for both import-substituting and export-generating purposes. The government directed firms into these targeted areas with, among other things, subsidized capital. Subsidized loans grew from approximately 30 percent of total credit over the 1965-70 period, to over 43 percent over the 1971-75 period, to an estimated 80 percent of manufacturing loans in 1978.[24] The government's success is illustrated by the fact that these newly established industries not only reduced the country's dependence on key foreign imports, they also increased their share of total exports from approximately 13 percent in 1970 to nearly 60 percent by 1985.[25]

The government was also not hesitant about undertaking key investment activities itself, through public enterprises, as in the case of petroleum, chemicals, and iron and steel. As a result, investment in public enterprises rose from 19 percent of total investment in 1970 to over 33 percent in 1975.[26] That year, in fact, twelve of the sixteen biggest firms in the country were government owned.[27] And, in contrast to the claims of most mainstream economists, the government's activities regularly pushed its budget into deficit.[28]

The government did eventually decide, as part of its heavy chemical industrialization program, that production should be primarily carried out by private firms. The resulting market environment, however, has little in common with mainstream visions of free-market competition. As part of the decision to establish new capital intensive industries and launch new exports in areas such as automobiles, shipbuilding, and computers, the government selected a small group of chaebol to dominate production. Supported by government licensing and credit subsidies as well as foreign trade and investment restrictions, the combined sales of the top ten chaebol relative to GNP soared from approximately 15 percent in 1974 to over 67 percent by 1984.[29] By 1988, the combined revenues of the top four chaebol—Samsung, Hyundai, Lucky-Goldstar, and Daewoo—equaled approximately 47 percent of Korea's total GNP.[30]

Finally, the South Korean government supported the rapid

growth of the chaebol and exports through a highly interventionist labor policy. To create a low cost but productive labor force, workers were kept disorganized and on the defensive for most of the 1960s and 1970s by government control over the only legal labor federation; a maze of ever more restrictive labor laws; and increasingly violent intervention into labor disputes by the Korean Central Intelligence Agency and special labor police. Government efforts to contain growing labor militancy in the 1980s were expanded to include frequent mass arrests and several major military assaults against workers, twice involving tens of thousands of riot police in combined air, sea, and land operations.

In summary, South Korea's rapid export-driven growth is not the result of free-market, free-trade policies, but rather effective government intervention in all aspects of the economy, including market entry and exit decisions, the allocation and price of capital, international trade and investment decisions, and labor market conditions. As we will see next, the same is true about Taiwan.

The Challenge to Conventional Wisdom: An Overview of the State in the Taiwanese Economy

The general picture of state involvement in economic affairs in Taiwan is similar to what was described in South Korea. But Taiwan's specific experience differs from South Korea's largely because the Taiwanese government and ruling Kuomintang Party (KMT) were dominated by Chinese who fled the mainland in 1949 and not by those Taiwanese who were already living in Taiwan. Fearful of sharing economic power and thus undermining their own political power, the national Chinese ruling elite chose to emphasize direct state production rather than the promotion of Taiwanese-owned conglomerates.

As a result of this policy, state enterprises accounted for almost 57 percent of industrial production in the early 1950s. Although that percentage has steadily declined to its present value of 20 percent, state production still dominates the country's strategic industries, including petroleum, steel, railways, electric power, shipbuilding, and telecommunications. A true picture of the state-party hold on the economy, however, also requires including the economic contribution of some fifty important companies owned in one form or another by the KMT itself. Combined state and party assets have been estimated as being equal to approximately half of the country's total corporate assets.[31]

The government also controls the financial sector through its ownership of almost all the country's banks. According to Robert Wade, an expert on the Taiwanese economy, "even as late as 1979 the four private banks had only 5 percent of the deposits and branches of the commercial banks as a whole and the biggest of the private banks was only nominally private."[32] Operating through this state-controlled system, the Central Bank of China has been able to direct the greatest share of funds to the large state and party-owned enterprises; state enterprises alone received some thirty percent of all bank loans in 1983.[33]

The government has used its enormous economic power to aggressively transform the country's industrial structure. Activity in the 1950s was organized around state and mainland import-substitution activity protected by closed markets, subsidized credit, and sectorial allocation of foreign exchange. Industries developed during this period ranged from textiles and apparel to cement and fertilizer. When the Taiwanese government began promoting exports in the early 1960s, it continued, much in the same way as South Korea, to advance a complementary import-substitution program. For example, it continued its promotion of petrochemicals and directed the establishment of basic metals production, aluminum production, shipbuilding, automobile production, and nuclear power.

In the 1970s, the government launched a second import-substitution drive to create the infrastructure necessary to support new, more technologically advanced firms. The ten major projects included new state-owned shipyards, petrochemical facilities, and an integrated cold-rolling iron and steel mill. The government also increased its support for production of precision engineering products, electrical and nonelectrical machinery, and metal manufacturing. State initiatives for the 1980s included modernization of telecommunications, upgrading of textile, auto, and computer production, and semiconductor development.

Exports have, of course, played a leading role in spurring Taiwan's growth. They were encouraged by the government in two different ways. By deliberately denying the great majority of small- and medium-sized Taiwanese businesses access to credit or the domestic market, the government left these businesses with no choice but to export. At the same time, the government actively used tax, labor, and credit policies to attract export-oriented foreign multinational corporations. In fact, the Taiwanese government often combined these two approaches by actively encouraging the creation of OEM ("original equipment manufacturer") arrangements which had Taiwanese firms producing products to be marketed by foreign buyers such as K Mart, Sears, IBM, and General Electric.

As with South Korea, however, support for exports did not mean that the Taiwanese government operated on the basis of free-trade principles. Only exporters have enjoyed a relatively open trade regime, normally being allowed to import the equipment and materials they need at world market prices. More generally, the government has used an extensive system of trade management to control imports.

All imports are classified into three groups: prohibited, controlled, and permissible. The controlled list includes luxury goods, goods subject to government monopoly procurement, and goods considered important to national security. Such goods cannot be imported without prior government approval and licensing. Goods not labeled prohibited or controlled are considered permissible and, theoretically at least, automatically eligible for an import license. However, even permissible goods can be restricted, often on the basis of both country of origin and importing agency. One mid-1970s study found the following goods listed as permissible but restricted in their import because of origin restrictions: yarns, artificial fibers, fabrics, some manufactured foodstuffs, chemicals, toilet preparations, machinery, and electrical apparatus. These were, of course, all products currently being produced in Taiwan.[34]

Even permissible goods that meet origin and agency restrictions can be restricted. All import requests must be referred to the Industrial Development Bureau which operates a hidden list system based on government priorities for national industrial development. If the import in question is considered likely to undermine national industrial policy, the government can simply refuse to grant a license. Domestic producers of petrochemicals, chemicals, steel, and certain machinery and components have all been protected in this way. Imports in these areas are allowed only if the government is assured that domestic firms cannot deliver the product within reasonable specifications of quality and price. If such a situation is found to exist, the government will also normally take action to upgrade domestic production.[35]

Finally, the government has also actively intervened in the labor market. To ensure that all firms, but especially foreign multinational exporters, have access to low-cost labor, the state enforced a highly restrictive labor code which denied the right to unionize to almost 80 percent of the work force; established and tightly controlled the only legal labor federation; and, governing under conditions of martial law until 1987, outlawed all strikes.

As in the case of South Korea, the Taiwanese experience described above is hard to reconcile with mainstream pronouncements that growth was the result of the operation of free labor and capital markets, free trade, and minimal government intervention into economic affairs.

First Lessons

Both South Korea and Taiwan are market economies in the sense that most production is organized by private producers in pursuit of individual profits. But, in both countries, control over credit, market entry, trade, and key industrial inputs like steel, give the state sufficient leverage to dictate policy to private capital. In other words, state policy and production shaped the structure and dynamic within which market activity occurred.

The role of the state in the Latin American NICs has been quite different. For example: while governments did place controls on imports, these controls were usually designed to localize production in response to existing market demand, not initiate or advance a plan of economic restructuring. One result was the rapid growth of a luxury consumption-goods industry rather than the establishment of an integrated industrial base.

Similarly, by not controlling or directing investment decisions and capital markets, Latin American governments allowed firms producing in protected markets to use their high profits for speculative rather than productive activities. Moreover, even when Latin

American governments did decide to promote exports, incentives to targeted industries were rarely combined with national industrial policies designed to create complementary centers of domestic production and technology. Export producers were, as a result, usually forced into dependence upon foreign multinational corporations, thereby greatly reducing their ability to further the industrial development of the country.

In short, Latin American states, as opposed to South Korea and Taiwan, have shown far less concern over who produces what products and whether speculative activity dominates industrial activity. Thus, in a reversal of the conventional wisdom presented earlier, I find it far more likely that the superior economic performance of South Korea and Taiwan relative to that of the Latin American NICs reflects their more extensive use of state regulation of trade, investment, and credit, rather than their reliance on free-market forces.[36] In making this argument, I do not mean to claim, however, that development is simply a matter of strengthening the economic powers of the state or that South Korea and Taiwan should be taken as models to be emulated by other countries. For one thing, strong states are not created by simple policy initiatives. The strength of the state in both South Korea and Taiwan, for example, is the result of specific and complex historical forces. And, on the negative side, such forces led to states made strong through military dictatorship and political repression. Moreover, both South Korea and Taiwan now face serious internal and external problems which threaten to undermine their future growth.[37]

It seems reasonable to conclude at this point that development is at least compatible with, if not contingent upon, strong social regulation of economic activity. What must be better understood are the dynamics that shape the national and international social relations which give rise to and help structure that regulation. Hopefully, the following examination of the South Korean experience will give us greater insight into that process and thus ways we can influence it for the better.

CHAPTER 2

THE STRUCTURE AND FUNCTION OF STATE PLANNING

Having discussed the pattern of state intervention in both South Korea and Taiwan, I now move beyond generalities to highlight the organization and operation of the South Korean state planning network created by Park Chung Hee after his 1961 military coup. To provide a context for this presentation, I begin with a brief historical overview of South Korea's pre-1961 experience with economic planning.

The Historical Roots of South Korean State Planning

South Korea, officially known as the Republic of Korea, was formally established on August 15, 1948, with Syngman Rhee as the country's first president. Because the division of Korea and creation of a separate nation in the south was largely the result of U.S. efforts and achieved over the objections of the great majority of Koreans, Rhee's government enjoyed little popular support but considerable U.S. backing.[1]

The U.S. government signed its first aid agreement with the South Korean government in December 1948, but it was only after the Korean War that U.S. aid contributions became sizeable. From 1953 to 1962, for example, U.S. aid totaled approximately 75 percent of South Korea's fixed capital investment and 8 percent of its GNP.[2] Rhee and the United States had, however, serious disagreements

over what constituted appropriate economic policy and thus how the aid should be used.

The United States, anxious to keep its aid burden to a minimum, supported a program of economic stabilization built around higher taxes, reduced government spending, especially on defense, and a lower exchange rate to stimulate exports of basic primary commodities. Rhee, in contrast, viewed such a program as political suicide. Responding to his own political interests, Rhee preferred an expansionary fiscal policy—with U.S. aid covering the budget deficit—since such spending allowed him to stimulate growth and create an attractive business climate for friends. This policy, coupled with an overvalued exchange rate and low interest rates, encouraged more U.S. aid, thereby giving Rhee greater ability to reward his friends.

For example, favored textile and flour producers were granted access to imported commodities such as cotton or wheat almost duty free, enabling them to make super profits on the domestic sale of their products. Other loyal businessmen were rewarded with access to scarce dollars, enabling them to make quick profits through the importation and then resale of products, such as fertilizer, which were in short supply on the domestic market. Still other businessmen benefited from loans at subsidized interest rates, special tax exemptions, or preferential contracts for large-scale government projects.[3]

Not surprisingly, early U.S. attempts to prod the South Korean government into constructing detailed economic plans that could then be monitored met with little success. As economists David Cole and Young Woo Nam explain:

> [Rhee and his followers] rejected the idea of overall planning and were not interested in trying to define the longer-run objectives or an integrated set of policies. This probably reflected a belief on their part that they could retain more flexibility and achieve better results in negotiations with donors by proceeding on an ad hoc basis. . . . To have agreed to [an economic plan] would have exposed the government to serious political risks.[4]

South Korea's dependence on U.S. aid was too great, however, and U.S. advisors finally succeeded in forcing Rhee to introduce an anti-inflation stabilization plan beginning in 1956. Internal and external pressures also forced Rhee to accept the creation of a new planning-oriented ministry, the Ministry of Reconstruction (MOR). The MOR was formed in 1955, initially working with U.S. aid advisors to develop and implement the annual stabilization plans demanded by the U.S. government.

In 1958, the Economic Development Council was created by the MOR and given responsibility for developing a long-term economic plan for South Korea. A Three Year Economic Plan was, in fact, drafted and presented for government consideration in April 1959. Although the plan was never implemented, the process itself proved to be significant: economists were trained in the art of planning; statistical gathering procedures were improved; and various ministries gained practice in working together.[5]

The plan was never implemented because not long after its adoption by the cabinet, Rhee's government collapsed. The U.S.-mandated stabilization plans, coupled with aid cuts, triggered a serious slowdown in investment and growth beginning in 1958. Rhee was finally driven from office by a student-led movement unhappy with the economic situation and outraged by his corruption and manipulation of the results of the 1960 election.

Syngman Rhee's replacement, Chang Myon, proved much more agreeable to United States policy dictates, but too weak to provide the leadership necessary to stabilize either the country's economic or political situation. Significantly, however, the planning process was begun once again. The MOR was instructed by the new government to continue its past efforts and draft a five-year plan to guide the economy. More important than the plan that emerged was the general agreement of those involved that successful planning required the creation of a new super-planning ministry which would combine planning responsibilities with control over the budget and foreign capital flows. As we will see later, this proposal was eventually adopted by the military government of Park Chung Hee in the form of the Economic Planning Board.[6]

Before Chang Myon had the opportunity to act on the plan or planning recommendations of his MOR, his regime was overthrown by a military coup. During the ten months that he was in power, approximately 2,000 street demonstrations took place, involving about 1 million people.[7] Demands for direct negotiations with the North for reunification of the country reflected continuing popular

rejection of the U.S.-initiated project of a separate, pro-capitalist South Korea. The South Korean military, having just fought a war to maintain the separation of North and South Korea, obviously feared the direction that the political events were leading. And when North Korean students accepted an offer by South Korean students to hold talks with the aim of increasing ties between the two countries, military leaders made plans for a takeover. On May 16, 1961, four days before the meeting and two days after a large rally in Seoul calling upon the South Korean government to endorse the talks, a small group of army officers, led by Park Chung Hee, carried out a *coup d'état.*

Active in army intelligence, Park knew that North Korea, with its interventionist state, was growing far more rapidly than South Korea and that without strong action to halt the economic slide and increasing opposition to the country's political economy, reunification of the peninsula might well occur—and on terms favorable to socialism and the North. Determined not to let this happen, Park moved quickly to establish control over political events by dissolving the National Assembly and all political parties; outlawing all demonstrations; abolishing existing trade unions; taking control of the press; passing new anticommunist laws that broadened the power of the state to arrest opponents; and creating the Korean Central Intelligence Agency (KCIA) to monitor and, when necessary, directly influence political developments.

Simultaneously, he also took action to gain control over the economy, including the creation of powerful new ministries as well as business and trading associations.[8] As the previous brief discussion of economic planning shows, Park's success in creating, almost overnight, the institutions and structures necessary for planning had much to do with developments that predated his takeover. Perhaps most important, these developments enabled Park to draw upon the practical knowledge and ideas of an existing group of economists who were already experienced with and committed to planning. The focus of the rest of this chapter will be on the actual organization and logic of the South Korean state planning apparatus.

The Planning Network: State Bodies

Park Chung Hee relied heavily upon five key state planning bodies to direct economic activity: the Economic Planning Board, the president's Economic Secretariat; the Ministry of Trade and Industry; the Ministry of Finance; and the Ministry of Construction. I will briefly consider each in turn, in order of their overall importance in the planning process.

Economic Planning Board

The Economic Planning Board (EPB) has been South Korea's most important planning body. *Business Korea*, a leading South Korean business publication, recently described it as follows:

> The EPB, which celebrated its thirtieth anniversary late last month, has no match in capitalistic nations in terms of its power and influence over the economy. Some compare it with the Japanese Economic Planning Ministry, but the role of its Japanese counterpart is much smaller than that of the EPB. The only possible comparison to the EPB may be central planning agencies in socialist nations.[9]

Created in July 1961 by joining together the Ministry of Reconstruction, the Bureau of the Budget, and the Bureau of Statistics, the EPB was given not only the responsibility to direct planning but also, by virtue of the fact that it controlled the national budget and thus government spending priorities, the ability to implement its plans.

To strengthen its planning and implementation powers, the EPB was also given the power to regulate foreign borrowing through its control over the issuance of mandatory government repayment guarantees as well as direct investment through its control over an investment screening process. The EPB was also granted the authority to regulate the prices of a number of domestically produced goods and services deemed essential by the government.

The EPB's power to shape and implement its plans was further strengthened by the fact that its chief minister also served as chair of the Council of Economic Ministers. Control of the Council of Economic Ministers by the EPB, where overall planning activities take place, was enhanced by its power to reduce the funding levels of any ministry that refused to comply with its program of action. In 1963, after the institution of civilian government, the head of the EPB was also given the title of deputy prime minister.

The President's Economic Secretariat

After his election as president in 1963, Park created his own special planning agency, the president's Economic Secretariat. Over time, with the President's support, the head of the Economic Secretariat came to exercise considerable influence over economic decision-making. In fact, beginning in the early 1970s, the economic secretary's influence on policy often rivaled that of the head of the EPB.[10] The president's Economic Secretariat ensured that the president himself was able to monitor and directly exert, if necessary, control over the planning process. We will see its importance later, especially when discussing the development and implementation of the 1973 heavy and chemical industry plan.

During the first half of the 1980s, under President Chun Doo Hwan's rule, the influence of this office on policy was greatly expanded once again. Reflecting this trend, President Roh Tae Woo recently upgraded the position of chief presidential aide for economic affairs (formerly the economic secretary) from the level of vice minister to that of minister. Similarly, a number of new committees such as the Social Infrastructure Investment Planning Task Force and the High-Speed Railway Task Force, which at one time would have come under the jurisdiction of the EPB, were placed under the direct control of the chief presidential aide.[11]

Ministry of Trade and Industry

Next in importance in the planning process was the Ministry of Trade and Industry (MTI). The MTI was responsible for export promotion and import controls, industry development plans and investment applications, project and firm designation, and trade licensing. Given the importance of foreign trade and manufacturing, this ministry was absolutely crucial to the successful implementation and direction of South Korea's economic policy. Over time, while some of MTI's responsibilities were given to new ministries such as the Ministry of Energy and Resources, its overall power has grown in significance because of its control over a number of quasi-governmental organizations dealing with trade and industry (to be discussed below).

Ministry of Finance

The Ministry of Finance also played a major role in South Korea's planning and policy implementation. Most important, it was responsible for regulating and supervising all domestic and foreign financial institutions. It also administered the foreign exchange plan and controlled tax as well as tariff assessment and collection. The ministry's importance increased in 1981 when it replaced the EPB as the ministry in charge of regulating foreign loans and investment.

Ministry of Construction

The Ministry of Construction was responsible for national material planning and the construction of all industrial estates, cities, highways, and ports. Because the government promoted the country's rapid industrial development through an aggressive program of infrastructure expansion, this ministry also played a significant role in directing the country's economic growth.

The Planning Network: Quasi-State Organizations

The actual size of the central bureaucracy, about 12,000 in the mid-1970s, remained rather small and stable, despite the enormous industrial transformation of the economy from 1967 to 1979.[12] The planning structure did grow, however, largely through the creation and use of a number of quasi-governmental organizations under the authority of one or more of the ministries highlighted above, usually the MTI. In fact, the growing significance of these organizations has greatly expanded the power of the MTI relative to other ministries, including the EPB.

These quasi-state organizations appear to give the government substantial control over the economy while ensuring that policy planning remains flexible and realistic. For example, they provide the state with a means of monitoring business activity and ensuring compliance with its policies. To illustrate their role in the South

Korean economy and planning process, I will highlight three of the most important: producer associations, the Korea Trade Promotion Corporation (KOTRA), and the Korea Foreign Traders' Association (KFTA).

Producer Associations

As part of Park's 1961 economic reorganization, the government required all incorporated businesses to join one of sixty-two business associations. These associations continue to function as intermediaries between the MTI and individual businesses and help ensure a steady flow of information between government and business.

When the government became interested in highlighting strategic industries in the late 1960s, it ordered relevant associations to join together to form new, more inclusive organizations. For example, the Korean Federation of Textile Industries (KOFOTI) was formed in 1967, uniting all textile-related producer associations. Similarly, the Korea Society for the Advancement of the Machine Industry (KOSAMI) was established in 1968 to cover the machinery industry.

Producer associations have been used by the government for three main purposes. First, the MTI has used them for purposes of industrial licensing. As Alice H. Amsden notes, "In the 1960s and 1970s, the government became the premier entrepreneur by using its industrial licensing policies to determine what, when, and how much to produce in milestone investment decisions."[13] By controlling entry into these associations, the MTI was able to monitor and regulate business activity.

Second, the EPB has used these associations to negotiate annual price controls on selected goods and services. The government can easily set prices in industries such as railways, transportation, electricity, coal, oil refining, and chemical fertilizers, where production is dominated by state-owned firms. However, through these associations, the EPB also has the power to negotiate, on an annual basis, ceiling prices for many privately produced goods. Producers affected by government-mandated price requirements are required to report price increases to the EPB and other relevant authorities within three days of a price increase. If the rise is deemed excessive, the government can use a number of different possible laws (Price

Stability Law, Monopoly Regulation and Fair Trade Law) and force a rollback as well as punish the offenders.[14] Since 1976 the annual number of items under price control has ranged from forty-six to 193.[15] Some of the 110 commodities whose prices were still being controlled in 1986 were flour, sugar, coffee, electricity, gas, steel, chemicals, synthetic fibers, paper, drugs, nylon stockings, automobiles, and televisions.[16]

Finally, as noted above, the government has also used these associations to promote the growth of industries deemed strategic for the country's development. For example, the government used the Korea Society for the Advancement of the Machine Industry (KOSAMI) to provide "maximum administrative and financial support" for the manufacture of certain machinery items intended to replace imports. KOSAMI was given a fund to support investment in targeted areas of the machinery industry and low-cost loans for buyers of locally produced machinery. In 1982, this organization included nineteen different associations of manufacturers formed under the 1961 legislation. Although supposedly a private "non-profit" organization, KOSAMI's staff size and selection is controlled by the MTI, and it has been audited by the Board of Audit and Inspection whose area of responsibility includes only state agencies.[17]

Korea Trade Promotion Corporation

The Korea Trade Promotion Corporation (KOTRA), established in 1962 as a nonprofit organization, played an important role in the government's early export efforts. KOTRA functioned as the MTI's overseas representative, and its officials traveled around the world looking for markets for existing products as well as investigating possibilities for the profitable development of new products.

KOTRA currently maintains over eighty-five Korean trade centers throughout the world. Using this network, it serves the government by monitoring all tariff and non-tariff barriers on goods from South Korea on a month-by-month basis and advising those businesses that might be affected by these barriers. Finally, it advises the MTI on possible overseas ramifications resulting from any modifications in South Korean trade policy.

The organization's role in export promotion diminished in the mid-1970s, however, when the chaebol established their own general trading corporations and worldwide network of trading centers. KOTRA now concentrates its efforts on supporting government initiatives, such as establishing direct trade relations with socialist countries, aiding the export efforts of small- and medium-size enterprises, and assisting foreign businesses wishing to import South Korean products.

Korea Foreign Traders' Association

The Korea Foreign Traders' Association (KFTA) was founded in 1946 with over one hundred companies as a purely private organization.[18] While still officially considered a private "non-profit" organization, it has functioned since 1961 as part of the government's planning network. As Tony Michell describes:

> The head is vetted by MTI and during the 1981-82 drive to cut the number of civil servants, the quota cuts for MTI and related agencies included some ordered in (KFTA). Its budget amounts to 100 million dollars per annum, and is described by one very senior government official as "all government money anyway"; it is often spent at the discretion of the central administration.[19]

In 1966, KFTA assumed control over the Korea Commercial Arbitration Board, which deals with disputes arising from international trade. It was reorganized and strengthened again in 1969 and given the right to levy a tax based on the value of imports into the country. The money from this tax allows the organization to engage in a number of activities of use to member firms, including trade and insurance assistance, as well as sponsoring South Korean participation in various bilateral economic councils, such as the Korea-Japan Economic Committee.

KFTA's most important role, however, is its use by the government to control trade activity of individual businesses. For example, all importers and exporters must be licensed, and only KFTA is empowered to grant such trade licenses. KFTA thus determines, in response to MTI policy, which firms will be allowed to engage in international activity, in what products, and with what countries. It also is responsible for monitoring an individual firm's compliance with existing government regulations concerning trade.

Discipline in Planning

While the ministries and quasi-state organizations described above formed the basic structure of South Korea's planning network, it was military discipline that ensured that they would function as a coherent whole in response to state directives. This discipline was imposed in a number of ways. For example, military leaders instituted a system of weekly meetings where top economic planners were required to brief them on the state of the economy. They also introduced "planning and control offices" in every major ministry. Each individual "office" was required to make quarterly reports on the status of the planning process in its assigned ministry to the nationally centralized Office of Planning Coordination, which in turn reported its findings directly to the prime minister and through him to the president. The military also introduced a series of reforms which, by centralizing the recruitment and placement of administrative personnel, gave them greater oversight and control over the entire state bureaucracy.[20]

Park, in fact, took full advantage of military discipline and relationships to establish his own chain of command which operated from the highest level of the bureaucracy down to the shop floor. As George Ogle, a keen observer of South Korean politics, explains:

> To make sure that commands were heard and obeyed the whole way down to the plant floor, Park had military comrades appointed as president or vice president of companies, as members of the boards of directors, as heads of the personnel department and to other key positions. To complement the military presence in industry, about 38 percent of non-economic jobs in government also went to military appointees. This permitted Park a direct and personal supervision of the entire industrial and political complex.[21]

Finally, as a direct check on the independence of the economic bureaucracy, Park established the Board of Audit and Inspection in 1963. This agency reports directly to the president and is free to "descend on any government or quasi-government organization without warning and conduct a detailed inquiry into financial and other activities; 51,468 corrupt officials (or 10 percent of all government employees) were punished for irregularities in 1976."[22]

As we have seen, the South Korean planning system offered the state the means to both generate plans as well as monitor business compliance. In the following two chapters I will show how it was used by the Park regime, along with other policy instruments, to direct the country's rapid growth and industrial transformation.