

THE POLITICAL ECONOMY OF STATISM IN THE KOREAN DEVELOPMENT

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I. INTRODUCTION

Neoliberal economic policies with concerns for prices and their role assume that market forces provide a self-regulating mechanism for an efficient allocation of resources and therefore a rapid economic growth : State involvement is viewed as a structural necessity useful to create an environment suitable for capitalist development.

In the case of Asia's newly industrialized countries like South Korea and Taiwan, however, capitalist development has been achieved under a strong state whose direction and intervention in resource allocation, rather than through market process, has contributed to the development of areas of the economy perceived by the state to have longer run potential. In the literature, the views on the role of the East Asian states have ranged from that of a minimalist state to that of an interventionist state (Jones & Sakong, 1980; Luedde-Neurath, 1988; Shafer, 1990). The interventionists see the state as coercing the private sector to achieve the kinds of economic restructuring perceived to facilitate rapid growth of the economy. According to the minimalist view, on the other hand, the East Asian state has intervened to essentially correct market failures. Many economists with a neoclassical bent attribute East Asia's success to an efficient state action in compliance with market principles.¹

In the context of the above debate, the present study takes Korea as a case to assess the role of the state with special reference to the period of rapid economic growth under a strong state (1961-87). This covers the period when state intervention was persistent and most active. It will be argued that the state played a critical role in the making of industrialization, prevailing in every sector of the economy. Market rationality was to be compromised by the paramount goal of industrialization.

This paper analyzes the historical process and the social structure that have given

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¹Refer to Section 3 for the reference.

dustrialization.

This paper analyzes the historical process and the social structure that have given birth to an authoritarian state in Korea. The intention here is not to develop a theory of the state but to bring to attention the particular features of East Asia's developmental state. The next section presents an overview of industrial development in Korea from the historical perspective, looking closely at the choice of development strategy and its consequences over the different phases of industrialization. Section 3 surveys the origin and scope of state authority, assessing the role of the state in the process of industrialization. A specific question addressed is how the state in the post liberation Korea has been able to maintain dominance over civil society. The concluding section summarizes the main points of the paper and explores the broad lessons from the Korean model.

II. DEVELOPMENT FROM A HISTORICAL PERSPECTIVE

1. The Colonial Legacy

The transition from a feudal agrarian economy to a modern industrial state in Korea began under Japanese colonial rule from the early twentieth century until 1945. Japan was a late comer in a global struggle for colonization. Its ultimate interest in the contiguous colonies like Korea and Manchuria was to closely intergrate them to the metropolis and to use the conquered territories as a basis to supply human and physical resources in resisting the West.

Japan's ultimate intention to make Korea perpetual part of the metropolis subsequently prompted heavy investments in administrative infrastructure, railroads, ports, communications and other physical facilities. The colony was used as the location for industry by drawing on the indigenous labor and raw materials. To facilitate the process of industrialization, the colonial administration exercised a strict control over the economy, relying on a triad state apparatus made up of zaibatsu conglomerates, the central bank, and administrative bureaucracy. As Landes (1965) points out, the colonial state stepped in to fill in the role of an absent or incipient entrepreneurial class in the colony. Japan's efforts to assimilate the colony were made easier by the fact that Koreans and Japanes are ethnically and culturally similar.

The colonial state, despite its harsh rule, contributed to the building of basic physical infrastructure, laying down the basis for industrial development (Kim, 1973).² More significantly, it provided a model of highly articulated, disciplined colonial bureaucracy, later to be adopted by Koreans for state-directed develop-

²In terms of value added, the share of manufacturing rose from 2 percent in the early 1910's to around 13 to 15 percent of GNP by 1940, while the share of primary activities declined from about two thirds of GNP to about a half.

ment. The colonial industrial organization is another legacy to the postwar Korea. The Japanese introduced a model of zaibatsu conglomerates. The Koreans in the postwar period fostered their version of conglomerates called “jaebol”, a close replica of the zaibatsu system. The corporate system is organized along the principle of structural family with ethical filiality

Liberation from Japan in 1945 crippled the Korean economy, as it had been closely integrated to the metropole Japan. The subsequent separation of the North from the South further disabled the economy: heavy industries, electrical power resources, and mineral deposits were mostly located in the northern part of the country, whereas industries in the south were mainly manufacturers of agriculture and light consumption goods. The fragile, industrial infrastructure left in the south was soon destroyed during the Korean War (1950-1953), this time almost entirely. The South had to industrialize out of the ruins left in the wake of the war.

For analytical purposes, in what follows the post Korean War period will be divided into three phases of development: they are, respectively, the period of inward orientation (1953-60), outward orientation (1961-79), and liberalization and balanced growth (1980-present).

2. The Inward-orientation (1953-1960)

The years between 1953 and 1960 mark the period of reconstruction under an import substitution regime. Policy emphasis was on import substitution of non-durable consumer and intermediate goods behind a protective wall of tariffs and quotas. The domestic currency was maintained persistently at an overvalued rate, which thwarted the export potential of the economy. Thus, exports remained negligible throughout the period, on average amounting to less than 1 percent of GNP. Imports, on the other hand, which were mostly financed by US. grants-in aid, accounted for more than 10 percent of GNP. Any kind of systematic, longer run commitments on the part of the state toward sustained development were conspicuously absent.

The Korean economy in the fifties possessed all the characteristics of an extremely poor third-world country. In 1953, its per capita GNP was about \$130 in 1970 dollar prices. About 46 percent of its GNP was generated by the agricultural sector with the manufacturing contributing to 6 percent of GNP. The average annual growth rate of GNP during the period was 4 percent. In 1961 nearly two-thirds of the working population were engaged in agriculture.

3. The Outward-orientation (1961-79)

3.1 Elements of Development strategy

The military coup in 1961 was a turning point in the Korean development. This is the beginning of the era during which the state pursued systematic, aggressive,

outward-oriented policies to achieve rapid economic growth. Initially, the government decided to intensify its promotion of import substitution. However, the inflow of US. aid, which peaked in 1957 had already started its irreversible decline. The government had to turn to such alternative sources of foreign exchange as foreign loans and export expansion, along with fiscal and interest rate reforms to mobilize domestic savings.³ Besides, markets for most of import substitutable products were already saturated in Korea by the early 1960s. The shift toward export expansion was a timely and logical move.

During the period of outward orientation, sustained state intervention in major economic activities became the rule rather than the exception. Three features of development strategy are worth noting. The first is the practice of targeting "strategic" sectors and firms for special support; the second relating to a neo mercantilistic trade policy of maximizing exports while minimizing imports; and the third concerning the state's agricultural policy.

The Korean government slipped into the practice later known as "targeting industry and product." The targeting system was introduced as the government began to select "strategic" industries for support over a series of five year development plans. With a notable exception of the first five year plan (1962-66) when infrastructure development was emphasized, the dynamic sequencing in industrial development was seen important to reflect the changing patterns of comparative advantage for Korea. The state support started with labor intensive industries, moving on to capital and skill intensive sectors in the subsequent plans.⁴ The choice of "strategic" industries has varied over time, ranging from sophisticated electronics to heavy and chemical sectors, iron and steel, shipbuilding and automobiles. Rather than channeling funds and adopting projects on an ad hoc base as opportunities might arise, systematic efforts were made to adapt to the technological changes taking place in the industry worldwide, to reflect scale economies and interindustrial linkages, and direct the economy along the desired path perceived by planners.⁵

The second feature of strategy concerns trade policy. Korea's outward oriented policy was an eclectic one in that while emphasizing exports, protection of selective domestic industries for import substitution—in particular, intermediate and capital goods sectors—has been given no less importance. The vertical integration of production structure was intended to lessen the economy's dependence on im-

³The interest rates on time and savings deposits and loans (except export credits) almost doubled in 1965, and as a result the share of time and savings deposits in the rapidly expanding total loan funds of the deposit money banks increased from less than 20 percent before 1965 to nearly half in 1971.

⁴For instance, the Electronics Promotion Law in 1969 recognized electronics as a "strategic export industry."

⁵In passing, it must be noted that the practice of sector targeting, beginning in the Fifth Five Year Plan during the 1980s, has been gradually phased out as the economy becomes increasingly sophisticated and complicated to manage. Except for the high tech sector which continues to receive government support, measures that can benefit all indiscriminately are now being implemented.

ports, while the longer run strategy has been to establish a viable industrial structure that can prove adaptable to the shifting comparative advantages in international markets. Thus, in the case of Korea import substitution and export promotion proceeded together, possibly with some time lags.⁶ Its experience in outward orientation must not be interpreted as an example of trade liberalization in the neoclassical sense.

The final feature of strategy relates to rural development. Korean agriculture, despite its importance in the economy, has for most of the time been subordinated to the goal of industrialization. Park's technocrats were much more concerned with industrialization than with agricultural development, although Korea was already in substantial food deficit. Park's strategy was to mobilize resources for activities that accelerate the pace of industrialization. Thus, to assure lower industrial wages through cheap imported food, the state denied to agriculture protection awarded industry and allowed imports of food grains. The consequent rural sector's adverse terms of trade ensured a continual flow of labor to urban industry. Throughout the 1960s, the rural sector remained, relative to the urban area, impoverished.

In the early 1970s rural political instability became a threat to the state. The political leadership saw the promotion of farming interests as a viable route to retaining political power.⁷ To put brakes on the rapid deterioration in the rural economy, the Park government initiated, along with providing extension services through rural oriented New Village Movement (*Saemaul*), a massive rice procurement program at prices several times the world market price to support farm incomes. As a result, the first half of the 1970s saw substantial improvements in rural living standards. In the case of Korea, the success with industry facilitated agricultural development through reallocation to it of industrial surpluses. The rising incomes also made possible to have improved health, high levels of educational attainment, and access to basic services. Thus, social and rural development in Korea depended on the pace of industrial development.

The policies to force growth with equity by supporting declining agriculture, on the other hand, proved economically costly. From the early 1970s on, the government has found itself committed to heavy subsidies on fertilizer and on the difference between the prices it paid to farmers for rice and barley and the lower prices at which it sold to consumers. The financial cost of supporting agriculture adds to the economic cost to the nation of protecting agriculture against competing imports. The labor intensive small farm sector, once functional to industrial development, has now become a hindrance.

⁶During the 1963-73 period, export expansion, in relation to import substitution, made a more than threefold contribution. However, prior import substitution in the 1960s had already created possibilities of improved utilization of capital for export expansion in subsequent periods.

⁷General Park was concerned with the possibility of losing rural votes in the 1971 presidential reelection.

3.2 Consequences and social costs.

The results of these efforts were predictable. Korea achieved significant level of import substitution behind heavy protective tariffs in such products as cement, fertilizer, refined petroleum, textile yarn and fabrics, which in due course emerged as a new generation of exportable goods. Also, export promotional policies gathered momentum over time. Taking advantage of favorable trade environment in the 1960s and privileged access to US. offshore procurements during the Vietnam War, the government resorted to an all out effort for exports. Exports rose dramatically: over the period of 1962-1979, Korea's real exports grew at the average annual rate of 33.7 percent. The growth performance was also spectacular: the average growth rate in real GNP during the 1965-79 period was 9.7 percent (Table 1); real per capita income showed an 18-fold increase to \$1,481 in 1980 from \$87 in 1962. Rapid economic growth brought with it a drastic transformation in Korea's industrial structure; primary activities which accounted for 40% of the total economic activities in 1962-64 declined to 18.3% by 1980 while manufacturing and mining rose from 18.1% to 30%.

Toward the late 1970s, the overall income distribution deteriorated as the government drastically reduced farm subsidies and continued with anti labor policies while sheltering interests of industrial capitalists (Table 2). Pro-*Jaebol* policies, in particular, contributed particularly to the widening of intra income gaps. Moreover, as fiscal policies tended to concentrate on industrial infrastructure development, ignoring social areas, the incidence of poverty became more acute in urban areas and on economically disadvantaged groups such as the elderly, disabled and female headed households. Regional disparities have, in addition, emerged as a political polemic, which resulted from the regional proclivities of economic policy makers. Government concerns with social areas and income inequality have been of relatively recent origin in the 1980s.

It is worth pointing out that despite the sector specific distributional inequities in the Korean development, South Korea is still considered to be a reasonably egalitarian society by developing country standards. Two factors, cultural and historical, have contributed to this: (1) the universal spread of education and (2)

[Table 1] Annual Growth Rates in Real GNP

(unit = %)

1965-1969 average	10.0
1970-1974 average	9.1
1975-1979 average	10.1
1980	-5.2
1981-1986 average	7.3

Source: Economic Planning Board.

even assets ownership in rural areas.⁸ Successful land reforms prior to industrialization eliminated land tenancy although the average farm size has been insufficient to provide satisfactory income relative to the urban counterpart, with the aid of the state they have enabled peasants to escape impoverishment. The high literacy rate in Korea is attributed to the wide spread of education among the populace. Reflecting culturally rooted enthusiasm for education, primary education was nearly universal already at the time of the state initiative for industrialization. The state did not have to spend particularly larger share of the budget for education in comparison to other developing countries.

4. Balance and Liberalization (1981-present)

4.1 Adjustments for Balanced Growth.

By the late 1970s, however, it became clear that the state's implementation machinery was working too effectively. The state bureaucracy's excessive zeal to surpass targets and consequently excessive interference in market functions gradually built into serious distortions and imbalances in the economy. Private companies blindly followed the government's lead without paying much attention to the underlying economic ills characteristic of inflation and distortions and rent seeking activities in the economy; too many production units were crowded into too few strategic sectors, resulting in too much capacity too fast. Some of these sectors did not really possess a comparative advantage, revealing distortion in the allocation of resources. Wage suppression and pro business policy also aggravated income distribution (Table 2). Although Korea's rapid growth, on the whole, was

[Table 2] Distribution of Household Income

Income groups	1965	1970	1976	1980
Bottom 40%	19.34	19.63	16.85	16.06
top 20%	41.81	41.62	45.34	45.39
Gini index	.344	.332	.381	.389

Sources: Choo, H.C. and Kim, D.M. (1978) & Economic Planning Board, Social Indicators of Korea (Seoul: EPB, 1981)

⁸The Korean data for income distribution for the 1960s and 1970s are limited in sample size and exclude the extreme lower and upper income classes: This makes the determination of the precise patterns of distribution difficult. Nevertheless, the available studies tend to indicate a slight deterioration in income distribution: except during the mid 1970s when the overall distribution slightly improved, the income share of the lowest 40 percent continued to decrease from 19.3% in 1965 to 15.5% in 1978. On the other hand, the share of the top 20 percent rose from 41.8% to 45.3% over the same period with the overall Gini coefficient changing from 0.28 to 0.38. Poverty incidence (the percent of the population considered as poor) is calculated 7.0 percent in 1988. See UNDP (1991).

achieved under a fairly equitable income distribution by developing country standards, the distribution worsened markedly during the period of rapid growth in the mid 1970s.

Coming to the late 1970s, a series of economic setbacks took place, including a crop failure and the impacts of the second oil shock and the global recession. They provoked a decline in real GNP in 1980 for the first time since 1953 and high inflation. The economic crisis was confounded with a series of political crisis epitomized by the anti government Kwangju uprising in 1980. The military regime led by Chun Doo Hwan intervened to repress the strong societal reaction, consolidating an authoritarian rule, and set to the task of economic stabilization.

The Chun regime initiated a two pronged economic policy of adopting a macroeconomic stabilization, while aiming at a longer term balanced growth and liberalization through restructuring of the economy. The self-imposed stabilization programs included aggregate demand control through restrictive monetary policy, elimination of subsidies, and reduction in government expenditure, and realignment of real exchange rate on a floating basis.

As regards programs for structural adjustment, excessive aspects of the command structure were gradually being discarded in favor of more initiatives from the private sector, and businessmen were urged to pay more heed to market signals and profits. Gradual and cautiously scheduled import liberalization program was introduced, reflecting a recognition of the importance of market forces in an already complex and highly sophisticated economy. The new program also included denationalization of the banking system, and elimination of cartel arrangements and price fixing, and a better balance between small and large scale firms. For this, with the help of the timely Japanese loans and aid,⁹ the state initiated the sectoral reorganization on the principle of one *jaebol* for each industrial sector.

Chun's structural adjustment policies abetted the performance of the economy. The results of stabilization measures succeeded to bring down inflation, and partly helped by the recovering world markets beginning in 1993, the Korean economy was on its way to expansion, registering an average of 9.5% growth in GNP between 1983 and 1987.

4.2 Liberalization under Political Reforms

The step down of one term president Chun in 1987 was followed by a wave of labor and student unrest. The subsequent years of rapid democratization under Roh have so far seen a general weakening of macroeconomic performance of the economy. Wage increases began to outstrip productivity gains by wide margins, thereby fueling inflation and sharply eroding export competitiveness. As inflation continued to accelerate and imports rose rapidly under on going trade liberaliza-

⁹In 1983 Japan promised some \$4 billion worth of package of loans and aids.

tion, the nation's trade balance which reached a surplus of \$14 billion in 1988 worsened in the last two years. South Korea is going through a critical period of transition from an authoritarian rule to political liberalization, and at the same time from excessive statism to economic liberalization.

The political transition to a democracy is creating a new environment in which economic policy makers must now work. Externally, Roh's government is committed to internationalize the Korean economy by opening domestic markets to foreign trade and investment. The state's role in industrial development is limited to assisting in the continued development of technology and human capital. Internally, a wider participation in political decisions is forcing the state to pay close attention to social welfare and equity. The government now faces the challenge of striking a proper balance between growth and equity. As a result, the government spending has been giving greater priority to meeting basic needs, operating more public assistance programs, including low income housing, for those specially disadvantaged.¹⁰ Political liberalization and active participation of civil society is beginning to have a salutary impact on social services. On the other hand, the prospect of high growth policies is now held in check. The economic growth rate has, in fact, slowed down considerably from 12 percent a year in 1986 to 1988 to 7 percent in 1990 to 1991. A long term GNP growth rate of 7 to 8 percent has indeed been targeted in the government's sixth five year plan (1987-1992).

III. ASSESSING THE ROLE OF THE STATE

Korea's success in rapid industrialization is, to a large, attributable to a strong state regime capable to energetically execute plans and strategies. The question that needs to be answered is: where has the primacy of the state derived from? What has been the extent of state control? How autonomous has the Korean state been in relation to various groups of civil society? And how has the state elicited compliance of the private sector? This section focuses on the origin and evolution of statism in Korea, and the relations of the state to civil society in historical and cultural perspective.

1. The Emergence of a Weberian State

The rise of a Weberian, modern state in Korea can be traced to Japanese colonial rule. Upon colonizing the country, the colonial state promptly swept away the traditional feudalistic order, replacing it by a bureaucratic centralized state apparatus. The modernization of the colony was to be facilitated by sweeping changes from above. The consolidation of a new political order was followed by

¹⁰The government expenditure now amounts to about 0.5% of GNP in 1990. In the 1960s it was a trivial amount.

the introduction of new capitalist social relations in industry in which a tripartite alliance of the colonial state's bureaucracy, central banking, and zaibatsu conglomerates dominated while in pre capitalist agriculture, the state introduced landlord tenant relations to exploit exportable surplus grains from Korea.

The colonial mode of production influenced the indigenous class structure. While tenancy in agriculture pauperized indigenous farmers, turning them into urban proletarians in industry dominated by Japanese capital, there also emerged a new class of indigenous capitalists, mainly in trade and small-scale industry, and a significant number of indigenous landlords. The emerging, propertied class tended to rely on the colonial state apparatus in sharing surpluses, as a way to retain its wealth and privilege. In the case of agriculture, the rural society continued to retain the feudalistic land-tenure system serving the interests of the colonial state, which turned into a factor contributing to the peasant uprisings immediately after Korea's liberation from Japan.

In the post-liberation Korea, the ensuing land reforms initiated by the US. Military regime which redistributed land to the tillers and outlawed tenancy, virtually eliminated the land owning class as a contending political force. A few remaining, indigenous industrial capitalists in the wake of Japanese withdrawal from Korea were a disorganized, weakened economic force to contend with. The policy makers in the liberated Korea could act autonomously, free from the interference and demands of elite classes.

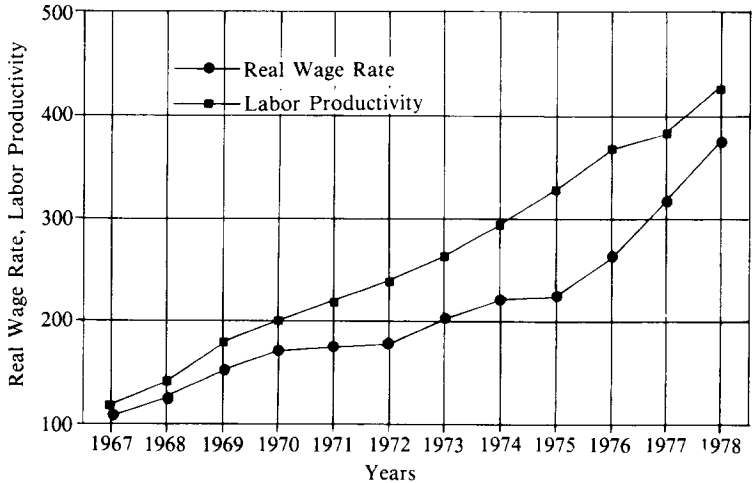
In terms of dealing with non elite classes, there was a geopolitical dimension contributing to the enhancement of state authority in the post liberation era. The US. security interest in South Korea during the rapidly evolving cold war years prompted the build up of a strong, anti Communist state apparatus backed up by the national police in a revived form of the colonial police. The tragic experience of the Korean War (1950-53) and the continued threat of renewed war by North Korea reinforced the authoritarian rule of Syngman Rhee with a strong backing of the military forces. While the post liberation state in South Korea formally professed a resemblance of a Western democracy with free elections and civil liberty, the state's coercive apparatus was used to suppress civil rights and political oppositions in the name of national security. The state, in particular, enforced an anti labor policy as organized labor was seen as a left leaning disruptive social force.

Thus, the state apparatus inherited by the post colonial Korea was in a position to subordinate all the indigenous classes with the inheritance of a military administrative apparatus. No particular social groups of forces could dare to challenge the state authority. The Korean state was in a position to directly appropriate a large part of economic surplus, deploying it in bureaucratically directed activities.

After the end of the Korean War a number of family based industrial conglomerates, called "jaebol", began to emerge as the new economic elites. As a result of extensive damage inflicted by the war, the South Korean economy depended heavily on consumer goods imports, which were mostly financed by US. aid.

The Rhee regime's plan was to encourage the development of domestic manufacture to gradually replace consumer goods imports. As the regime's import substitution based industrialization plan was based on a heavy reliance on foreign aid and imports, windfall profits could be had through privileged access to foreign exchange and import licenses. The corrupt Rhee regime prompted the rise of new economic elites by expediting accumulation in selected domestic enterprises. Because of the close relationship between the state and the selected private capital, the effects of government measures for industrial development were largely concentrated on the latter, the emerging *jaebol*.

The emergence of new capitalists did not detract from the state's exercising its autonomy. Under the Rhee regime, private capital was created and supported to serve as the instrument of the state, nonetheless, often leading to formation of a close relationship with the state in sharing the fruits of rent seeking activities involving mainly the commercial deals. What prompted the demise of the particular capitalist social relations in the 1950s was the indignation of the populace directed against the rent seekers under commercial capitalism, and the inability of commercial capital to provide for the needs of the people. Despite some advance made in import substitution to replace potential imports, the impact fell far short of paving the way toward a self sustained economy; the economy under an inefficient and corrupt administrative infrastructure remained a stagnant, dependent one with import dependence rising in many manufacturing sectors and most significantly, in agriculture.



Source: For wage series, Bureau of Labor, and for productivity series, Center of Productivity.

[Figure 1] Real Wages and Labor Productivity in Manufacturing

2. Statism during the Export-Led Phase

The economic and moral crisis engendered by an inept and corrupt regime made it easier for Park Chung Hee's military faction to legitimize the coup in 1961 in the name of national security and economic survival. After coming to power, Park's immediate task was to institutionalize an authoritarian and interventionist rule in carrying out a kind of economic revolution from above. The military coup was organized by a previously isolated section of the state apparatus with no linkages to particular social groups. The coup came under the revolutionary mandate to eliminate the rent seeking activities and to restore national security and economic prosperity. There were no countervailing forces to check the huge military institution. The military regime was soon able to institutionalize an authoritarian rule.

Learning from Japanese experience in the Meiji Restoration (*Ishin*), Park saw the sweeping changes from above as the only way to facilitate modernization of Korea. Under the pretext of national 'revitalization' (*Yshin*), the constitution was amended to consolidate the dominance of the executive under a one party rule. After amassing sweeping powers for the presidency, the Park regime set itself to the task of designing and implementing strategies for accumulating industrial capital. Park saw rapid industrialization as the way to modernize the nation. A system of meritocratic bureaucracy backed by military muscle was ushered in to implement policies to develop modern manufacturing industry. The political system envisioned as ideal to carry out such a strategy was one wherein the policy makers, based on the coalition of competent bureaucracy, business and the military, are autonomous in decision making from the interference of non capitalist classes.¹¹ The elimination of leftist forces, which continued throughout the 1950s after the Korean War, freed the government from the need to pursue populist policies, making it easier for the state to consolidate and narrow down on the range of debates on policy alternatives. The period of the Park regime witnessed the rebirth of a kind of Japanese colonial rule of militarized control, decisive economic planning, all out mobilization of resources for industrial development (Henderson. 1988).

The state's strategy for accumulation of industrial capital has had far reaching consequences upon class structure in Korean society. One particular class viewed by the state as a potential threat to the success of economic growth has been industrial labor. The success of export oriented industrialization required mobilization of cheap and disciplined labor. The military regime played a critical role in shaping the form of labor movements and also that of labor process through intervening within the factory or through ruling the capital labor relations.

Historically, Korea's trade unions, created by the state to support anti communist struggle against the left wing labor movements, have often acted like its

¹¹The Korean state has often been compared to the authoritarian state described by O'Donnell (1973).

[Table 3] Growth of Conglomerates

No. of conglomerates	Annual growth rate (1973-1978)	As percentage of GDP	
		1973	1978
5	35.7	8.8	18.4
10	30.0	13.9	23.4
20	27.5	21.8	33.2
46	21.4	31.8	43.0
GDP Total	17.2	100.0	100.0

Source: Korean Development Institute.

agency. Workers have until recently been denied the right to organize union that might foster in them class consciousness. Industrial unions are typically organized at the enterprise level. Collective bargaining is carried out at the enterprise level. This internal company unionism precluded the possibility of unions to form a united front on common economic and social interests, thereby diminishing their influence on national policies.

The politics of labor demobilization continued throughout the 1970s. When the average real wage rate rose in response to tight labor market conditions developed in the early 1970s, Korea was threatened with the deterioration in competitive edge in its labor intensive exports. The government quickly enacted a series of measures to restrain wage increases by curtailing the power of trade unions.¹² As a result, real wages fell behind the rise in labor productivity, which for instance, increased almost 50% faster between 1967 and 1978 (Table 2).¹³ The slower growth in relative wages reflect labor's declining share in output¹⁴; labor's share in manufacturing value added declined from 36.6 percent in 1958 to 23.0 percent by 1975.

While repressing labor movements, the state reorganized the capitalist class. At the time of the advent of the military regime, the old bourgeoisie, discredited with the downfall of Rhee, was on the verge of extinction. When Park decided to pursue a capitalist strategy for industrialization, he needed to enlist business

¹²An example of this was the 1971 Special Emergency Law enacted under the umbrella of a series of national security provisions: In a situation of emergency threatening national security, the settlement of labor disputes would automatically fall under the jurisdiction of the government controlled Labor Tribunals; open walk outs would then be illegal; other forms of restrictions would be imposed on collective bargaining;

¹³After 1977 real wages gained some ground over productivity increases. These gains reflect the impact of structural adjustment in labor markets, which was instituted in response to increasingly militant labor movements.

¹⁴Note that the rate of change in labor's share of GDP reflects the difference between the rates of change in real wages and productivity.

support, the previous industrialists were given the opportunity to collaborate with the state while creating new business interests. The business sector was not, however, allowed, to become autonomous in relations with the state.

The nurturing of big businesses was seen as an imperative for the development of heavy industry in Korea. Economic logic favored large scale production, as a minimum scale in plant size would be required for efficiency in production in such heavy sectors as automobiles, steel, and shipbuilding. The *jaebol* must compete in international markets with the large scale, foreign multinationals. The size of the firm is also an important factor to consider in joint ventures with foreign partners, since there would be the risk that the latter could dominate and control the domestic counterparts.¹⁵

As a result, the breadth and speed in the rise of the *jaebol* have been unprecedented in Korea's history of enterprise. There were some fifty major conglomerates with each unit composed of half a dozen to fifty member firms that were horizontally and vertically integrated in the industrial structure.¹⁶ As shown in Table 3, between 1973-1978 the annual rate of growth in value added contributed by the 10 largest conglomerates was as high as 30 percent. In terms of the share of their contribution to GDP, they accounted for 14 percent in 1973, rising to 23.4 percent by 1978. The top 46 firms, taken together, accounted for 31.8 percent of GDP in 1973, which rose to 43 percent over the same period. These measures clearly show the extent of progress in industrial concentration during the military regime.¹⁷

To elicit compliance from the private capital, the state resorted to a strictly enforced system of 'carrots and sticks.' Incentives were offered to those who complied with the directions of the state. The most important instrument was the allocation of bank credit and of access to foreign capital. Businesses in Korea critically depended on bank credits, as over two thirds of the cash flow of manufacturing firms came from the financial institution borrowing from financial institutions controlled by the state. The debt equity ratio in the private sector typically

¹⁵Another important benefit from supporting big business was the political funds the President could count on from them.

¹⁶The largest four conglomerates are Hyundai, Dae Woo, Samsung, and Gumsung, which together recently accounted for close to 10 percent of total exports. Furthermore, 10 Korean conglomerates were recently listed among the top 500 corporations in the world excluding the United States in *Fortune* magazine.

¹⁷In the earlier days of industrialization, the business environment was conducive to opportunities for forward or backward integration in industry. A broad spectrum of sectors opened up for entrepreneurs to participate in, as export demand suddenly rose in diversified areas. Access to financing was made easy, as the government provided easy credit in efforts to promote exports. Once the government was convinced the entrepreneur could succeed, this would usually have a snow balling effect, success breeding success, since the government credit was largely based on past achievements. This type of credit policy made it possible for successful entrepreneurs to launch several ventures at the same time, which eventually led to a race for empire building in business.

ranged from four to six, and the industrial capitalists were put on a weak bargaining position dealing with the state.

Within the public sector which included state run enterprises, heavy pressures were exerted on the bureaucrats, frequently by imposing output targets, to execute their jobs well. The forms of intervention ranged from a 'friendly' telephone call from the president's office to the allocation of bank loans. One influential administrative institution is the tax authorities. They have sanctioned non compliant enterprises by inspecting their returns more strictly. The state also controlled prices to subsidize export and targeted sector activities through reductions in imported input prices or through increases in monopolistic prices for profits. The 'carrots and sticks' system worked well for Korea; industrial capitalists soon realized that compliance with government directions would be the only way to survive and prosper.

In sum, the Korean state during the export led phase was free from constraints of civil society, and could direct the economy in ways to pursue the national goals perceived and formulated by technocratic bureaucrats. Given the geopolitical constraint to remain a capitalist system, the state guided the form and pace of capital accumulation by cajoling or forcing the collaboration from private capital. The state thus ruled over the interests of capitalists without the possibilities of the latter's dominating over the former. State involvement turned out to be most extensive and substantial during the export led phase in the Korean development.

3. Statism in the Context of Structural Adjustment

The decade of the 1980s began with the political and economic crises. The assassination of President Park in 1979 was followed by a brief move toward civilian constitutionalism, which ended with the Kwangju riot where the army suppressed a pro democracy, incipient rebellion with considerable force, resulting in hundreds of casualties. Economically as already discussed, Korea was severely affected by the global economic downturn during the late 1970s and early 1980s. Precipitated by the social unrest and a crop failure in 1980, the economy was plunged into a stagnation for the first time since 1961. The military turned President Chun Doo Hwan, elected for a single seven year term, decided to oversee the continuation of the Park regime.

State intervention under the Chun regime revolved around two major themes of macroeconomic stabilization and balanced growth in the context of economic liberalization at a piecemeal pace. as far as the basic character of the state is concerned, it is still closer to a bureaucratic authoritarian state as described by O'Donnell. The control of the state continued to remain comprehensive, technocratic and often repressive. The goals of the state was to be attained at all costs social and economic. When the market system worked in the desired way, it was to be left alone; when it couldn't, state intervention was legitimate to direct it in the

desired way. Class structure was to be reformulated to suit the needs of the state.

Thus despite the urgency for economic liberalization and decentralization, the subordinate relations of business to the state remained unchanged under the Chun regime. Although the alarming trends of industrial concentration set in,¹⁸ the government continued to work with big businesses. Large firms with scale economies could be counted on to more successfully complete crucial projects for national development. Funds flowed more readily into larger companies, since they were generally in a better position to outbid smaller firms in government financed projects.

The impressive economic growth combined with low inflation rates during the Chun regime was indeed attained at the expense of workers and farmers. To maintain export competitiveness, the state pursued a through repression of labor outlawing strikes and unions¹⁹ and reduced farm subsidies while attempting to liberalize agricultural imports. Chun's government initially evinced greater interest in promoting a balanced growth with equity. In reality, the reforms for equitable development had been incremental in changes. There were no drastic structural reforms in the political economy. At the same time, Chun's structural adjustment policies relied on the effective working of state bureaucracy. The capacity of the state to formulate and execute strategies under the Chun regime is not very different from that under the Park regime. The state continued to influence the class formation. While differences between the two regimes exist the choice of economic strategy, the character and structure of the state remains essentially the same.

The deepening of industrialization in Korea gradually weakened the state's strength and autonomy in relation to various groups of its political economy. As the economy grew in size and complexity, state intervention became more costly, economically and politically. As the number of laborers increased and the *jaebol* became economically more powerful, they became increasingly vocal about the negative aspects of the centralized role of the state. The laborers and so far, the most acquiescent farmers have become most outspoken in their demands for larger share of the benefits of economic growth.

3.1 The State in the Transition to Democracy

The year 1987 when Chun stepped down from the presidency turned into a turning point of South Korea's political life. The crisis of state authority erupted

¹⁸In terms of output, the largest group of firms employing more than 500 persons grew at an annual rate of 27.6% between 1967 and 1979 compared to 11.1% for the smallest units employing fewer than 9 persons. In Korea any establishments employing less than 500 persons are considered as small and medium units.

¹⁹In 1981 real wages fell 5 percent while labor productivity rose 16 percent.

already in 1985 when the opposition parties gained more strength in the February parliamentary election. The ensuing presidential election, as a result of split in the opposition party candidates, restored the former military general Roh as president of the sixth republic. Roh's government faces a National Assembly dominated by the opposition parties. Although Roh was able to organize a coalition with two of the opposition parties, creating the Democratic Liberal Party, dissension within the party and sharp criticism from the largest remaining opposition party, led by Kim Dae Jung, made agreement on policy issues difficult.

Certainly, the recent political reforms have led to political liberalization and the widening of the power base but not democratization. The genuine democratic institutions have not yet emerged that could hold the government accountable for its actions and offer an alternative set of policies to the voters. Pluralism is legalized, but a viable alternative opposition force has not yet emerged as a countable political force. The post 1987 era will see in Korea a rigid but not a very strong state. There has been a significant reduction of state autonomy from civil society; the government is now more prone to pressures from influential interest groups. A transition from "hard" to "soft" authoritarianism appears to be taking place.

4. Statism Embedded in East Asian Culture

The preceding discussions have related to primacy of the Korean state to historical factors. We have argued that the state authority in Korea has not been derived from linkages to a particular civilian base of support. The state has, on the contrary, determined the formation of class structure, creating alliances with particular classes as it sees necessary.

The emergence in Korea of a "hard state" a dominant state strongly committed to economic development cannot, however be viewed as a simple historical accident. The question remains: why has statism, despite its many potential pitfalls, worked in East Asia? In accounting for the legitimacy of state authority, one must go beyond the historical process in the development of state capitalism in East Asia. The primacy of the state accompanying a tenuous development of any competing social and political classes has a long history in East Asia, embedded in its culture and tradition throughout the entire phase of modernization.

The centuries—old Confucian ideology in Asian societies, which inculcates the virtue of authority emanating from a vertical social order, legitimizes state intervention. Civil servants are accorded highest social hierarchy to rule. Under the Confucian civil service system in Korea, meritocratic examinations have traditionally been used to recruit the best minds into the state bureaucracy. As the state under Park gained almost an absolute autonomy from civil society, a meritocratic recruitment system via elite academia was reinforced to build a competent, bureaucratic organization for facilitating the process of industrial transformation.

Under the Confucian system of hierarchy, business is expected to serve the rulers

of the state; and non elite classes respecting the guidance of elites.²⁰ Thus, the concept of a horizontal social order, as exemplified in Adam Smith's 'invisible hand,' would utterly be at odds with the Confucian ethics which values "the wisdom and moral ethics of the supreme ruler and ruling elite." (Luedde Neurath, p.98) This lingering influence of traditional culture has made the bureaucratic authoritarian rule easier and acceptable to the populace in East Asia. Of course, in the case of Korea, the linguistic and cultural homogeneity in a territorial compact nation facilitates the formation of a centralized polity.

5. Efficacy of State Authority

The selective but vigorous promotion of infant industries and upgrading of the country's competitive advantage by articulate industrial policies, and all these through the concerted efforts for resource mobilization were the key elements of state activism in Korea. The question to address here is whether these state actions have benefited the economy. Given the complexity of the developmental process, it would be impossible to measure the consequences of state intervention. Nor would it be possible to appraise the counterfactual case, had Korea followed a noninterventionist strategy. Thus, the most one can conclude from the available data is that rapid economic growth in Korea has taken place under a strong interventionist state which is dedicated to economic development.

The particular contribution of state intervention is more discernible, however, when the judgement involves the efficacy of implementation. A major characteristic of bureaucratic organization under Park was centralization of economic policy formulation and implementation by the Economic Planning Board. The Board, staffed by well trained, competent technocrats and headed by a Deputy Prime

[Table 4] Plan targets and performance

		(Average annual rate; %)									
		The First Plan (1962-1966)		The Second Plan (1967-1971)		The Third Plan (1972-1976)		The Fourth Plan (1977-1981)		The Fifth Plan (1982-1986)	
		Planned	Actual	Planned	Actual	Planned	Actual	Planned	Actual	Planned	Actual
Real GNP growth		7.1	7.8	7.0	9.7	8.6	10.1	9.2	5.5	7.6	8.7
Export growth		5.7	5.8	5.0	1.5	4.5	6.1	4.0	0.1	11.4	10.8
Unemployment rate		15.0	14.3	10.7	19.9	13.0	13.0	14.2	9.7	4.0	n.a

Source: Economic Planning Board & Bank of Korea.

²⁰For a fuller account of the Confucian influence on business in Korea, see Kim (1988) and Steinberg (1988).

Minister who is directly accountable to the president, is an all-empowered agency in the economic area. It has the ultimate power to plan and execute economic policies by coordinating activities of Economic Ministers through control of the budgetary process. Centralism was viewed necessary to facilitate speed and flexibility in decision making and implementation.

If the effectiveness of state intervention is judged on the basis of how closely the targeted goals have been achieved, the Korean case can be seen as a success. The Korean planners in the earlier period were known to have tendency to set output targets in over ambitious, quantitative terms. Despite this practice, actual performance exceeded planned targets by substantial margins in all the plan periods except during the fourth plan period (Table 4). The economy encountered unusually adverse shocks—external and internal—during this period.

6. The Polemic on the Korean State

The polemic surrounding the role of the state in the Korean development is not whether or not the state has intervened in the economy. By now, that the Korean state has been dominant and active is widely accepted. The issue of contention seems to be concerned with the quality of intervention. A number of neoclassical economists view that Korea pursued neutral, market oriented trade policies (Balassa, 1982; Frank & et. al., 1975; Krueger, 1979; Little, 1982; Westphal, 1978 & 1990). Export promotional measures during the rapid growth phase neutralized the bias against exports from the prior policies of import substitution. The policy neutrality is seen as coming close to a free trade regime in the sense that the resulting resource allocation is consistent with comparative advantage, and one that would be obtained under free trade.²¹ In this context, Korea and Taiwan have often been quoted as the case of rapid growth attained by “getting the prices right.”

To attribute the high growth during the export oriented phase to the working of “correct” pricing is, however, an unhelpful oversimplification of the Korean experience. There are fundamental flaws with the argument. First of all, the assertion that the Korean state’s intervention was “neutral” is questionable on empirical grounds. While Westphal’s study (1990, 44) concludes that “the most important incentive apart from the exchange rate was the virtual free trade regime, which accounted for more than two thirds of total export incentives in 1968,” this argument is contradicted by Nam (1981, 205) who shows that Korean export sales, on average, received greater incentives than domestic sales. In particular, the effective protection in agriculture alone averaged more than 70 percent during the growth phase. This fact alone should make the whole argument of a free trade

²¹See a review by S. Younger of G.M. Meier’s *Emerging from poverty* (New York: Oxford University Press, 1984) in *Journal of Economic Literature* (December 1985): p.1793.

regime questionable. Amsden in her recent work (1989) even argues that the success of Korean textile exports in the 1960s was due to the effective subsidies, not because their relative prices were 'market correct.'

One must note in passing that calculations of effective protection involve econometrically intractable problems of what to include to exclude, and in particular, of how to quantify non tariff barriers. The problem is serious since the Korean government resorted to export targeting, quantitative restrictions, non-market incentives and sanctions that defy quantification. More importantly, the comparison becomes more complex since the advantage of a free trade regime would possibly be in reducing the rent seeking activities in the economy.

On the conceptual plane, if market rationality implies that the economic decision makers are not only an efficient selector of alternative courses of action but also an optimal estimator (Stein, 1978), many of the state actions in the 1960s and 1970s would not fit into this framework. It is difficult to reconcile such practices as the picking of the winners and the losers for infant industry development, credit allocation favoring big businesses, and output targeting at the firm level as "market conforming" or "market friendly" activities. More importantly, even if the empirical claim for neutrality of Korean trade policy proved correct, it still is questionable whether or not a bias in favor of both export and import substituting activities would have the same effects as does a free trade regime. The answer must be sought beyond the neoclassical bounds of allocative efficiency. There are other issues, such as scale economies, X efficiency, or interindustrial linkages, that must be taken into account in the comparison. The concept of neoclassical rationality ignores other factors. Therefore, it is not a useful concept in describing the behavior of the Korean state. The state actions, in particular during the export led phase, can be viewed as rational by other standards. One can argue that the state behavior is rational by the standard of the national objective for rapid industrialization. Viewed in this context, the market conforming activities of the state, when necessary, only facilitate the attainment of the prioritized goals.

IV. CONCLUSION

This paper has examined the role of the state in the Korean development from a recent, historical perspective. The striking and persistent feature of the Korean state throughout the history of Korea's industrial development is preservation of state authority to prevail over any particular class interests. The legitimacy for primacy of the state in Korea is embedded in its culture and in its historical legacy beginning in Japanese rule throughout the cold war geopolitics in the postwar era. This historical process that accorded the state a large degree of autonomy, free from constraints of civil society, was critical in Korea's success in industrialization. In the case of Korea, the autonomy of the state combined well with a competent technocratic and private entrepreneurial infrastructure in pursuing the

national objective for industrial development.²²

The Korean model reflects a form of state capitalism. Perceiving the building of a modern industrial economy as the supreme national interest, the state, organized in the fashion of a corporate unit, intervened whenever this seemed to be in the national interest. The state pursued essentially non ideological, pragmatic approaches to industrial development, accommodating to market forces only when they they worked. Thus, the market did not serve as an organizing principle of the economy. It was used as an instrument to facilitate the national goal toward industrial capital accumulation. Also, the private sector played an important role only because the state was willing to reward their entrepreneurial risks. As Kim Jae Ik, a top economics adviser to President Chun summarized, "Ultimately, it was the government that ignited high growth and put Korea on the fast track."²³ Thus, the Korean experience shows that despite many conceivable pitfalls, state interventions are instrumental in facilitating the process of development.

As regards the prospective role of the Korean state, the ultimate question that arises will be: whether or not a Western democracy can serve as a framework for sustained development in an environment where the political culture and historical tradition have not been conducive to political modernization. While the nation faces the challenge of structural adjustments in the economy prompted by the recent move toward political and economic liberalization,²⁴ the state needs to respond more readily to increased demands from the popular sector for social services. The situation will be further complicated by the fact that the country is going through a learning process of policy formulation and implementation in a more democratic environment. Clearly, the success and the speed with which the proper role of the state in a democratic environment is redefined will be a critical factor determining the future of the Korean economy.

²²The argument made here is not to refute the critical role of private capital. On the contrary, without the effective collaboration from the high quality entrepreneurial elite, Park's growth oriented policy would not have succeeded.

²³*The Wall Street Journal*, May 3, 1982.

²⁴Korea has agreed to phase out all import restrictions on the basis of article 8 of the GATT by July 1997. The restructuring of the economy currently under way calls for the shift within manufacturing toward higher technology and higher value added production, and for the shift toward import liberalization in imports as well as in the domestic agricultural and financial sectors.

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