Smith, Patrick (1997) *Japan: A Reinterpretation* (New York: Pantheon).
Somrudee Nicro (1993) 'Thailand's NIC Democracy: Studying From General Elections', *Pacific Affairs*, vol. 66, pp. 167–82.
van Wolferen, Karl (1999) 'The Global Conceptual Crisis', *New Perspectives Quarterly*, vol. 16, pp. 17–26.
Verba, Sidney (1987) *Elites and the Idea of Equality* (Cambridge, Mass.: Harvard University Press).
Vogel, Ezra (1991) *The Four Little Dragons: The Spread of Industrialization in East Asia* (Cambridge, Mass.: Harvard University Press).
Wallerstein, Immanual (1974) *The Modern World System: Capitalist Agriculture and the Origins of the European World-Economy in the 16th Century* (New York: Academic Press).
Wallerstein, Immanual (1980) *The Modern World System II: Mercantilism and the Consolidation of the European World-Economy, 1600–1750.* (New York: Academic Press).
Wallerstein, Immanual (1989) *The Modern World System III: The Second Era of Great Expansion of the Capitalist World-Economy, 1730–1840s* (New York: Academic Press).
Weber, Max (1946) *From Max Weber: Essays in Sociology*, ed. H. H. Gerth and C. Wright Mills (New York: Oxford University Press).
Wyatt, David K. (1984) *Thailand: A Short History* (New Heaven, CT: Yale University Press).
Yoshihara, Kunio (1999) *Building a Prosperous Southeast Asia: from Ersatz to Echt Capitalism* (Richmond, Surrey: Curzon Press).

7 A Reflection on the East Asian Development Model: Comparison of the South Korean and Taiwanese Experiences

Phillip Hookon Park

INTRODUCTION

Since the 1970s the economic development of East Asia has increasingly attracted the attention of development economists and those interested in development studies. East Asia's newly industrialised economies (NIEs) – Singapore, Hong Kong, Taiwan and South Korea – grew at annual rate of 9 per cent during the 1971–80 period and 8.3 per cent from 1981–90, while the world economy grew at the average rate of 2.9 per cent from 1981–90. As well as geographical proximity, the East Asian NIEs share some common characteristics in terms of economic development, such as export-oriented industrialisation, state guidance and involvement in economic development and high investment in human capital formation. Because Singapore and Hong Kong are city states, their economic development can hardly serve as a model for other developing countries. Many developing countries, including those in Southeast Asia (the so called ASEAN-4: Indonesia, Malaysia, Thailand and the Philippines), tried to emulate Taiwan and South Korea, and experienced tremendous success until 1996. The development success of the East and Southeast Asian countries seemed to confirm the validity of the East Asian model.

However in the last quarter of 1997 financial crisis spread through Asia and undermined the economic performance and sometimes the political stability of some of the East and Southeast Asian countries. One of the hardest hit was South Korea. As a result it experiencied negative growth for the first time in 20 years; moreover in a just six months the unemployment rate doubled from 3 per cent to 7 per cent while per capita GNP shrank by more than 40 per cent. Observing this crisis, some scholars and

significant figures such as the chairman of US Federal Reserve Board, Alan Greenspan, commented that the East Asian model could no longer be considered valid and declared the US-style free market system triumphant. On the other hand the contagion did not spread to Taiwan, another adherent of the East Asian model. Although Taiwanese economic growth fell from 8 per cent in 1997 to 5.6 per cent in 1998, its economy continues to show robustness and flexibility in the eyes of most observers.

The aim of this chapter is to analyse and compare the economic development of the East Asian model economies of South Korea and Taiwan from the 1960s to 1997. Until 1997, both countries were heralded as exemplars of the East Asian model. Today South Korea is in deep economic crisis, but to date Taiwan has not only avoided the East Asian financial contagion, but has also continued to grow at a respectable rate. This chapter will attempt to identify and explain this difference. In particular the following questions will be addressed:

- How did the economic policies of and management in South Korea and Taiwan differ?
- How can a star performer such as South Korea end up in a crisis of such magnitude and severity as the one that occurred in 1997?
- How has Taiwan escaped the financial contagion in East Asia and managed to grow at a respectable rate?
- What role did reforms of the financial sector and greater capital market integration play in bringing about the crisis in South Korea?

This chapter will also attempt to draw lessons from the recent economic experience of South Korea and Taiwan to reevaluate the highly acclaimed East Asian model. In this respect the questions of interest are as follows. What are the main features of the East Asian model? Is the model itself in crisis or is there an alternative explanation for the general crisis in East and Southeast Asian countries? What economic policies are consistent with and complementary to the model? In particular, what lesson can be drawn from these countries' experiences with reforms (for example financial reforms), especially in the highly globalised trade and investment regimes?

THE EAST ASIAN DEVELOPMENT MODEL

When we consider South Korea's and Taiwan's development experiences, three important characteristics of the East Asian development model stand out.

First of all the state plays an important and sometimes decisive role in each country's economic development. In Johnson's words, they are

developmental states characterised by three features of the developmental state (Johnson, 1987). First, economic development is the foremost priority of state action. The state emphasises economic development as the principal goal and does not hesitate to intervene in an otherwise market-dominated economy in pursuit of this goal. Second, since the developmental state is a capitalist state it is firmly committed to private property and the market. The market, however, is closely governed by state managers who formulate strategic industrial policy to promote development. Third, within the state bureaucracy pilot agencies (such as the Ministry of International Trade and Industry, MITI, in Japan) play a key role in strategic policy formulation and implementation. Such agencies are given sufficient scope to take initiatives and operate effectively, and are staffed by the best available managerial talent in the state bureaucracy (So and Chu, 1995). Fourth, as a recent World Bank study indicates, these countries have sound 'policy fundamentals', which allow rapid capital accumulation, aggressive investment in human capital and improvement in factor productivity. All of these contribute to rapid growth within a framework of sound macroeconomic management (World Bank, 1993). Fifth, East Asian governments are relatively autonomous and strong *vis-à-vis* local interest groups. The state allows a high degree of bureaucratic autonomy in the implementation of development policies (Onis, 1991).

These are the salient features of the 'East Asian model' and form the core of the experiences of South Korea and Taiwan. However these common features do not mean that the two countries have implemented identical policies. For instance economic policy in South Korea has emphasised growth while macroeconomic stability is given higher priority in Taiwan. Big business conglomerates, known as *chaebol*, dominate the South Korean economy whereas small- and medium-sized firms play a central role in the Taiwanese economy. These differences are important in explaining the different outcomes in the late 1990s.

SOUTH KOREA'S DEVELOPMENT STRATEGY

South Korea's first concrete economic development strategy was launched when Park Chung Hee assumed political power following the coup *d'etát* in 1961 and inaugurated the first five year plan in 1962. Before Park the South Korean government was led by the first president, Rhee Syungman, who lacked a clear vision of economic development, largely because he was preoccupied with taking over North Korea by force. During the period directly after the Korean War, the South Korean economy was heavily dependent on US aid. For instance during Rhee's presidency (1953–60)

South Korea received $2.3 billion in aid (approximately two thirds of South Korea's total imports), with 85 per cent coming from the USA. In the late 1950s US. economic aid to South Korea accounted for over 10 per cent of South Korea's GNP (Lie, 1998). The Rhee government was characterised by corruption and an inability to implement any viable economic policy. In April 1960 Rhee was ousted by a student-led popular uprising and replaced by Chang Myun. Well aware of the causes of Rhee's downfall, Chang made economic development the number one priority of the new government and vowed to clean up corruption within the government. However, owing to the lack of both external support and internal unity, Chang's economic development plan never materialised. Chang's second republic was short-lived – it only lasted about 10 months and was toppled by a military coup, led by Park and a group of graduates from the Korean Military Academy.

Park Chung Hee's Economic Development Strategy (1962–79)

Unlike his two predecessors, Park had a concrete economic development objective. His principal goal was to establish a self-reliant economy. Surprisingly his first five year plan did not include export-oriented industrialisation; it was essentially an extension of the Chang regime's five-year plan, which had emphasised import-substitution industrialisation (Lie, 1998). On the other hand Park was keenly aware of Japan's development success and was determined to adopt the Japanese model. A look at Park's background makes clear his reason for wishing to adopt this model. After graduating from teacher training school in Kyungsang province Park gained admission to the Japanese imperial military academy in Manchuria. He graduated top of his class and was sent to Tokyo for further training at the Tokyo Military Academy. He was then sent back to Manchuria and served in the Japanese imperial army until Japan surrendered to the Allied forces in 1945.

Manchuria was a testing ground for a wartime economy under military rule. The Japanese military ran the Manchurian economy according to a model developed in Japan, with a touch of military regimentation. The Japanese model was essentially in line with the model in which the state directs and utilises enterprises to serve national economic development by controlling finance. In the context of imperial Japan, the government was directly involved in planning and directing economic plans and distributing income. Park's exposure to the Japanese state's involvement in postwar economic development, especially in heavy industry, came to have a profound impact on Korea (Clifford, 1998).

When Park assumed the political leadership of South Korea in 1961 he put into practice what he had learned during the Manchurian years. First he set up an Economic Planning Board (EPB) with wide powers to draft overall economic planning, control the national budget and implement plans. The role of the Ministry of Commerce and Industry (MCI, later the Ministry of Trade and Industry, or MTI) was further strengthened. The MTI was responsible for export promotion, import control, industrial development plans, investment application and trade licensing (Lansberg-Hart, 1993). Likewise the role of the Ministry of Finance (MoF), which was responsible for regulating and supervising all domestic and foreign financial institutions, was greatly strengthened.

Park's economic development strategy changed from import substitution to export orientation as the international environment became favourable for South Korean exports. There were two important external developments that induced the government to turn to export oriented industrialisation (EOI). First, South Korea normalised diplomatic relations with Japan in 1965, despite opposition from the South Korean public. Many South Koreans, remembering the brutal years of the Japanese colonial period and fearing renewed dominance by Japan, protested against the normalisation of relations. Nevertheless Park was determined to proceed and ruthlessly repressed the protesters. Diplomatic normalisation was significant to the South Korean economy for a couple of reasons. First, it received a quick infusion of capital ($800 million) from Japan,[1] which compensated for the fall in economic aid from the USA, and gained access to Japanese technology and capital. South Korean enterprises took over the production of some Japanese products and machinery used for lower value-added and labour-intensive production as Japanese enterprises moved into higher value-added and more capital-intensive production.

Second, South Korea's involvement in Vietnam provided a spur to light industry and exports. During the Vietnam War (1965–73), South Korea earned over $2 billion from a combination of military and civilian activities in Vietnam and increased its exports to Vietnam. Utilising its links with the USA during the war,[2] South Korea exported cement, fertilisers, petroleum products and consumer items such as textiles, shoes and plywood. The receipts from this represented approximately 19 per cent of South Korea's total foreign exchange earnings over the period.

By following Japanese companies in the product cycle and seizing business opportunities during the Vietnam War, South Korea changed its development strategy from import substitution to an export drive. More importantly, after a period of dormancy the industrialisation process took off. As can be seen Table 7.1, the average annual GNP growth rate during this period was 9.5 per cent and the average annual export growth

Table 7.1 GNP and Export growth rate, South Korea, 1962–80 (per cent)

	GNP growth rate	*Export growth rate*
1962	2.2	31.7
1963	9.1	61.1
1964	9.6	37.9
1965	5.8	45.8
1966	12.7	42.9
1967	6.6	34.0
1968	11.3	45.1
1969	13.8	35.4
1970	7.6	34.0
1971	8.8	28.5
1972	5.7	47.9
1973	14.1	95.9
1974	7.7	37.5
1975	6.9	10.8
1976	14.1	56.2
1977	12.7	28.6
1978	9.7	26.5
1979	6.5	15.7
1980	−5.2	17.1

Source: Bank of Korea.

rate was 44.4 per cent. Manufactured exports rose from 8 per cent of final demand in 1963 to 22 per cent in 1966 and 40.1 per cent in 1973. Employment in the production of goods for export accordingly rose from 6.4 per cent of total manufacturing employment in 1963 to 16.5 per cent in 1966 and 34.5 per cent in 1973 (Song, 1990). Park used the EPB and other state bureaucracies such as the MTI and MoF to shape and dictate the economic development process. Consequently the size and influence of these economic bureaucracies grew and strengthened.

State intervention was particularly pronounced in the financial sector. The government owned and controlled all five commercial banks, including the Bank of Korea (the central bank), all six special banks and two of the country's three major non-bank financial institutions. The state also introduced the exceedingly stringent Foreign Capital Inducement Law in 1962 to control foreign capital flows and access to foreign capital by the private sector. According to this law, all foreign loans had to be guaranteed by the government. Moreover the law forbade all overseas transfers of US$1 million or more that had not been approved by the government. By controlling finance, the state could exercise complete dominance over

the business sector. Businesses could turn to the kerb market for capital, but this was not an attractive option as the interest rate in that market was exorbitantly high.[3] The implication was obvious; enterprises' business activities were moulded and directed by the state. Those firms that followed the directions of the state were rewarded with much-needed capital while those that were not willing to operate within the boundaries of the state's plan were abandoned to the kerb market (Lansberg-Hart 1993).

From 1965 economic policy in South Korea was dominated by the growth-first goal and the maxim was dynamic rather than static efficiency; this goal inspired 'supply side' intervention by means of planning, export promotion measures, credit allocation, control of access to foreign exchange, and industrial policy. What was achieved was mainly due to the greater role of state bureaucracies such as the EPB and MoF and the nationalisation of the banking system. South Korea's growth-first approach seemed to be working as the economy grew at an average rate of 9 per cent during the 1965–72 period. However the strategy also had a number of grave consequences.

First, in order to induce firms to concentrate on growth, the state had to adopt a low interest rate policy. However the holding of interest rates below their equilibrium level created excess demand for investable funds and the banks were forced to ration credit. In general, credit rationing favoured large firms – the established customers. The problem was exacerbated by the granting of concessionary loans by the state to favoured companies that complied with state policies and plans. Nonetheless these firms were not necessarily the ones that earned the highest rate of return on their investments. Hence credit rationing by government policy crowded out some higher-return investments – this would have been avoided if the interest rates had been allowed to perform their allocative function in the credit market. Moreover, credit rationing also provided the breeding ground for crony capitalism.

Second, the low interest policy generated excess demand for capital, resulting in high inflation. There were two negative consequences of this. First, inflation reduced the real value of debt for both debtor and creditor, which in effect redistributed real wealth from creditors to debtors. In South Korea, this kind of wealth redistribution always favoured big business enterprises over small and medium-sized enterprises as the former were the recipients of most concessionary and special loans.

Third, domestic savings were discouraged in this high-inflation environment as people had less incentive to keep their money in the bank. As a result the government had to rely on foreign borrowing to finance its industrialisation drive. This problem worsened as the state pursued its growth-first

Table 7.2 Inflation and Saving Rates, South Korea, 1961–72

	Inflation Rate in CPI	*Household Savings*
1961	6.1	−0.97
1963	20.0	3.45
1964	29.8	0.18
1965	14.7	4.15
1966	11.2	1.38
1967	10.8	3.06
1968	10.4	7.45
1969	12.4	3.51
1970	16.2	3.17
1971	13.5	5.70
1972	11.5	8.98

Source: Bank of Korea.

strategy (Table 7.2). Fourth, its heavy reliance on foreign borrowing made South Korea vulnerable to external shocks, and as it was pursuing an export-oriented strategy its vulnerability to external shocks was doubled. It needed to earn enough foreign currency through trade to service its debts. If the external environment had become unfavourable (for instance if the environment in the foreign markets had become sour or if interest rates had risen suddenly due to a supply shock, such as an oil crisis). South Korea's industrialisation drive would have been jeopardised or halted.

South Korea's industrialisation drive entered its second stage in 1972. The third five-year plan (1972–76) was a watershed in the country's economic development. Park's first regime was faced with internal and external problems[4] and Park's response was to strengthen his authoritarian rule by promulgating the new Yushin Constitution[5] in 1972 and launching the Heavy Chemical Industrialisation (HCI) Plan. The HCI Plan, known as the 'Big Push', hardly came as a surprise as Park's aim from the beginning had been to develop a self-reliant economy. The HCI Plan called for the construction of heavy and capital-intensive industries such as iron and steel, shipbuilding, machinery, electronics and petrochemicals. Park hoped to reduce imports and produce higher-value-added exports to solve the country's balance of payments problems and achieve self-sufficiency. The plan was also motivated by the need to build up a defence industry as Park increasingly doubted the USA's commitment to defend South Korea.

The HCI Plan represented a strengthening of the state's intervention in the economy. A special Heavy and Chemical Industry Committee was created

and took priority over the rest of the governmental institutions, bypassing the EPB and giving orders directly to the MoF and MCI (Clifford, 1998). The government once again gave concessionary loans and business licences to companies that were supportive of its plan. Businesses were induced to invest in heavy industry, which required about US$10 billion in investments, and big companies became even bigger. The HCI Plan laid the foundation for the emergence of gigantic conglomerates known as *chaebol*. The combined net sales of the top 10 *chaebol* rose from 15.1 per cent of GNP in 1974 to 30.1 per cent in 1978 and 55.7 per cent in 1981 (Song, 1990).

The state's growth-first strategy did not change; rather it was strengthened and given greater emphasis. For instance when the first oil shock hit the world economy and raised oil prices four fold, the general response in other countries was to slam the brakes on monetary policy in order to control inflation. South Korea, interested in growth only, did nothing about it. Domestic prices shot up 40 per cent in 1974 as M1 increased by 30 per cent. Consequently real GNP rose from an annual average of 9 per cent in the early 1970s to an average 10.8 per cent from 1975 to 1979 (Amsden, 1989).

In order to finance the ambitious HCI Plan the government borrowed heavily from foreign countries. Foreign borrowing was not the only option available – foreign direct investment (FDI) could have been utilised to finance part of the plan, but the government preferred foreign borrowing over foreign investment because it wanted to maintain domestic ownership of these industries. Foreign investment was not to play a significant role in financing economic development in South Korea until the 1990s. For instance foreign loans during the third five year plan (1973–76) amounted to US$5432.8 million whereas total foreign direct investment was a mere $556 million, only about 10 per cent of total foreign loans during the period. As South Korea insisted on foreign borrowing its foreign debt rapidly increased. In 1962 the total foreign debt was $157 million but it increased to $392 million in 1966 (at the end of the first five year plan), $2922 million in 1971 (at the end of the second five year plan), $10533 million in 1976 (at the end of the third five year plan) and $20500 million in 1979, the year in which Park was assassinated. Moreover, as the state encouraged businesses to borrow and expand, the debt–equity ratio (the sum of fixed and current liabilities expressed as a percentage of the firm's net worth) increased dramatically. By the end of 1979 the debt–equity ratio in manufacturing in South Korea had reached 488 per cent, compared with 167 per cent in Taiwan and 110 per cent in the USA (Scitovsky, 1986).

In sum the South Korean growth-first strategy during Park's tenure (1962–79) involved borrowing from abroad, using the proceeds to pay for oil and invest in new industrial plants, and using the plants to increase exports and foreign-exchange earnings. While South Korea did achieve its economic objective – the average annual GNP growth rate over the 18-year period was 9 per cent – domestic expansion created an inflationary pressure that negatively affected domestic savings. Thus the government had to borrow even more heavily from abroad to offset the shortage in domestic funds. The practice of foreign borrowing was intensified by the government's decision to limit direct foreign investment. With $20.1 billion in outstanding debt by the end of 1979, South Korea ranked among the largest foreign borrowers in the world, trailing only Argentina, Brazil and Mexico. The government's utilisation of credit allocation, the government-controlled financial system, and the bolstering of prioritised and privileged industries did serve to achieve the goal of rapid growth, but it also helped to create giant conglomerates, which by the end of the 1970s had become too big to fail. Against this backdrop, South Korea entered a new political era.

Economic Policy During the Chun and Roh Regimes (1981–91)

Chun Doo Hwan seized political power in 1980 by means of a military coup and a bloody crack-down on a people's uprising in Kwangju. Unlike Park, Chun had neither a clear vision nor a concrete plan for economic development when he took power. However it was clear to him that if he squandered Park's legacy of economic growth he would not survive. Hence, he listened to the technocrats, who wished to restructure the high-growth, high-inflation economy into a more rational and stable one. The technocrats in the early Chun regime had two important goals: price stability by cutting the government deficit, limiting monetary growth and slowing wage hikes; and market liberalisation by selectively introducing measures to privatise and deregulate the national commercial banks and anti-*chaebol* measures to limit and check the *chaebol's* economic power.

The technocrats' first objective – price stability – was maintained throughout this period. Except in 1981, the inflation rate was kept under 10 per cent from 1981–91 (Table 7.3). Their second objective – market liberalisation – was only partially accomplished. In 1981 the government introduced a programme that included the privatisation and deregulation of the five national commercial banks, the ten provincial banks and all non-bank financial institutions. By the end of 1983 all five national banks and all financial institutions had been privatised. However privatisation

Table 7.3 GNP growth and inflation, South Korea, 1981–91 (per cent)

	Real GNP Growth	*Rate of Inflation, CPI*
1981	6.62	11.3
1982	5.6	7.3
1983	11.9	3.4
1984	8.4	2.3
1985	7.0	2.5
1986	12.9	2.8
1987	12.8	3.0
1988	12.4	7.1
1989	6.8	5.7
1990	9.0	9.5
1991	8.4	9.7

Source: Bank of Korea.

and deregulation did not mean that the government had relinquished all power to the private sector; the state continued to influence the financial sector by reserving the right to appoint the management of the banks, set interest rates and loan allocation guidelines, and mandate policy loans. *De facto* the banking sector remained a government organ. Because the state saw control of the financial system as the most effective tool with which to discipline businesses, it constantly intervened in that sector. However this created problems. For instance when the economy slowed down in 1985 (the growth rate dropped from 11.9 per cent in 1983 to 8.4 per cent in 1984 and 7.0 per cent in 1985), the state-controlled Bank of Korea cut its interest rate from 6 per cent to 3 per cent and pumped 300 billion won in emergency low-interest loans to the banks in order to relieve the burden of their non-performing loans (Bae, 1995).

There were other notable changes. The majority of non-bank financial institutions came under the control of the *chaebol*. Although the government took a number of preventive steps, such as putting an 8 per cent ceiling on the ownership of shares of commercial banks and a 15 per cent ceiling on the ownership of provincial banks (ibid.), the *chaebol* found ways of gaining control over the newly privatised banks. By the end of 1989 the *chaebol* owned 25–35 per cent of the shares of the commercial banks and controlled about 63 per cent of the funds of security companies. The technocrats' hope of limiting the power of the *chaebol* failed miserably. Instead the privatisation and deregulation measures served to increase the *chaebol's* power to the point where they could challenge the influence of the government in

the financial sector. The erosion of state power occurred not only because of the *chaebol's* challenge, but also because the South Korean state evolved in such a way that it came to resemble a racketeering state rather than a developmental one.

Economic development had not been on Chun's agenda when he took power and he quickly became tired of disciplining businesses – he became more interested in enriching himself, his family and his supporters by taking advantage of state–*chaebol* relations. During Chun's seven-year tenure as president he and his associates forced businesses to pay political contributions or quasi–taxes. The latter were estimated to range from 0.48 per cent to 0.85 per cent of the total annual sales of South Korean companies. In 1989 the average corporation spent 1.4 billion won (about $2 million) on quasi-taxes. This amount did not include unreported donations to Chun and his associates, which a conservative estimate placed at $4–5 billion over the eight years of his tenure (Clifford, 1998). Roh Tae Woo, who succeeded Chun, embezzled about the same amount of money while he was president.

Between 1986 and 1989, for the first time since long-term economic planning began in 1962 South Korea generated a large trade and current account surplus.[6] The economy grew at a phenomenal rate: 12.9 per cent in 1986, 12.8 per cent in 1987 and 12.4 per cent in 1988. This unparalleled economic boom was largely due to external factors. As the USA's and Western European countries' trade imbalance with Japan continued to deteriorate, five major industrial nations agreed artificially to reduce the strength of the US dollar in the September 1985 Plaza Accord (ibid.). At the same time interest rates and commodity prices, especially that of oil, were lowered. Since the won was loosely pegged to the dollar, South Korean exports became cheaper than competing Japanese exports in consumer electronics, steel, ships and cars. Moreover the cheaper oil prices and lower interest rates helped to produce a current account surplus and reduce foreign debt.

As the economy continued to grow at a record rate, South Korean businesses decided to increase their investment in new plants and production facilities. Although the government continued to loosen monetary policy after 1985, businesses wanted even more capital to take advantage of the economic boom. Concerned about inflation, the government would not allow companies to borrow capital from abroad so they increasingly turned to the stock market, which was also booming. Hence companies became more independent of the government as they became less dependent on banks for financing. Moreover South Korean companies, especially *chaebol*, started to invest abroad as domestic labour costs rose and the currency appreciated. This trend continued during Chun's and Roh's presidencies,

when corrupt government had disastrous consequences. The cozy relationship between the state and businesses continued and state officials received bribes or kick-backs from businesses. Concessionary or special loans were given to those with special connections with the Blue House and the Ministry of Finance. Furthermore, since the state usually bailed out big companies in trouble, firms borrowed heavily and diversified their businesses recklessly. This practice resulted in dangerously high debt–equity ratios (Table 7.4).

In summary, the technocrats attempted to rationalise the economy by controlling monetary policy and implementing a deregulation and liberalisation programme in the financial sector in the early years of Chun's presidency. On the one hand this brought down inflation, which had been a chronic problem in South Korea. On the other hand the deregulation and liberalisation programme failed to control or limit the power of the *chaebol*. Or the contrary they became even more powerful as they were now able to influence the financial sector. Owing mainly to the 'three external lows' (low US dollar, low interest rates and low energy prices), the economy grew at a rapid rate – GNP growth averaged 9.3 per cent during the 1981–91 period. Although the government maintained a strong grip on the banking system its power eroded considerably as businesses started to rely on the stock market for financing and found new ways of avoiding the administrative guidelines. The state began to lose its autonomy as its officials, including two presidents, sought self-enrichment by accepting bribes from firms. Moreover firms utilised their cozy relationship with the state to obtain special concessions from banks and they recklessly enlarged their businesses with borrowed funds. All this put the South Korean economy in an extremely precarious position as it became highly leveraged and more vulnerable to an economic downturn (as more of the cash flow must be devoted to the interest payments) and disruptions in international capital markets.

Table 7.4 The *chaebols*' debt–equity ratio

Year/Month	*Debt/Equity Ratio*	
	Top Five Chaebol	*Top 30 Chaebol*
1988./12	314.8 %	239.9%
1992./3	442.2 %	361.1%

Source: Office of Bank Supervision and Examination.

Economic Crisis in 1997

Kim Young Sam's government attempted to shed the legacy of Park Chung Hee's top-down, state-led, and authoritarian development strategy and adopted the establishment of a free market system and deregulation as its major economic policy objective. As soon as Kim Young Sam assumed the presidency, he launched 'The Five Year (1993–97) Plan of New Economy'. The core of the new plan was to strengthen free market mechanisms by relaxing or repealing regulation and promoting incentive and participation. A series of economic reform measures was introduced and in May 1993, in order to promote competition among the banks, the government launched the 'Financial Sector Self-Regulation Program'. In June of the same year, the government also initiated a 'Foreign Currency and Capital Transaction Liberalization' program. In early August, in an attempt to bolster his new economic plan, Kim Young Sam announced an emergency decree outlawing the use of aliases in financial transactions. He also tried to clean up corruption by disclosing senior officials' assets; as a result, many government officials including three ministers, five vice-ministers, and the mayor of Seoul along with many others were forced to stepped down. Furthermore, the government put a few *chaebol* executives on trial for corruption. But, by the 1990s the *chaebol* had become too big and powerful to be checked by the government. They continued to dominate the South Korean economy,[7] and the fundamental pattern of corruption remains deeply ingrained in the country's political and economic culture (Clifford, 1998). Moreover, the government's attempts to deregulate, internationalise, and liberalise the economy in the context of a *chaebol* controlled economy only allowed them to take advantage of the situation. For example, the 1994 to 1996 period saw a burst of liberalisation tied to South Korea's bid for membership of the OECD. The *chaebol* and other private sector companies took this opportunity to binge on foreign borrowing. As a consequence, between 1994 and 1997 foreign debt tripled from $56.9 billion to $154.4 billion. Almost all the foreign borrowing was done by the private sector and more than half of the total debt was short term (Table 7.5).

International lenders preferred short-term lending to long-term lending because this gave them the option not to roll-over outstanding debts if they became too risky, so South Korean firms borrowed short-term funds but put them into long-term investments. This portfolio mismatch paved the way for the recent currency crisis, when foreign lenders suddenly decided not to roll-over their short-term liabilities as crises loomed in Thailand and Indonesia.

There were other factors that contributed to the South Korean financial crisis, including the problem of excess capacity or overaccumulation in the

Table 7.5 Total external liabilities, South Korea, 1993–97 (billion US dollars)

	1993	*1994*	*1995*	*1996*	*1997**	*1997*
Total external debt	43.9	56.9	78.4	104.7	161.8	154.4
Medium and Long-term	24.7	26.5	33.1	43.7	72.9	86.0
Financial institutions	13.0	13.9	19.6	27.7	53.2	50.4
Private enterprises	7.9	9.0	10.5	13.6	17.6	17.6
Public sector	3.8	3.6	3.0	2.4	2.0	18.0
Short term	19.2	30.4	45.3	61.0	88.9	68.4
(% of total)	(43.7)	(53.4)	(57.7)	(58.2)	(54.9)	(44.3)
Financial institutions	11.4	19.4	29.7	39.0	63.1	43.8
Private and non-financial sector	7.8	11.0	15.6	22.0	25.8	24.6

* November.
Source: Bank of Korea.

East and Southeast Asia region. For example, between 1980 and 1991 Asia's share of world trade rose from 9 per cent to 15 per cent while the developed nations' share slipped from 72 per cent to 63 per cent. By 1994 more than half of all investments in developing countries was going to East and Southeast Asian countries (McNally, 1998). Private capital flows into Indonesia, Malaysia, the Philippines, South Korea and Thailand nearly quintupled between 1990 and 1996, soaring from $20 billion to $95 billion per year. The money pouring into these countries fuelled growth that was increasingly based on a pyramid-type, Ponzi-style asset market. Value went up because more money flowed in, attracting still greater capital inflows. Since assets had been purchased with borrowed funds, which had to be refinanced to support highly leveraged positions, some of the assets had to be liquidated to cover debts. As stock and property holdings were sold, panic spread. Currency flight followed as investors pulled out of these markets. In 1997 these countries experienced a net outflow of private capital of $20 billion. China's export drive, which was mainly based on cheaper labour costs, was another important factor in driving down the currency and equity markets. China's growing exports cut into markets, and regional productive capacity came to exceed the absorptive capacity of the global market.

In addition to these external factors, a main cause of the economic crisis in South Korea was its political–economic structure. The growth-first strategy, coupled with the government's preference for foreign borrowing over foreign direct investment, led to the further growth of the giant *chaebol*. As the *chaebol's* power increased and the government turned its eye to racketeering rather than development, the state's power eroded and the

chaebol became too big to fail. Against this backdrop, the government continued to implement financial deregulation and liberalisation policies. The domestic financial deregulation process, begun in the early 1980s, neared completion in the 1990s and the country's borders were opened to short-term financial capital flows, thereby undermining the state's ability to control speculation against the won. In this deregulation process the *chaebol* began to dominate the financial sector and borrowed heavily when the government lowered the mandatory ratios on medium and long-term borrowing in 1996. When the Asian crisis erupted, there was a flight of investor capital from Asian markets and the South Korean economy was pushed to the verge of collapse as foreign banks refused to roll-over loans. Hence the crisis not stemmed only from outside factors such as overcapacity in the region or speculative attacks by hedge funds, but also from inherent problems in the South Korean economic structure. Now let us examine how Taiwan escaped the crisis.

TAIWAN'S ECONOMIC DEVELOPMENT STRATEGY

After the communist victory in mainland China in 1949, General Chiang Kai-shek moved his Kuomingtang (KMT) regime to Taipei. At first Chiang and his fellow mainlanders were not interested in the economic development of Taiwan because their primary objective was to take over the mainland. As the hope of this dimmed and US aid diminished in the 1960s,[8] Chiang turned his attention to economic development.

Taiwan's economic development strategy was quite similar to that of South Korea. In both countries, development was guided by state-led industrial policy, utilising credit allocation, regulated and differential interest rates, prioritised industries and technologies, coordination of investment plans, regulation of the labour market, high state spending on education and infrastructure, managed trade, controls over the movement of money capital into and out of the country, and regulation of inward and outward FDI (Crotty *et al.*, 1997). However there were subtle but crucial differences between the two strategies.

First of all, defeat in the mainland heavily influenced Chiang's economic policies in Taiwan. Unlike Park, who was more concerned with growth, Chiang's main concern was to control inflation and maintain stability, for he and the KMT leadership believed that runaway inflation had contributed to their loss of public support and eventual defeat at the hands of the communists. Hence in Taiwan, the Central Bank of China exerted a strong and ultraconservative influence on the economic bureaucracy (Field, 1995).

In order to maintain low inflation, the government was legislatively prevented from borrowing from the central bank. To maintain monetary stability, the government nationalised the banking system in Taiwan and took very tight control of the entire financial sector.

The government's strong grip on the financial sector continued during the 1960s and 1970s. It was not until the mid 1970s that the government allowed the growth of a formal money market in short-term debt, and until 1991 private commercial banks were not allowed to operate in Taiwan, apart from a few small foreign banks and some non-bank financial institutions such as life insurance or trust and investment companies (Wang, 1998). Non-bank financial institutions such as insurance companies, trust funds and bill finance companies did not play an important role in the financial sector as they accounted for only 7 per cent of total financial claims outstanding by the late 1970s. Up to 1964 the total assets of government-owned banks were 71.3 per cent of the aggregate of all financial institutions in Taiwan. Even up to 1990 the government owned more than 50 per cent of 12 of the 16 domestic commercial banks (Liu, 1992).

The KMT government's institutionalisation of a credit-based, bank-led financial system blocked the development of security-type of financial instruments such as bonds and stocks. Furthermore, unlike their counterparts in South Korea, major banks in Taiwan were not strongly motivated to form security networks or engage in more intensive relational transactions with private firms, for three reasons: a significant proportion of most banks' loans were allocated to the government; most bank loans to the private sector were secured by collateral; and banks generally did not take equity positions in private enterprises. As a result of this tight regulation and control of the financial sector, traditional household networks became the major source of capital accumulation and security sharing. This reliance on traditional household networks for finance limited the size of Taiwanese companies to small and medium-sized firms. Because Taiwanese entrepreneurs pooled capital among themselves, family members, close relatives or intimate friends – as opposed to heavy subsidies and long-term security sharing from concentrated financial resources directly or indirectly supplied by the state, as in South Korea – the Taiwanese firms could not expand as much as those in South Korea. Moreover this reliance on traditional household networks for finance also limited the debt–equity ratio of private firms in Taiwan.

Another important distinction between the South Korean and Taiwanese economies was the longevity of the state's autonomy in Taiwan relative to that in South Korea. Whereas South Korean presidents and government officials received bribes and kick-backs from businesses, the KMT government managed to maintain autonomy. The KMT implemented a

drastic 'party reform' in 1950–52 to remove corrupt elements and tighten party discipline. The party came to resemble a Leninist vanguard party: a single, 'democratic centralist' elite party, exercising leadership throughout the entire political system (Jacobs, 1978). This organisational structure, combined with the nationalists' extensive network of military and security agencies bent on rooting out corruption, collusion and communism, ensured that the state organs remained free from societal influences. However the most important factor in the state's autonomy was its financial independence. After the Second World War, most of the large, capital-intensive, technology-intensive industries were state-owned,[9] which prevented the top party leaders and their bureaucratic minions from becoming captives of potential private capitalist clients. In addition, most of the political refugees arriving from the mainland were military personnel or civil servants with no local property or family connections. The linguistic and cultural differences were substantial between the mainlanders and the natives of Taiwan. These differences compounded the subethinic division and gave the nationalist state a high degree of autonomy from Taiwanese society (Field, 1995).

Although Taiwan was ruled by mainlanders and the KMT, they were the numerical minority and faced a rapidly expanding private sector that was dominated by ethnic Taiwanese. Hence the KMT leadership introduced a division of labour that placed virtually all political power in the hands of the minority mainlanders and left the private sector to the local Taiwanese. Concerned that economic power might be translated into political power, the KMT leadership also introduced policies that limited economic concentration and promoted the equitable distribution of income.

This concern with equitable income distribution of was also influenced by the teachings of Sun Yat-sen, Chiang's predecessor. Sun, a revolutionary influenced by socialism, preached a doctrine that advocated the regulation of capital and the equalisation of land tenure, but without class struggle and granting a significant role to free enterprise (Gold, 1986). Sun's ideas had a significant influence on the KMT leadership, especially when they moved to Taiwan after their defeat by the communists.

These subtle but crucial differences gave rise to a very different industrial and financial structure in Taiwan. The KMT government's anti-inflationary policy, in fact a high-interest-rate policy, boosted capital accumulation and growth. Savings deposits accumulated very rapidly because of the substantial interest paid on deposits. The raising of interest rates also rendered investment a more efficient and more effective engine of growth. In South Korea, concessionary and special loans to favoured companies, credit rationing by banks and government policy crowded out investments

that might have brought high returns if the interest rate had been the main factor limiting the demand for credit. In Taiwan, since credit was rationed mostly by interest rates rather than bank managers and government officials, it raised the average return on the total volume of investment, further accelerating growth (Scitovsky, 1986).

Furthermore the Taiwanese government was much less vigorous than its Korean counterpart in applying financial controls such as concessionary credit allocation and the use of tariffs and quotas as instruments of selective protection. Although exporters (who received a subsidised rate) and large enterprises (which could obtain bank loans) received favourable credit rates relative to other private sector borrowers, Taiwanese policymakers' fear of inflation, the private concentration of capital and accusations of favouritism meant that they were much more reluctant than their Korean counterparts to use preferential financial treatment – whether concessionary loan rates or direct financial bailouts – to foster the success of the few at the expense of the many (Field, 1995).

As a result of the policy of avoiding excessive consolidation of financial resources and the conservative approach to banking operations, Taiwanese firms had to rely on their own funds, small loans from a number of banks or money borrowed from relatives, friends and so on. This reliance on traditional household networks for financial help explains two important features of the Taiwanese industrial structure. First, the size of firms tended to be smaller since Taiwanese firms could not obtain large concessionary or special loans, unlike their South Korean counterparts. Second, the debt–equity ratio tended to be lower than in South Korea because banks were not willing to lend large amounts to individual firms and they could only pool so much of their money in traditional household networks.

Taiwan's financial and industrial structure had a number of important advantages. Since a major proportion of capital needed for investment was generated internally through domestic savings, Taiwan did not have to depend on foreign capital to finance domestic investment. In sharp contrast to South Korea, between 1971 and 1994 Taiwan financed its entire gross domestic capital formation out of domestic savings (Table 7.6). This of course reduced its vulnerability to foreign debtors and thus stabilized the economy. Also, under the constraints of the government's financial and industrial policies, Taiwanese firms had to conduct their financial and industrial operations in a highly flexible, widely diversified manner (Wang, 1998). The small-scale, flexible and informal household network groups became highly advantageous instruments in the implementation of so-called flexible specialisation, which eased the adaptation of the economy to changing circumstances.

Table 7.6 Gross national savings and gross domestic investment in Taiwan, 1951–94 (percentage of GDP)

	Savings	*Investment*
1951–60	9.8	16.3
1961–70	19.7	21.9
1971–80	31.9	30.5
1981–90	32.9	21.9
1991–94	27.4	23.2

Source: UNCTAD data base.

Table 7.7 Debt–equity ratio of manufacturing firms in South Korea and Taiwan, 1972–85 (per cent)

	South Korea	*Taiwan*
1972	313.4	–
1973	272.7	–
1974	316.0	91.5
1975	339.5	99.3
1976	364.6	100.4
1977	367.2	97.4
1978	366.8	92.8
1979	377.1	85.3
1980	487.9	82.5
1981	451.5	78.6
1982	385.8	78.1
1983	360.3	84.8
1984	342.7	110.1
1985	348.4	121.2

Source: Bank of Korea.

More importantly, unlike in South Korea, where the excessively large conglomerates wielded a strong influence over government policy, Taiwanese firms were not allowed to concentrate or consolidate their economic power or political power. Due to the KMT government's decision to limit public lending to private firms, the debt–equity ratios of Taiwanese firms were considerably lower than those of South Korean firms (Table 7.7). As highly leveraged firms are extremely vulnerable to economic downturns or other external shocks, the low debt–equity ratio of Taiwanese firms indicates economic robustness and stability. Finally, while South Korea expressly blocked FDI, Taiwan welcomed it and FDI played an important role in Taiwan's transformation into a newly industrialised economy. FDI not only contributed to capital formation but was also a crucial vehicle for technology transfer to Taiwan (Chowdhury and Islam, 1997).

These differences explain why Taiwan was able to avoid the contagion of the currency crisis of 1997 while South Korea was one of the main casualties. Nonetheless it is very important to point out again that no country could be safe if it was subject to the massive international capital outflow that took place in Southeast and East Asia in 1997. In 1996, the year before the crisis, there was a net flow of $93 billion to South Korea, Malaysia, Indonesia, Thailand and the Philippines, while in 1997 the net outflow was $12 billion – more than 10 per cent of the area's precrisis GDP. This would be equivalent to a change in net capital flows of $850 billion in the US economy, which would undoubtedly wreak havoc on the US financial markets (Crotty and Dymski, 1998). However it is also important to point out that all the countries hit by crisis had large foreign debts, especially South Korea. South Korea's outstanding foreign debt was around $160 billion in 1997 and about 55 per cent of the entire external debt was short term.

The whim of international investors may have triggered the Asian crisis in 1997, but as we have seen, South Korea was suffering from two major structural problems. Its economic stability increasingly weakened as its dependence on foreign borrowing continued. External pressure from powerful international agents such as the G7, the OECD, the IMF, the IBRD and transnational banks and corporations to deregulate the domestic financial markets and capital flows and reduce barriers to imports and FDI, together with the South Korean government's hasty decision to join the OECD, have loosened almost all controls on the financial institutions and eliminated the state's ability to control speculation against the won.

The South Korean government also lost its autonomy and failed to control the *chaebol* which became too big to fail and were able to exert considerable influence on the government's economic policies. The government, rather than directing and guiding businesses towards its developmental goals, began to resemble an agent of big business. For example in the 1990s the *chaebol*, in their thrust to invest in new capacity and new technology at home and abroad, allied themselves with external forces to pressure the government to hasten the pace of domestic financial market deregulation. In response, the Kim Young Sam government, consented to the establishment of 24 new merchant banks by 1996. The *chaebol* took significant ownership positions in many of these new banks and borrowed extensively from them. Furthermore, as the *chaebol* and the new merchant banks were also attempting to gain fuller access to foreign credit markets in order to

take advantage of the lower global interest rates, which were about 50 per cent of South Korea's semiregulated rates, they pressured the government to liberalise – prematurely and excessively – short-term inward capital flows, bank loans and portfolio capital (Crotty and Dymski, 1998; Amsden and Eun, 1997). All this increased the fragility of the South Korean financial market and significantly reduced the government's ability to control and regulate international hedge funds, known as 'hot money'.

In contrast the Taiwanese government never lost its autonomy although significant liberalisation measures were introduced in the financial and industrial sectors, such as the privatisation of state-owned banks, easing restrictions on foreign banks and freeing interest rates. The government also lowered average real tariffs from 7.8 per cent to 5 per cent during 1986–91, freed the exchange rate and sought to shift output from exports and into domestic consumption (Kuo, 1990; Auty, 1997).

These deregulation and liberalisation measures did not signficantly change state–business relations because the government's penchant for controlling and regulating private capital remained intact. Banks in Taiwan are still very conservative in allocating loans to private enterprises, which they keep at arm's length due to the strict penalties that are imposed on bankers who fail to abide by rules such as limiting total loans to a single customer to 25 per cent of the bank's net worth. In the light of such regulations, private firms prefer to obtain financing through the informal kerb market (Wang, 1998). It is important to note that the state still occupies the 'commanding heights' in Taiwan. In order to restrict the expansion of business network groups, the government promulgated the 'Fair Trade Law' in 1992, which provides for the close monitoring of potential monopoly enterprises, including private firms with over US$40 million in annual sales, single businesses with a 50 per cent market share, three companies accounting for two thirds of a product's sales, or five firms with three-quarters of a particular market. However this law does not apply to state-owned enterprises that are deemed crucial to key economic policy (*Free China Journal*, 11 February, 1992).

THE EAST ASIAN DEVELOPMENT MODEL RECONSIDERED

South Korea and Taiwan were prime examples of the East Asian development model. Both countries can be characterised as a developmental state in which the government played a strategic role in taming domestic and international market forces and harnessing them to achieve national ends. Both countries also promoted a bank-based financial system under

close government control. Finally, both countries emphasised trade as the primary means of economic development. These commonalties explain the phenomenal economic success of both countries for three decades.

However there were also important differences between them that explain why South Korea was affected by the currency crisis of 1997 while Taiwan remained largely unscathed. The key differences lie in how the respective governments utilised the financial institutions to achieve regime priorities. In South Korea economic growth took priority over everything else, so the state deliberately nurtured big business groups to facilitate this. The *chaebol* received concessionary and special loans (with low or even negative interest rates) and grew bigger, more concentrated and politically powerful. In Taiwan, the KMT regime's main objective when creating and commanding the repressive formal financial system was to maintain price stability and prevent the concentration of private capital. Taiwanese firms turned mainly to traditional household networks and informal kerb markets for financing, and as a result they tended to be small, fragmented and flexible.

These differences in development strategy had far more important consequences. In South Korea the growth-first strategy, especially during the big push period of the 1970s, inevitably resulted in high inflation. Consequently domestic saving suffered as in a high-inflation environment people have less incentive to keep their money in a bank. Therefore the government was compelled to seek investment funds abroad. Moreover the government consciously limited foreign direct investment in order to maintain full control over domestic enterprises. This decision to rely on foreign borrowing while restricting foreign investment had very serious consequences. Although foreign borrowing may provide a country with more autonomy than would be the case if it allowed foreign equity ownership, the South Korean economy became highly vulnerable to external shock. Ironically, when South Korea was caught up in the 1997 currency crisis and requested an IMF rescue package it virtually lost its economic sovereignty.

During the economic development process the *chaebol* became the main beneficiaries of the government's growth-first strategy. By taking advantage of their access to cheap and often risk-free financing, they were able to increase their size, diversify their products and enhance their international competitiveness. On the other hand, they became too big to fail and too powerful to control. When South Korea started to deviate from its status as a developmental state in the 1980s and 1990s, the *chaebol* took advantage of the situation and even pressured the government to accommodate their private interests.

In Taiwan, the leadership of the KMT government had learned a painful lesson from their defeat on the mainland. Chiang Kai-shek and other mainlanders regarded inflation as one of the main causes of their defeat and

were determined to pursue an economic development strategy aimed at growth with stability. The KMT regime implemented economic policies designed to prevent inflation, financial instability and the overconcentration of private capital. Over the years, by keeping interest rates relatively high the government managed to maintain price stability and encouraged high private saving rates. This proved to be a sounder policy than the growth-first strategy of South Korea. Taiwan was not exposed to the vulnerability inherent in excessive foreign debt because investments were financed by domestic savings rather than foreign borrowing. This is the main reason why Taiwan avoided the contagion that swept through those East and Southeast Asian countries whose investments heavily depended on short-term foreign borrowing.

Unlike the South Korean state, which by and large became a captive of the *chaebol*, Taiwan remained a developmental state because of its financial independence from interest groups. In order to accommodate the large flow of mainlanders and consolidate its power, the KMT took over major industries and economic institutions in the early stages of its rule and over time developed a publicly owned industrial sector characterised by large-scale, capital-intensive or high-tech production technologies and monopolistic operations. This financial autonomy enhanced the state's strength and insulated the top government officials and other state bureaucrats from the influence of private capitalist clients.

Since the end of 1997, most research on East Asian economic development has focused on 'what went wrong'. Most neoliberal or neoclassical commentators assert that the roots of the Asian crisis lie in the incompatibility between the external global environment and most Asian countries' internal economic structures and policies. They also stress that market fundamentals should drive outcomes, and that state intervention can only worsen outcomes. Contrary to this view, other analysts argue that South Korea's continued reliance on foreign borrowing, especially short-term borrowing, was one of the fundamental causes of its economic crisis in the late 1990s. However this only explains the surface of the crisis. South Korea's decision to give growth greater priority than stability at the start of its economic development programme made the economy prone to high inflation, which negatively affected the domestic savings rate. As investment could not be financed through domestic savings. the government relied heavily on foreign borrowing to finance the industrialisation drive. As a consequence the economy became highly vulnerable to external shocks such as that which occurred in 1997.

Furthermore, contrary to the neoliberal view that too much government interference in the private sector and too much cronyism caused the crisis, the South Korean government's weakening in relation to the *chaebol*, precipitated the crisis. As we have seen, the *chaebol* became too big and powerful and eventually pressured the state prematurely and excessively to liberalise short-term inward capital flows in the mid 1990s. The preconditions for the crisis were created by the failure of the government to maintain its responsibility to monitor and control economic activity in the national interest.

The different outcomes of South Korea's and Taiwan's economic development in the late 1990s has taught us crucial lessons. First, stability should not be sacrificed to growth. When a developing country formulates an economic development strategy, stability should be one of the prime objectives. Second, as Peter Evans argues, an economic bureaucracy that is highly capable and closely connected to – but still independent of – the business community, is an essential institutional prerequisite for successful policy formulation and implementation (Evans, 1998).

Notes

1. $200 million in public loans, $300 million in grants and $300 million in commercial loans.
2. Over the eight years of the Vietnam War, South Korea sent over 300 000 soldiers and became the largest US-allied force after the South Vietnamese.
3. It was as high as 54 per cent during the 1966–70 period.
4. Park had become very unpopular. Despite his economic success as a result of the first and second five year plans and his extensive and well-funded political organisation, he only narrowly defeated Kim Dae Chung in the 1971 presidential election because there was growing dissatisfaction with his harsh authoritarian rule among students and the educated middle class. Foreign debt surged out of hand in the late 1960s and South Korea was forced to turn to the International Monetary Fund for help in 1971. In terms of security Park was unhappy about the withdrawal of nearly a third of the US forces on the peninsula in the wake of the Nixon doctrine. Moreover the world economy began to slow in the early 1970s and protectionism began to rise. For instance the USA pushed South Korea to sign a bilateral trade restraint agreement on textiles, which were South Korea's leading export item. In 1970 textiles accounted for 33 per cent of total manufacturing output, 32 per cent of manufacturing employment and 38 per cent of total exports. Textile exports to the USA alone accounted for 15 per cent of all South Korean exports (Woo, 1991).
5. The Yushin Constitution was essentially designed to make Park a dictator for life.
6. The trade surplus was $3.13 billion in 1986, $6.26 billion in 1987, $8.89 billion in 1988 and $.92 billion in 1989. The current account surplus was $4.62

billion in 1986, $9.85 billion in 1987, $14.16 billion in 1988 and $5.06 billion in 1989.

7. The top *chaebol* groups increased the number of individual companies within their fold by 150 in 1996 and were involved in 114 company mergers in the first nine months of 1997 (Yoon, 1997).
8. Total US military assistance to Taiwan over the period 1951–65 amounted to about US$2.5 billion. US economic and military aid accounted for about 4 per cent of Taiwan's GNP during this period.
9. The party-state has directed manufacturing activities in the following areas: electric power, heavy construction, petrol, petrochemicals, fertilisers, breweries, sugar, tobacco, aluminum, shipbuilding, steel, bus transportation and airlines (Wang, 1998).

References

Akyuz, Y., H. J. Chang and R. Kozul-Wright (1998) 'New Perspective on East Asian Development', *Journal of Development Studies*, special issue, pp. 4–36.

Amsden, A. (1989) *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press).

Amsden, A. and Y. D. Eun (1997) 'Behind Korea's Plunge,' *New York Times*, 27 November.

Auty, R. S. (1997) 'Competitive Industrial Policy and Macro Performance: Has South Korea Outperformed Taiwan?', *Journal of Development Studies*, vol. 33, no. 4, pp. 445–63.

Bae, Y. M. (1995) 'Finance in South Korea', in Korean Socioeconomic Conference (ed.), *Lecture on the South Korean Economy* (in Korean) (Seoul: Hanwool Economy series).

Bank of Korea (1970–98) *Annual Report* (Seoul: Bank of Korea).

Chowdhury, A. and I. Islam (1997) *Asia-Pacific Economies: A Survey* (New York: Routledge).

Clifford, M. (1998) *Troubled Tiger: businessman, bureaucrats, and generals in South Korea* (Armonk, NY: M. E. Sharpe).

Crotty, J. and G. Dymski (1998) 'Can the Global Neoliberal Regime Survive Victory in Asia?', *International Papers in Political Economy*, no. 3, pp. 17–29.

Crotty, J., G. Epstein and P. Kelly (1997) 'Multinational Corporations, Capital Mobility and the Global Neo-Liberal Regime: Effects on Northern Workers and on Growth Prospects in the Developing World', *Seoul Journal of Economics*, vol. 10, no. 4, pp. 297–337.

Cumings, B. (1987) 'The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles and Political Consequences', in F. C. Deyo (ed.), *The Political Economy of the New Asian Industrialism* (Ithaca, NY: Cornell University Press), pp. 44–83.

Deyo, F. C. (ed.) (1987) *The Political Economy of the New Asian Industrialism* (Ithaca NY: Cornell University Press).

Evans, P. (1995) *Embedded Autonomy: State and Industrial Transformation* (Princeton, NJ: Princeton University Press).

Evans, P. (1998) 'Transferable Lessons? Re-examining the Institutional Prerequisite of East Asian Economic Policies', *Journal of Development Studies*, special issue, pp. 66–86.

Field, K. (1995) *Enterprise and the State in Korea and Taiwan* (Ithaca, NY: Cornell University Press).

Glenson, W. (1979) *Economic Growth and Structural Change in Taiwan: The Post War Experience of the Republic of China* (Ithaca NY: Cornell University Press).

Gold, T. (1986) *Economic Development, Principles, Problems, and Policies* (New York: W. W. Norton).

Gold, T. (1988) 'Colonial Origins of Taiwanese Capitalism', in E. A. Winckler, and S. Greenhalgh, *Contending Approaches to the Political Economy of Taiwan* (New York: M. E. Sharpe), pp. 101–17.

Hsiao, F. and M. Hsiao (1996), 'Taiwanese Economic Growth and Foreign Trade', in J. Kuark (ed.), *Comparative Asian Economies* (Greenwich, CT: JAI Press).

Jacobs, N. (1978) *The Origin of Modern Capitalism and Eastern Asia* (Hong Kong: Hong Kong University Press).

Johnson, C. (1982) *MITI and the Japanese Miracle*, (Stanford, CA: Stanford University Press).

Johnson, C. (1987) 'Political Institutions and Economic Performance: the Government–Business Relationship in Japan, South Korea, and Taiwan', in F. C. Deyo (ed.), *The Political Economy of the New Asian Industrialism* (Ithaca, NY: Cornell University Press).

Lansberg-Hart, M. (1993) *Rush to Development. Economic Change and Political Struggle in South Korea* (New York: Monthly Review Press).

Lau, L. (ed.) (1986) *Models of Development: A Comparative Study of Economic Growth in South Korea and Taiwan* (San Franscisco, CA: Institute for Contemporary Studies Press).

Lie, John (1998) *Han unbounded: the political economy of South Korea* (Stanford, CA: Stanford University Press).

Liu, J. C. (1992) *An Economic Analysis of Postwar Taiwan* (Taipei: Jen-Jien Publishing).

Kuo, S. (1990) 'Liberalization of the Financial Market in Taiwan in the 1980s', in S. G. Rhee and R. P. Chang (eds), *Pacific-Basin Capital Markets Research* (Amsterdam: North-Holland).

McNally, D. (1998) 'Globalization on Trial: Crisis and Class Struggle in East Asia', *Monthly Review*, vol. 50, no. 4, pp. 1–14.

Office of Bank Supervision and Examination (Republic of Korea) (1987–1993) *Annual Report* (Seoul).

Onis, Z. (1991) 'Review article: The logic of the developmental state' *Comparative Politics*, vol. 24, pp. 109–26.

Scitovsky, T. (1986) 'Economic Development in Taiwan and South Korea, 1965–1981', in L. Lau (ed.), *Models of Development: A Comparative Study of Economic Growth in South Korea and Taiwan* (San Francisco, CA: Institute for Contemporary Studies Press).

So, A. Y. and S. W. Chu (1995) *East Asia and the World Economy* (Thousand Oaks, CA: Sage).

Song, B. N. (1990) *The Rise of the Korean Economy* (Oxford: Oxford University Press).

Stiglitz, J. (1994) 'The Role of the State in Financial Markets', in *Proceedings of the World Bank Conference on Development Economics 1993* (Washington, DC: World Bank).

UNCTAD (1997) *Trade and Development Report, 1997* (New York and Geneva: United Nations).

Wade, R. (1990) *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press).

Wade, R. and F. Veneroso (1998) 'The Asian Crisis: The High Debt Model vs. the Wall Street–Treasury–IMF Complex', *New Left Review*, no. 228 (March–April).

Wang, H. H. (1998) *Technology, Economic Security, State and the Political Economy of Economic Networks* (New York: University Press of America).

Woo, J. E. (1991) *Race to the Swift: State and Finance in Korean Industrialization* (New York: Columbia University Press).

World Bank (1993) *The East Asian Miracle: Economic Growth and Public Policy* (Oxford: Oxford University Press).

World Bank (1996) *Global Economic Prospects and the Developing Countries* (Washington, DC: World Bank).

Yoon, Jin-Ho (1997) 'IMF Bailout and Employment Crisis: the labour response', Korean Confederation of Trade Unions, 11 December, 1997.

8 Dual Sources of the South Korean Economic Crisis: Institutional and Organisational Failures and the Structural Transformation of the Economy

Dongyoub Shin

THE POLITICO-ECONOMIC INSTITUTIONS AND CORPORATE ORGANISATIONS OF SOUTH KOREA: FROM CORE COMPETENCIES TO CORE RIGIDITIES

This chapter analyses the sources of the South Korean economic crisis and the current economic reforms. Many business scholars and practitioners have tried to figure out the causes of the economic crisis that swept through most Asian countries in 1997. Among the seriously damaged Asian countries, the case of South Korea, which used to be the world's eleventh largest trading country, has drawn special attention from students of Asian economic systems. Until the financial crisis in 1997 the South Korean economy had enjoyed miraculous growth. In the early 1960s South Korea was one of the world's poorest nations, but by the mid 1990s it had become a major competitor in many core industries, such as semiconductors, cars, ship-building, steel and electronics. The South Korean economic system was so highly praised that it was closely studied and ardently copied by many developing countries. South Korea was even acclaimed as 'the next giant' that would follow in the footsteps of Japan as a significant force in the world economy (Amsden, 1989). As late as the mid 1990s few anticipated the sudden collapse of the economy. So what went wrong?

There are various possible causes of the South Korean economic crisis, but this study focuses on structural problems at the institutional and