

L

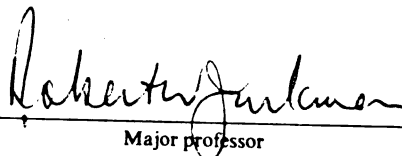
LIBRARY
Michigan State
University

This is to certify that the
dissertation entitled
The State, The International Economy,
and Industrial Development in the
Republic of Korea

presented by
Russell John Mardon .

has been accepted towards fulfillment
of the requirements for

Ph.D. degree in Political Science


Major professor

Date Nov. 3, 1987



RETURNING MATERIALS:

Place in book drop to
remove this checkout from
your record. FINES will
be charged if book is
returned after the date
stamped below.

~~SEP 11 1989~~

~~032 268~~

~~OCT 23 1989~~

~~296~~

~~NOV 20 1989~~

~~324~~

~~JAN 3 1990~~

~~FEB 4 1990~~

~~A #7 L~~

~~MAR 5 1990~~

~~D #67~~

~~MAR 04 1990~~

~~JUN 26 1990~~

~~AUG 12 1990~~

~~SEP 17 1990~~

~~0324~~

~~JAN 04 1990~~

~~057~~

~~MAR 27 1990~~

THE STATE, THE INTERNATIONAL ECONOMY, AND
INDUSTRIAL DEVELOPMENT IN THE REPUBLIC OF KOREA

By

Russell John Mardon

A DISSERTATION

Submitted to
Michigan State University
in partial fulfillment of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

Department of Political Science

1987

ABSTRACT

THE STATE, THE INTERNATIONAL ECONOMY, AND
INDUSTRIAL DEVELOPMENT IN THE REPUBLIC OF KOREA

By

Russell John Mardon

Copyright by

RUSSELL JOHN MARDON

1987

In the mainstream of the leading schools of thought on economic development in developing countries -- the liberal and the Marxist perspectives -- the state has not been viewed as an autonomous or significant actor. In both of these traditions of thought, though with different lines of reasoning, the state tends to be viewed as a function of societal structures. Thus, neither of these theoretical perspectives examine the interrelationship between the state and the pattern of economic development. By examining the empirical record of economic development and the significant role that the state has played in leading the industrial transformation that has occurred in the Republic of Korea over the past twenty-five years, it becomes apparent that neither the liberal nor the Marxist theoretical explanations is adequate.

In Korea, the state has played a highly significant role in intervening into the economic development process and altering societal structures to facilitate industrial growth. The capacity of the Korean state to act in a relatively autonomous manner to implement and shape the pattern of economic development defies the prevailing assumptions and arguments of both the liberal and Marxist perspectives.

There is an emerging, or perhaps, reemerging trend within the study of economic development theory that focuses upon the state as a force that can affect and shape the course of economic development.

ABSTRACT

THE STATE, THE INTERNATIONAL ECONOMY, AND INDUSTRIAL DEVELOPMENT IN THE REPUBLIC OF KOREA

By

Russell John Mardon

In the mainstream of the leading schools of thought on economic development in developing countries -- the liberal and the Marxist perspectives -- the state has not been viewed as an autonomous or significant actor. In both of these bodies of thought, though with different lines of reasoning, the state tends to be viewed as a function of societal structures. Thus, neither of these theoretical perspectives examine the impact that the state can have on society and the pattern of economic development. When examining the empirical record of economic development and the significant role that the state has played in leading the industrial transformation that has occurred in the Republic of Korea over the past twenty-five years, it becomes apparent that neither the liberal nor the Marxist theoretical explanations is adequate.

In Korea, the state has played a highly active role by intervening into the economic development process and shaping societal structures to facilitate industrial growth. The capacity of the Korean state to act in a relatively autonomous manner to facilitate and shape the pattern of economic development defies the prevailing assumptions and arguments of both the liberal and Marxist perspectives.

There is an emerging, or perhaps, reemerging trend within the study of economic development theory that focuses upon the state as a force that can affect and shape the course of economic development.

The regime type in power, its goals and priorities, its capacity to accumulate and effectively allocate resources, and its capacity to shape the pattern of foreign capital and technological inflows into the domestic economy become crucial factors in explaining development experiences.

Utilizing primary and secondary data sources, this study examines the role of the Korean state in the economic development process. It analyzes the manner in which the Korean state established economic policy, organized its bureaucratic apparatus to implement that policy, and shaped its relationship with the Korean society and the international economic community. A Korean "model" is developed with an explanation and an analysis of six key areas of economic activity in which the state actively intervened to shape economic outcomes.

To Gayoeb, Dyana, Lenore, and my Mother

Whose love I cherish,
and to the Korean people
and the hope that they may
reunify without warfare.

ACKNOWLEDGMENTS

With a project of this size, the contents are never truly the work of an individual. The thinking and effort of many people have gone into this study. Some people are acknowledged in the footnotes, but many are not. Here I would like to acknowledge those who have had the most direct impact on my academic training and on the course of this study. Of course, none of them are responsible for the content of this study or its conclusions. That responsibility is mine alone.

My intellectual debts are many and varied. Professor Robert Jackman, the chairman of my dissertation committee, has given me considerable support and assistance at all stages of this study's development. His scholarly commitment, his methodological skills, and his personal character make him a scholar and a person worthy of high respect. Professor Atul Kohli has read earlier versions and drafts of this manuscript and has made major contributions through his suggestions. He also significantly influenced the course of my academic training in the early stages of my graduate curriculum.

Professors Michael Bratton, David Rohde, and Brian Silver, I would like to thank for serving on my committee. For their time, patience, advice, and assistance I am very grateful.

I would also like to acknowledge and thank the Political Science Department at Michigan State University. The department has been very supportive throughout my graduate education. The faculty members have

given generously of their time, the department has provided valuable funding without which my graduate education would not have been possible, and the office staff has been extremely helpful and efficient at all times. Especially, I would like to thank Iris Dunn, Karen Albrecht, and Rhonda Tiedt for their administrative assistance, and Harriet Dhanak for her instruction and assistance in the politometrics research laboratory.

In addition, I would like to thank the University of Maryland/Asian Division and its director in Korea, Dr. Larry Hepinstall. As an instructor with the University of Maryland, I was able to finance my research in Korea. Dr. Hepinstall, very graciously and at times with great difficulty, arranged my schedule so that the time I had to conduct my research was maximized. I would also like to thank the many Korean government officials, scholars, and businessmen as well as the many foreign business and banking representatives who cooperated with me in the course of my research.

Finally, I would like to thank my wife, Gayoeb. She has made a very significant contribution to this dissertation. Her careful proofreading uncovered many inconsistencies and other errors. She has also typed and retyped this manuscript with great patience.

TABLE OF CONTENTS

LIST OF TABLES	x
Chapter I: The Construct of the State in International Economic Development Theory	1
The Mercantilist Perspective and the Role of the State	12
The Liberal Perspective and the Role of the State	18
The World System Perspective and the Role of the State	30
The State Intervention Perspective	48
Chapter II: Korean Political - Economy Prior to the Military Coup of 1961	64
The Traditional Korean Economy	65
The Japanese Occupation of Korea	76
The Struggle for Power and the Economic Policy of the Korean Republic: 1945 - 1961	93
Chapter III: The State and the Industrialization Process	123
The Reorganization of the State and its Relationship to Society	127
A Central Planning Institution that Develops and Coordinates Industrial Development Strategy	149
Financial Institutions and Policies that Coordinate Capital Accumulation	174
The Effective Allocation of Resources to Develop Industries Targeted by Central Economic Development Plans	185

State Control Over Private Enterprise and the Concentration of Industrial Production in a Relatively Few Corporate Conglomerates	199
State Repression of Labor	212
Institutional Mechanisms that Survey and Regulate the Inflow and Usage of Foreign Capital and Technology	220
Summary: The Korean State and the Industrialization Process	225
Chapter IV: The State and Foreign Capital: Inducement, Regulation, and Control	231
Legal and Bureaucratic Control of Foreign Penetration in Korea	243
Korean State Strategies and the International Economy	257
The Inducement, Utilization, and Management of Foreign Capital Loans	264
State Management of Foreign Direct Investment	278
State Policy and the Inducement of Foreign Technology	318
Summary: The Korean State and the Control of Foreign Capital and Technological Inflows	336
Chapter V: Concluding Observations: The Korean Development Model and Its Implications for Other Developing Countries	340
The State and Economic Development in Korea	341
The Implications of Korean Industrialization Policy for Other Developing Countries	348
Appendix: Primary Data: Sources and Collection Techniques	367
Bibliography	379

LIST OF TABLES

Table 2.1	Trade Balance After the Signing of the Treaty of Kanghwa (1876)	72
Table 2.2	Korean Rice Production and Export: 1912-1933	.79
Table 2.3	Per Capita Food Consumption of Cereals and Beans in Korea	81
Table 2.4	Annual Average Mineral Production in Korea	.83
Table 2.5	Composition of Korean Production: 1925-1939	.84
Table 2.6	Composition of Korean Industry: 1930-1939	.86
Table 2.7	Composition of Population and Land in North and South Korea: 1945	.90
Table 2.8	Net-Commodity Product in South and North Korea: 1939-1940	91
Table 2.9	Composition of Manufacturing Production Between North and South Korea in 1939	.92
Table 2.10	Economic Aid Received: 1953-1960	114
Table 3.1	Targets and Achievements of Five Year Plans: Annual Growth Rates	154
Table 3.2	Economic Structure and Growth Rate by Sector .	161
Table 3.3	Composition of Exports: 1964 - 1984	168
Table 3.4	Investment and Savings	181
Table 3.5	Government Revenues, Expenditures, and Investment	.183
Table 3.6	Social Indicators	.218
Table 4.1	Foreign Capital Arrivals	265

Table 4.2	Foreign Investment by Economic Sector/ Number of Projects	281
Table 4.3	Foreign Investment by Economic Sector/ Value	282
Table 4.4	Foreign Investment by Investment Ratio/ Number of Projects	294
Table 4.5	Foreign Investment by Investment Ratio/ Value	295
Table 4.6	Foreign Technological Licenses by Industrial Sector	327

determined to develop the Korean economy. Economic development was viewed by this military regime as being directly related to the survival of the state and hence the highest national objective. In the view of the new government, only economic development would increase the military capacity of the state so that it could defend itself from an external military threat. In 1961, the Korean military and economy were entirely dependant upon United States' assistance. Its survival depended upon American compliance with Korean national defense needs. The new regime was determined to increase the level of autonomy that the Korean state could exercise over its own national defense needs. Developing an industrial economy would lead to increased military capacity through domestic production of strategic goods and through increased capacity to fund military expenditures domestically. This, in turn, would increase the level of national autonomy that the Korean state could exercise over its own national defense decisions.

In addition to the external threats to the Korean state, the new regime was not viewed as a legitimate government by the Korean population. Internal opposition to the new regime was of a large magnitude. However, the Korean population was poverty stricken; malnutrition was rampant in society; and very little employment was

Chapter I: The Construct of the State in International Economic Development Theory

In 1961, a military coup in the Republic of Korea (hereafter referred to simply as Korea) placed in power a young military clique determined to develop the Korean economy. Economic development was viewed by this military regime as being directly related to the survival of the state and became the highest national objective. In the view of the new government, only economic development would increase the military capacity of the state so that it could defend itself from an external military threat. In 1961, the Korean military and economy were entirely dependent upon United States' assistance. Its survival depended upon American compliance with Korean national defense needs. The new regime was determined to increase the level of autonomy that the Korean state could exercise over its own national defense needs. Developing an industrial economy would lead to increased military capacity through domestic production of strategic goods and through increased capacity to fund military expenditures domestically. This, in turn, would increase the level of national autonomy that the Korean state could exercise over its own national defense decisions.

In addition to the external threats to the Korean state, the new regime was not viewed as a legitimate government by the Korean population. Internal opposition to the new regime was of a large magnitude. However, the Korean population was poverty stricken; malnutrition was rampant in society; and very little employment was

available. The new regime viewed economic development as the means to gaining legitimacy. If jobs could be generated and living standards increased, the population would come to support the regime, it was believed. The engine of this growth was principally led by exports and income. With economic development being the highest priority of the new regime, the new government quickly moved to reorganize the bureaucracy in an attempt to structure state instruments into a central position to facilitate the planning and implementation of economic initiatives. The state proceeded to penetrate society at all social strata, using a combination of incentives and compulsion to reorder society in compliance with government directives in relation to state economic development strategies. The state became directly involved in economic planning, in capital accumulation, and in the allocation of investment financing to ensure that resource allocation fit a pattern consistent with state economic development plans. In 1960, Korea had one of the lowest GNP per capita in the world -- below \$100 annually.¹ At this time, approximately 45 percent of GNP was generated by the agricultural sector, while mining and manufacturing accounted for only 17 percent of GNP. In 1960, the value of imports was 10 times greater than the value of exports, domestic savings equalled less than 1 percent of GNP, and 78 percent of total investment was financed by foreign aid.² By 1980, per capita GNP had increased to \$1,605 annually, and this figure would exceed \$2,000 by 1986. The GNP growth rate between 1963 and 1980 averaged over 10 percent annually in real terms. In 1980, agriculture accounted for only 14 percent of GNP, while

1. Yearbook of National Account Statistics, United Nations, (1966), pp. 730-733.

2. Bank of Korea, Economic Statistics Yearbook, 1973.

manufacturing accounted for 30 percent, and financial and other services accounted for 56 percent. Between 1963 and 1980, the growth rate of manufactured goods increased at an annual rate of over 20 percent. The engine of this growth was principally led by exports and increasingly financed by domestic savings. By 1985, exports in value equaled \$32 billion, with over 96 percent of exports being manufactured goods. Domestic capital formation as a percent of GNP increased from negligible in 1960, to 21 percent in 1980, and to 27 percent in 1984. Total domestic investment, which in 1960 was 78 percent financed by foreign aid, became dominated by domestic savings. In 1965, domestic savings equaled 49 percent of total investment. In 1980, domestic savings equaled 70 percent of total investment. This figure increased to over 90 percent by 1984.³

The Korean economy is still a developing economy and has several vulnerabilities. For example, domestic savings have increased substantially. However, domestic savings are still inadequate to finance total investments, and Korea has accumulated a foreign debt of over \$45 billion as of 1985. Servicing this debt, although manageable at the present time as the Korean debt-service ratio is near 20 percent, is a significant drain on the Korean economy. Also, with a limited domestic market, Korea was forced to rely on exports in order to drive industrialization. This made the Korean economy vulnerable to protection or recession in other economies. Korea has also had to rely heavily on imported machinery and technology, especially at earlier stages of its development. Although Korean R & D and technical knowledge have increased substantially, Korea is still

4. See: Bruce Cumings, "The Origins of Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles, and Political Consequences," *International Organization*, Winter 1984, 100-120.

3. Economic Planning Board, Major Statistics of Korean Economy, 1986.

vulnerable to its dependence on foreign technology in high technical sectors.

However, recognizing these structural weaknesses does not negate the fact that the economic base has been transformed. In relation to economic growth in real terms and diversification of production, it can be argued that Korea has had successful capitalist economic development.⁴ This development has been planned and facilitated by powerful political structures that consciously direct the economic processes. In Korea, economic development has been state induced and manipulated. Private industrial capital has been directed by political authority and subjected to the controls of that authority. The state manipulated market mechanisms in a manner it viewed as favorable to the goals of the state, then induced private industrial capital through compulsion and incentives to abide by state directives. The industrial bourgeoisie has essentially carried out state planned economic development initiatives. The state and the industrial bourgeoisie have developed a symbiotic relationship where state political goals and private industrial economic goals have become intertwined and inseparable. However, the substantial political and economic goals and the more significant mechanisms of control (i.e. coercive mechanisms and the allocation of finance for investment) remain within the authority of the state. The industrial bourgeoisie, while a significant actor, remains vulnerable and dependent upon state development strategies and state allocations of investment finance.

4. See: Bruce Cumings, "The Origins of Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles, and Political Consequences," International Organization, Winter 1984. Charles Barone, "Dependency, Marxist Theory, and Salvaging the Idea of Capitalism in South Korea," Review of Radical Political Economics, Spring 1983.

The central concern of this study is to examine the role that the state can play in shaping political economic structures in a manner that will effectively facilitate economic development. In the mainstream of the two leading schools of thought on economic development -- the liberal and the Marxist perspectives -- the state has not been viewed as an autonomous actor. In both of these bodies of thought the state tends to be a function of societal interests. Both of these bodies of thought, though with very different lines of reasoning, view society as shaping government and do not generally examine the impact of the state on society.⁵ There are exceptions within each body of literature. In the liberal tradition, political scientists such as Huntington have argued explicitly for the need to build strong state institutions to maintain political stability while economic development is occurring.⁶ In Marxist literature, the minority structuralist school, led by scholars such as Althusser and Poulantzas, has argued that the state is a relatively independent actor; however, the state operates within the overall structure of a capitalist system, and its primary function is to maintain the cohesion of the system as a whole.⁷ Although there are these exceptions, the main thrust of these theoretical approaches perspective documents the negative impact of foreign investment, highlighting the lack of national control and the dependent

5. Alfred Stepan, The State and Society: Peru in Comparative Perspective, (Princeton: Princeton University Press, 1978), p. 17. Also see: Peter Evans, et al., Bringing the State Back In, (Cambridge: Cambridge University Press, 1985).

6. See: Samuel Huntington, "The Change to Change: Modernization, Development, and Politics," Comparative Politics, April 1971.

7. See: Louis Althusser, Politics and History: Montesquieu, Rousseau, and Marx, (London: New Left Books, 1972). Lenin and Philosophy and Other Essays, (London: New Left Books, 1971). Nicos Poulantzas, Political Power and Social Classes, (London: New Left Books, 1973). "The Problems of the Capitalist State," New Left Review, Nov./Dec. 1969. (New York: Basic Books, 1972).

assign very little independent weight to the state when discussing economic development.

In both of these theoretical approaches, direct foreign investment, primarily in the form of multinational corporation investment, plays an important role in determining the pattern of economic development in contemporary developing nations. The liberal perspective tends to assume that free trade and expanding multinational corporation (MNC) activity are positive factors in the economic development of a developing country. This perspective, when focusing on multinational corporations and economic development, is primarily concerned with how multinational corporations function and with how MNC activities can be expanded.⁸ However, the global rationality of the MNC is often in conflict with the interests of the internal economic need of a developing nation. The liberal literature that addresses the economic concerns of developing nations tends to favor the expansion of MNC activity and does not direct attention to the issue of how a developing nation may control MNC activity in a manner that is favorable to its domestic economic needs.

The Marxist literature on foreign investment and economic development also examines multinational corporation activity. This perspective documents the negative impact of foreign investment, highlighting the lack of national control and the dependent relationship that foreign investment in a developing economy tends to

9. See: Theotônio Dos Santos, "The World as a System," *American Economic Review*, May 1970; David Collier, *Dependency and Development* (Princeton: Princeton University Press, 1972); Cardoso, "Associated Dependent Development," in *Dependency and Development in Authoritarian Brazil*, (New Haven: Yale University Press, 1979); Volker Bornschier, "Multi-National Corporations and the Development of the Cross National Unit for the Decapitalization of the Developing World," *World Development*, 1977; and David. 8. See: Raymond Vernon, *Sovereignty at Bay*, (New York: Basic Books, 1971); The Storm over the Multinationals, (Cambridge, Mass.: Harvard University Press, 1977); Louis Wells and John Stopford, Managing the Multi-National Enterprise: Organization of the Firm and Ownership of the Subsidiaries, (New York: Basic Books, 1972).

facilitate.⁹ However, like the liberal perspective, the Marxist perspective offers little attention to the impact that state strategies can have in altering the effect of foreign investment on developing economies.

When examining the empirical record of capitalist economic development in Korea, it becomes apparent that neither the liberal nor the Marxist theoretical explanations is totally adequate. By focusing upon society, these perspectives tend to view the state as a dependent variable. Because of the limitations of their theoretical framework, they fail to capture the dynamic role that a state can play in shaping internal structures and in bargaining with foreign investment to facilitate domestic capital accumulation and to shape the development process. I am not asserting that the Korean state is totally autonomous in its economic or political affairs. There are certainly external and internal constraints that tend to shape, inhibit, and at times, effectively control the actions of the state. However, the Korean state has included relatively effective institutions that have consciously devised and implemented policies to facilitate domestic industrial development. The Korean state has acted to facilitate capital accumulation and has effectively allocated these funds to finance economic development. This capacity of the Korean state to act in a relatively autonomous manner to facilitate economic

10. See Alfred Stepan, *Democracy and Socialism: Paths in Comparative Perspective* (Princeton: Princeton University Press, 1979).

9. See: Theotonio Dos Santos, "The Structure of Dependence," American Economic Review, May 1970. Peter Evans, Dependent Development (Princeton: Princeton University Press, 1979). Fernando Cardoso, "Associated Dependent Development," in Alfred Stepan, Authoritarian Brazil, (New Haven: Yale University Press, 1978). Volker Bornschier, "Multi-National Corporations and Economic Growth: A Cross National Test for the Decapitalization Thesis," Journal of Development Economics, June 1980. For an alternative empirical analysis of the effect of foreign direct investment on economic growth in developing nations, see: Robert W. Jackman, "Dependence on Foreign Investment and Economic Growth in the Third World," World Politics, Vol. 34, January 1982.

development objectives defies the prevailing assumptions and arguments of both the liberal and Marxist explanations of development. There is a need in the study of the political economy of development to focus upon the role the state can play in determining strategies that may be employed to shape internal economic structures and to increase the bargaining position of a developing economy in relation to the international economy. My purpose is to examine the role of the state in Korea and the manner in which it actively intervened to facilitate Korea's industrial transformation.

There is an emerging trend in the study of economic development theory that views the state as a force that can affect the course of its own social environment to a significant degree.¹⁰ The regime type in power, its ability to accumulate and to allocate capital effectively, and its capacity to shape and control the pattern of foreign investments, technological inflows, and loans become crucial factors in explaining development experiences. Portes argues:

The main lesson emerging from these (economic development) experiences is that development does not just happen. Instances of accelerated economic growth or social transformation among modern nations have generally been preceded by deliberate policies initiated and sustained by national governments. This process, in turn, has been dependent on the arrival to positions of power of new ruling

10. See: Alfred Stepan, The State and Society: Peru in Comparative Perspective, (Princeton: Princeton University Press, 1978). Theda Skocpol, States and Social Revolutions: A Comparative Analysis of France, Russia, and China, (Cambridge: Cambridge University Press, 1979). Alejandro Portes, "On the Sociology of National Development: Theories and Issues," American Journal of Sociology, Volume 82, No. 1. Atul Kohli, et al., "Inequality in the Third World: An Assessment of Competing Explanations," Comparative Political Studies, Fall 1984. Stephan Krasner, Defining the National Interest, (Princeton: Princeton University Press, 1978), "Approaches to the State: Alternative Conceptions and Historical Dynamics," Comparative Politics, Vol. 16, No. 2, January 1984. Peter Evans, et al., Bringing the State Back In, (Cambridge: Cambridge University Press, 1985).

groups. Such 'developmental elites' have had the most varied social origins -- from radical intellectual groups to middle classes and the military. Their common theme, expressed under different ideological forms, has been the attainment of national autonomy by somehow bridging the gap between their countries and advanced nations. State resources are then employed to implement the image of the national future held by the new elites.¹¹

The presence of development-oriented ruling elites, their effective control of the state apparatus, and their deliberate attempt to transform the social structures have been necessary, even though not sufficient conditions, for national development.¹² Carnoy states:

How the growing State is shaped has become for social scientists a crucial issue -- perhaps the crucial issue -- of our time. The State appears to hold the key to economic development, to social security, to individual liberty, and, through increasing weapons 'sophistication,' to life and death itself. To understand politics in today's world economic system, then, is to understand the national State, and to understand the national State in the context of that system is to understand a society's fundamental dynamic.¹³

Successful economic development is dependent upon effective state structures that are directly oriented toward modernization.¹⁴ The state intervention perspective on economic development does not deny that international economic structures may be inequitable, placing major constraints on a developing nation. This theoretical perspective also recognizes the need for obtaining capital and

11. Alejandro Portes, "On the Sociology of National Development," American Journal of Sociology, Volume 82, No. 1, July 1976, p. 59.

12. David Apter, Choice of the Politics of Allocation, (New Haven: Yale University Press, 1971).

13. Martin Carnoy, The State and Political Theory, (Princeton: Princeton University Press, 1984), p. 3.

14. Tony Smith, The Patterns of Imperialism, (Cambridge: Cambridge University Press, 1981), pp. 81-83.

technology from multinational corporations. However, the state intervention perspective focuses upon the state as a significant and autonomous actor that must actively intervene into economic affairs. This state intervention can include the development of strategies to aid the developing economy cope with international constraints through the effective regulation and control of foreign capital and technological inflows. Such strategies should increase the likelihood that contact with the international economy aids in the attainment of established development goals.

My analysis proceeds first with an examination of the role of the state within economic development theory. The mercantile, liberal, and Marxist-world system paradigms will be reviewed. Mercantilist theory is pertinent to the case of Korea because of its emphasis on the central role of the state in initiating and guiding economic development, but many of its assumptions and specific substantive claims are archaic. The liberal and Marxist-world system theoretical explanations have dominated contemporary discourse on economic development. However, they are inadequate in explaining the case of Korea and the primary role that the state has played in facilitating economic development. A more appropriate theoretical explanation for the economic growth and industrial transformation in Korea is found in the state intervention theoretical perspective. A review of the state intervention perspective will conclude the first chapter of this study.

The second chapter of this study presents an explanation and analysis of Korean political and economic conditions prior to the radical altering of state structures that occurred after the 1961 military coup. This examination traces key political and economic

factors in Korea's transformation from a traditional feudal society, to incorporation into the Japanese colonial system (1910-1945), and to the establishment of the Republic of Korea under President Rhee Syng-man. Chapter II focuses on the contributions of each of these periods to the Korean political-economic condition as it existed in 1960. This examination creates a base from which state economic policy and intervention subsequent to 1961 can be examined.

The third chapter of this study examines the rise to power of the military government of Pak Chung-hee in 1961, and the primary alterations in state and societal structures subsequent to the formation of this government. Central to understanding the Korean industrialization process is an awareness of the goals of the military regime, the close association and knowledge of the regime leaders with the Japanese industrialization model, and the manner in which the regime restructured the state's relationship with key economic actors. This chapter will explain and analyze six primary state economic interventions that characterize and dominate the Korean industrialization model. These principal state interventions which highlight the Korean model were adopted directly from the Japanese development experience and adapted to fit the Korean environment.

The fourth chapter of this study explains and analyzes Korean state policy in relation to foreign capital loans, direct investment, and technological inflows. It shows that the empirical patterns of foreign loans, direct investment, and technological inflows are a result of conscious Korean state policies that are directly aimed at controlling the sectoral flow of foreign investment and at increasing the likelihood of technological transfer to Korean domestic producers. State policies in relation to these foreign inflows have consistently

attempted to shape foreign inflows in a manner that would maximize the benefits received by the domestic economy. The effectiveness of these policies has varied over time and from sector to sector, but the net result is that the Korean state has implemented policies that have favorably altered Korea's structural relationship with the international economy.

Throughout the course of this study, I have drawn on a variety of sources. In addition to the secondary sources listed in the bibliography, a number of primary sources have been utilized. Primary sources of data were collected by myself between August 1984 and December 1986. These primary sources can be broken down into three main categories: 1) Statistical yearbooks and other sources of published Korean Government data and policy papers, 2) Internal Korean Government documents and data made available to me directly from government officials who I interviewed, and 3) Data obtained from Korean business leaders, foreign businessmen, and foreign banking officials through questionnaires and interviews. For further explanation of these primary data sources and collection techniques utilized, see the appendix of this dissertation.

The Mercantilist Perspective and the Role of the State

Mercantilism as an economic doctrine is a set of ideas and practices which prevailed from approximately 1500 to 1800 in Western Europe.¹⁵ During this period in Europe, the feudalistic economic system of the Middle Ages and the political influence of the Catholic

15. Edmund Whittaker, Schools and Streams of Economic Thought, (Chicago: Rand McNally and Company, 1963), p. 31.

church were declining. In its place a state system was emerging, and the self-sufficiency of the feudal community was giving way to increasing trade between national regions and across frontiers. The use of money as a system of exchange and the role of the merchant in economic affairs were expanding.

During this period states such as Spain, England, and France attempted to increase their capacity to control economic resources by claiming sovereignty over colonial possessions. The discovery of precious metals in many of these colonies, especially the discovery of vast volumes of gold in Spanish held American territories, compounded an ever increasing interest in trade and the economic importance of precious metals. As the relative importance of trade in the process of economic development increased in Europe, the role of the merchant as a middleman between production and consumption vastly increased. A new economic doctrine, mercantilism, emerged to replace feudalistic economic relations. This new doctrine viewed the economic interest of the state to be tied closely to the interest of merchants and advocated policy that would facilitate merchant activity so as to increase the wealth of the state.

Mercantilism as an economic doctrine is not a coherent body of literature. Being merchants and administrators, the primary advocates of the mercantilist tradition such as Mun, Petty, and Colbert were not as interested in theoretical explanation as they were in attaining specific political and economic goals. Mercantilist writers, viewing precious metals (specifically gold and silver) as the source of wealth and wealth as the source of the political strength of a state, tended to focus on various strategies that would increase the state's holdings of precious metals.

To facilitate the accumulation of precious metals, mercantilists advocated a highly active role for the state in regulating economic activity. A variety of economic policies was devised, implemented, and enforced by the state in order to maximize the state's wealth. These policies were designed to increase the level of production of export goods and to decrease the level of imports and of domestic consumption. The mercantilist state regulated production by granting monopolies and special privileges to merchants who maintained a high level of production and quality control over goods that could be sold ✓ as exports. The state created import barriers to protect local industries from competition in the domestic market and to limit the volume of imports to maximize the balance of trade. The state also set low wage standards as a mechanism to minimize the cost of production and to stifle internal consumption.

✓ The granting of monopoly and special privilege became a major mercantilist strategy to increase the level of production and the diversification of goods produced. This strategy was intended to limit competition and risk to the merchant, thereby creating an incentive to establish and expand export production. Monopolies were also granted in the colonial trade. For example, the British East Indies Company was granted exclusive rights to all trade in India until the Sepoy uprising in 1857.

✓ Quality control as a mercantilist strategy was also important to export production. Mercantilists advocated that the state maintain strict quality control over production to insure uniformity in the method and the quality of the state's exports. Mercantilists realized the importance of a market reputation for their states' export products and advocated quality regulations in order to secure a

regular utility and value of an export item. Jean Baptiste Colbert, as French Minister of Finance in the mid-seventeenth century, wrote four volumes, totaling over 2,000 pages, of regulations that French manufacturers and merchant exporters were compelled to abide by in an attempt by the state to control the quality of French exports. These regulations established production procedures for several items of export, specified the raw materials to be used in production, and created guidelines for its finished form. The regulations were enforced by representatives of the state, and violators were fined or imprisoned.¹⁶

A major characteristic of the mercantilist system was the free movement of goods within a state but the placing of protective tariffs and barriers on import goods. Tariffs were placed on goods that would compete on the local market against domestically produced goods. In this manner not only was the local producer protected from competition in the domestic market but also foreign exchange would not be sent out of the country for goods that could be produced at home, thereby further aiding the balance of payments.¹⁷ Raw materials needed in the production of export items were exempt from tariffs; however, goods imported that would not compete with local production but were to be consumed domestically were placed under high tariffs because of their negative effect on the balance of payments. Sir William Petty in Political Arithmetick, published in 1690, argued that imported consumer goods should be taxed so that they would be more expensive

16. Robert Lehachman, A History of Economic Ideas, (New York: Harper and Row Publishers, 1959), pp. 45-47.

17. Jacob Oser, The Evolution of Economic Thought, (New York: Harcourt, Brace and World, Inc., 1963), p. 9.

than goods produced in England. The state would thereby increase its holdings of bullion and foster a positive balance of trade.¹⁸

To implement their economic policies, mercantilists encouraged nationalism and advocated a strong central state. A strong central state, it was argued, was a necessary condition for the efficient operation of mercantilist economic activities. The state needed to be centrally controlled and strong in order to grant and enforce monopoly privileges, regulate imports and exports, and to regulate labor, agriculture, mining, and manufacturing.¹⁹ Thus, the state was to play a major role in controlling economic activity, and nationalism was promoted as a mechanism to rally support and unify the population behind the objectives of a state.

With the advancement of the Industrial Revolution and the evolution of the capitalist system, the mercantilist doctrine became outmoded. The growth of the banking system and the expansion of the market economy made it clear that factories, machinery, and inventories of goods and commodities were also items of wealth. This reduced the emphasis placed upon the accumulation of gold and silver as the exclusive item of wealth. By the mid-nineteenth century in the industrial European states, the merchant capitalists position as the key actor in the process of accumulating national wealth had been replaced by the industrial entrepreneur. To promote the interests of the industrial entrepreneur, laissez faire was preferred to regulation and monopoly as a strategy to promote technological innovation, efficient use of resources, and to increase international trade. Regulations to control quality came to be seen as barriers to

18. Ibid., p. 22.

19. Ibid., p. 10.

innovation as they impeded experimentation and improvements in production techniques.²⁰ By the mid-nineteenth century, mercantilist doctrine began to be replaced by liberal economic theory. However, in the early stages of the transformation from agrarian to industrial based economies, the countries of Western Europe as well as the United States and Japan all utilized various mercantilist policies -- protection of local industry, restriction of unnecessary imports to strengthen balance of payments, the grant of monopoly rights, etc. -- to alter market mechanisms in a manner that was deemed necessary to the advancement of the national interest by facilitating domestic industrial production.

Although liberal philosophy and doctrines began to dominate economic discourse during the nineteenth century, several mercantilist policies have had a lasting impact on the international order and are evident in contemporary economic activity. Economic trade barriers to protect local producers and to assist the balances of trade are a common economic policy in developed as well as developing nations today. The granting of monopoly rights and special privileges is not uncommon when a state wishes to induce investment into a more risk-taking sector of the economy. The role of the state and state bureaucracies has also grown in most nations as their economies have developed. This appears to be an empirical regularity in every type of society from advanced industrial to primary goods exporters. The state has been active in the economics of production, finance, distribution, and in promoting nationalism through education and in the media.²¹

20. Ibid., p. 13.

21. Martin Carnoy, The State and Political Theory, (Princeton: Princeton University Press, 1984), p. 3.

In contemporary developing countries that are attempting to follow an "export platform" strategy of economic development, such as Korea and Taiwan, mercantilist policies remain very influential. In these economies where raw materials are imported in order to manufacture products for export, the similarities with the classical mercantilist state economic policies are intriguing. "Export platform" developing economies tend to place trade barriers and tariffs upon imports that would compete in the domestic market with local industries as well as those imports oriented toward private consumption because of their effect on the trade balance. However, imported goods that are necessary for the production of exports are generally exempt from tariffs and other trade barriers. Monopoly, special financing, and other privileges are granted to export producers who directly contribute to the balance of payments and the accumulation of hard currency needed to finance further economic development. The mercantilist policy of promoting nationalism is also a major aspect of most "export platform" nations. Nationalism becomes a rallying point to promote loyalty to the stated national interest of economic development and to justify a need for national civil obedience and labor discipline. In Korea, nationalism is focused upon the perceived external threat of North Korea and becomes a mechanism in the attempt to grant legitimacy to state regulation of economic affairs and to the state's goal of rapid economic development.

The Liberal Perspective and the Role of the State

During the early stages of the Industrial Revolution, the policies of mercantilism placed the state in a central role in

facilitating the accumulation of wealth and the advancement of national economic interests. Protection of local markets for local industries and a major emphasis by the state to encourage the development of exports were central factors in the transformation from agricultural to manufacturing economies. By the late eighteenth century and early nineteenth century, England had clearly become the leader in the development of specialized manufactures. Its strength in shipping and its military capacity provided a foundation for colonial expansion which, in turn, created a market for British finished goods and a source for needed raw materials. Mercantilist policy and regulations had helped to create structures that facilitated the development of the manufacturing industry in England; however, by the end of eighteenth century the involvement of the state in economic affairs was becoming highly criticized.

In what would become known as liberalism, the separation of politics from economics was advocated. Liberalism, arising as industrial-capitalist strength was becoming dominant in England and when the manufacturing capacity of England was becoming dominant in the international arena, advocated that the state should no longer interfere in economic activity.

In 1776, Adam Smith published the seminal liberal work, An Inquiry into the Nature and Causes of the Wealth of Nations, in which he advanced the principles of laissez faire and the concept of the "invisible hand." Smith argued that free enterprise should be applied to both domestic and international economic activities, that a policy of non-government involvement would lead to the more efficient use of resources and facilitate the maximum economic progress possible. The "invisible hand" of a free market would regulate the economy in a much

of Nations. Edwin Cannan, ed., (New York: 1904).

23. Ibid.

more efficient manner than could the state. The "invisible hand" would work as a social force causing the individual actor to promote the public good. Smith did not believe that the individual, if left unregulated by the state, would consciously pursue economic activities that were good for society as a whole, but rather in pursuit of his own interest the individual would seek out the most advantageous use for whatever capital he held. It is his own interest that the individual pursues, but the pursuit of his own advantage naturally, or rather necessarily, leads him to prefer the employment of capital which is most advantageous to the society.²² According to Adam Smith and traditional liberal doctrine, the "invisible hand" of market mechanisms would perform the primary functions to ensure economic growth.

Smith argued that economic activity would proceed most successfully without government intervention. However, the state did have three primary functions. First, the state should protect the nation from internal violence and from invasion from external forces. Secondly, the state should administer a system of justice for its citizens and protect the free market from monopoly. Thirdly, the state should undertake the construction and maintenance of public works which are necessary to society as a whole but are not profitable enough for the individual to induce private investment.²³ According to Smith, the market is self-regulating, but the state must provide defense, impartial administration of justice, and physical infrastructure for the market to function.

22. Adam Smith, Inquiry into the Nature and Causes of the Wealth of Nations, Edwin Cannon, ed., (New York: The Modern Library, 1965).

23. Ibid.

In Wealth of Nations, Smith emphasized that wealth is not only trade and the accumulation of bullion, but more importantly, wealth is to be gained by developing the national economy and increasing productivity. Smith cited labor as a source of value, and that the division of labor and the use of machinery increased productivity, and thereby a nation's wealth. The individual, left unregulated by the state, would be free to pursue his interests by innovating new machinery and more effective production processes that would maximize the return on his investment and increase productivity. Specialized use of machinery and the division of labor were viewed by Smith as the basic elements in productivity growth, and the "invisible hand" of the free market was more suited to these needs than regulation by the state.²⁴

Contemporary liberal theorists of development economics tend to view the role of the state in the development process as similar to the role assigned to the state in classical liberal theory. The state is to maintain social order and defense, an impartial administration of justice, and necessary infrastructure. In a contemporary setting, necessary infrastructure includes modern communications, transportation, and financial institutions to facilitate domestic and foreign investment and trade. According to liberal arguments, the primary economic problems in developing nations are the shortages in capital accumulation, technological capacity, skilled manpower, and insufficient marketing mechanisms. Foreign investment, international trade, and contact with multinational corporations are seen as the strategies to overcome these weaknesses in factor endowments. Liberal theory argues that economic development can occur in developing

24. John Pincus, Trade, Aid, and Development: The Rich and Poor Nations, (New York: McGraw Hill Book Co., 1967), p. 93.

countries under the existing international economic structures as long as free flows of capital and technology are unencumbered by economic regulation. According to liberal theory, several economic constraints to development can be overcome by foreign investment. However, economic development can not proceed without social and political development occurring simultaneously. The facilitation of the development of the economy also requires the transformation of traditional societal structures to modern structures. From this liberal tradition a body of literature emerged in the 1960's and 1970's that focused upon development in the Third World. This body of literature, known as modernization theory, argued that the primary impediment to economic development was the existence of traditional societal structures that were unsuitable to the facilitation of economic development. In order for economic development to occur, modernization theorists argued, first, traditional societal structures needed to be transformed.

Much of the research conducted by modernization theorists was directed toward establishing the criteria that distinguish a modern from a traditional society.²⁵ Once these criteria were established, it was assumed that the nations of the world could be grouped into one of these two categories. Modernization then became a process of transformation from a traditional to a modern society. Many of the elements of a modern society and a traditional society that the modernization theorists established were first suggested by Durkheim in his discourse on mechanical and organic solidarity.²⁶ According to

25. Samuel Huntington, "The Change to Change," Comparative Politics, April 1971, p. 286.

26. J.S. Valenzuela and A. Valenzuela, Modernization and Social Change, (Cambridge: Cambridge University Press, 1971).

most modernization theorists, in a modern society the population tends to view the world in a universal sense; merit is the primary determinant of social worth; the political system is structurally specific; the economy is based on industry; and the important social functions are performed by specific organizations. Contrary to this, in a traditional society the population tends to be primarily concerned with parochial matters; ascription is the primary determinant of social worth; the political system is fused into one structure; the economy is based on agriculture; and important social functions are performed by the family and the church. Furthermore, a modern political system is characterized by rational authority, mass participation and the capacity to accomplish a broad range of goals.²⁷ Modernization theorists assumed that the values, institutions, and patterns of action of a traditional society are both an expression and cause of underdevelopment and are the main obstacles in the way of modernization.²⁸

Within the liberal perspective, there is the general tendency to separate politics from economics. It was generally assumed that the individual was the focus of creative activity and the state was wasteful, inefficient, and the granter of monopoly privileges which favored a few enterprises to the detriment of the economy as a whole. To promote economic growth, the liberals argued, the state should not intervene in economic activity but should allow the individual the necessary freedom so that he could freely pursue his own economic interest. It was argued that state regulation of the economy stifled

27. Samuel Huntington, "The Change to Change," Comparative Politics, April 1971, p. 292.

28. J.S. Valenzuela and A. Valenzuela, "Modernization and Dependency: Alternative Perspectives in the Study of Latin American Underdevelopment," Comparative Politics, July 1979, p. 538.

economic growth, whereas a free market would lead to innovation and growth through competition. This would maximize economic progress. It was also assumed that a free market would distribute goods in a relatively equitable manner and lead to political stability. Due to this assumption that the economy and politics could be separate phenomena, the role of the state has been normatively underemphasized and analytically not recognized as significant in liberal economic analysis. However, as it became apparent in the later 1960's that economic development and political stability did not necessarily coincide, and that, in fact, political instability could retard economic growth, political scientists within the modernization school began to argue for an increased role for the state in providing political stability. Two writings to demonstrate this concern were Political Order in Changing Societies by Samuel Huntington and Crisis and Sequences in Political Development by Leonard Binder.²⁹

Huntington argued against the then commonly held assumption that political stability and economic development were both products of modernization. Huntington pointed out that political stability and economic development were distinct from each other rather than correlations of modernization. In fact, Huntington argued that economic development could actually create political instability. Huntington argued that more attention needed to be devoted to creating political institutions that could maintain the state apparatus in relation to the rising demands placed upon the political system by a population that was becoming more politically and socially mobile. Huntington proposed the proposition that the state must be strong in a

29. Samuel Huntington, Political Order in a Changing Society, (New Haven: Yale University Press, 1968). Leonard Binder, et al., Crisis and Sequences in Political Development, (Princeton: Princeton University Press, 1971).

developing country in order to maintain civil control over its population while the society and economy are transforming to modernity. Huntington asserted that the primary problem of politics in developing countries is the lag in the development of political institutions behind social and economic change.³⁰ The primary role of the state, according to Huntington, becomes the establishment of political institutions that are strong enough to meet and control the rising demands of a transforming society.

Binder also argues that the process of modernization requires a strong state. Binder highlights the multiple crises that a developing state will confront. He does not view modernization as having a single "take-off" that is an end in itself, but, rather, the state continually has multiple problems to confront in order to control the rising demands of a society that is becoming mobilized by modernization. Binder agrees with Huntington that if a nation is to modernize and meet the rising demands of the population, a strong, well organized state is a necessary prerequisite.³¹

Both Huntington and Binder argue for an increased role to be played by the state in the development process. However, this increased role is a political intervention and not an intervention directly into the economic sphere. In this sense, neither Huntington nor Binder is deviating from the traditional liberal view of the function of the state. On the contrary, they are, in effect, arguing for an increased role for the state in order to maintain political control so that economic activity and foreign investment can proceed

30. Samuel Huntington, "The Change to Change," Comparative Politics, April 1971, pp. 283-322.

31. Leonard Binder, et al., Crisis and Sequences in Political Development, (Princeton: Princeton University Press, 1971).

unimpaired by rising societal demands. As Kesselman points out, "Both Huntington and Binder diverge from a tradition in American social science which regards political order as dependent on value consensus. Precisely because consensus is unlikely and stability is problematic, Huntington and Binder stress the fundamental role that political power must play in maintaining political order."³² This conception of political order tends to legitimize any regime as long as it is established in power and can maintain control of its population.

Huntington and Binders' idea of the role of the state conforms to Adam Smith's view that the state should maintain internal political order. However, Smith assumed that a free market would create a situation where the individual would be rewarded by the "invisible hand" of the market, and political stability would advance with economic development. To Smith, like to most liberal economists, there was no contradiction between economic development and social cohesion. Huntington and Binder recognized the possible contradiction between these two constructs, and in order to maintain the functioning of the market they advocated strong state mechanisms to control the rising demands of the population.

Contemporary liberal scholars argue that the free flow of capital and technology without government intervention is the optimal way for the economies of all nations to develop. To these scholars, the activities of multinational corporations should be expanded and allowed to function in a free international market. It is argued that multinational corporations provide such factors of production as capital, technology, and marketing expertise that are needed in developing economies. It is argued that multinational corporations

32. Mark Kesselman, "Order or Movement: The Literature of Development as Ideology," World Politics, October 1973, p. 141.

can increase a developing nation's exports, thereby improving the balance of payments.⁸ However, the liberal theorists who argue that expanded multinational corporation activity and foreign investment into developing economies will lead to development and interdependency tend to have trouble differentiating between the normative and the present empirical situation. They discuss the mutual benefits of capital flows and trade under a free market system, but generally ignore the absence of a real free market under the present system and do not adequately address the question of whether a free market is even possible.

The liberal argument rests on a theory of the marketplace which, in effect, claims that by facilitating the expansion of multinational corporations and by allowing the corporations to enrich themselves, the welfare of the developing country will also be enriched. There is a very fundamental contradiction in this reasoning. Multinational corporations and developing countries often have conflicting interests, priorities, and needs. The primary role of the multinational corporation is maximization of profits in a global market setting. To increase profits in the global economy, the multinational firm often perceives it to be to its advantage to divert income from developing countries to other markets. Developing countries, on the other hand, need to maximize the benefits to their domestic economy by maximizing their domestic savings and by effectively investing these savings into their own economic development.

A traditional liberal argument in favor of MNC expansion has been that foreign investment mobilizes resources and provides needed

capital and technology to developing economies.³³ These claims are also questionable. Several studies have demonstrated that multinational corporations tend to formulate the majority of their capital for investment in developing countries through domestic sources.³⁴ According to Fajnzylber's study, corporations in Latin America financed 83 percent of their investment from local savings and from local earnings. Only 17 percent of investment was formulated outside of the Latin American countries. Furthermore, the corporations in Latin America reported that an average of 79 percent of profits were expropriated from the local economy. The claim that multinational corporations transfer needed technology to developing economies is also misleading. Little research and development is carried on by multinational firms in developing countries. The technology transferred to developing countries can determine the pattern of production and consumption in the developing countries. Often, this technology is inappropriate for the developmental needs of the developing countries, is unnecessarily expensive, and can create a dependence upon the multinational corporation that further reduces the

33. Raymond Vernon, Sovereignty at Bay, (New York: Basic Books, 1971), pp. 152-156, 170-171.

34. See: Peter Evans, "National Autonomy and Economic Development: Critical Perspectives on Multinational Corporations in Poor Countries," in Robert Keohane and Joseph Nye, ed., Transnational Relations and World Politics, (Cambridge, Mass.: Harvard University Press, 1972). Richard Barnett and Ronald Muller, Global Reach, (New York: Simon and Schuster, 1974), pp. 152-165. Fernando Fajnzylber, Estrategia Industrial y Empresas Internacionales: Posicion Relativa de America y Brasil, (Rio de Janeiro: United Nations, CEPAL, 1970) p. 65, as cited in Global Reach, op. cit., pp. 152-154. Gert Rosenthal, The Role of Private Foreign Investment in the Development of the Central American Common Market, (Chicago: Adlai Stevenson Institute of International Affairs, 1973), p. 235. Economic Commission for Latin America, External Financing in Latin America, (New York: United Nations, 1965). David T. Devlin and George R. Kruer, "The International Investment Position of the United States," Survey of Current Business, Vol. 50, No. 1, October 1970.

host countries' bargaining position in relation to the corporation. In nations with high unemployment, inexpensive labor, and shortages of capital, the capital intensive nature of technology that multinational corporations tend to provide can aggravate existing problems.

Because of the conflicting nature of goals pursued by multinational corporations and developing countries, liberal policies of free trade and capital flows will not necessarily work to the advantage of developing economies. Laissez faire policies will tend to benefit the global rationality of international capital, but will not maximize the economic interests of developing countries. In fact, they may do the opposite, leading to the decapitalization of the developing nation under circumstances where multinational corporations see it in their global interest to transfer large levels of capital to more profitable investments elsewhere. In order for a developing state to accumulate domestic capital, to channel foreign investment into sectors of its economy where it needs foreign investment and foreign technology, and to limit foreign investment into sectors that would displace indigenous production, the state must intervene to regulate foreign investment. Liberal policies of free trade may be beneficial to the goals of multinational corporations, but in a developing economy the state must actively shape the development pattern in order to maximize its own capital accumulation and to channel investment into particular economic and societal needs.

The World System Perspective and the Role of the State

The world system paradigm focuses its analysis of international political economics on the worldwide capitalist class and the international network of world capitalism. Under this paradigm, as in the liberal paradigm, states are secondary actors. However, under the world system perspective, states are not pluralist institutions that serve the interests of various segments of society by maintaining a free market, but rather they are political institutions that primarily function to maintain the division of labor and to serve the interests of the dominant bourgeois class.

The world system literature examines the linkage of international capital between nations. Much of the literature focuses upon economic linkage in the relationship between advanced industrial countries and the developing nations. This literature attempts to document the inequalities among nations in the international arena by historically examining economic structures established in the colonial era, their effects on present international economic structures, and the resulting impact of these international economic structures on the political and economic systems in developing countries. Under the world system paradigm, multinational corporations are viewed as the primary facilitators of international capitalist relations and as the agents that internationalize the mode of production. It is argued that the present international system places the periphery nation in a dependent relationship with the industrialized core country, and that it systematically expropriates the economic surplus of the periphery nation. This, in turn, causes the underdevelopment of the periphery

economy. These scholars refer to such empirical evidence as declining terms of trade for primary product producers, limited access to international capital markets, trade barriers imposed upon periphery manufactured goods entering developed country markets, and the power of widening gap in the distribution of wealth between the North and the South. It is implied by most world system scholars that the periphery states can not act in an autonomous manner to develop their domestic economies. this, the state can not provide neutral procedural

World system scholars derive many of their assumptions on the role of the state from Marx, Engels, Lenin, and other scholars of the Marxist tradition. Marx himself did not write extensively on the role of the state, but he did develop fundamental conceptions of the state which subsequent Marxist writers have elaborated on. Marx described capitalism in terms of class relationships between the wage earning proletariat and the bourgeoisie, owners of the means of production. Competition within various units of the bourgeoisie led to capital accumulation and technological progress, but the falling rate of return that was inherent in capitalism inevitably created class conflict between the bourgeoisie and the proletariat. Marx argued that the mode of production determined the structure of society and the state, but he rejected the Hegelian view of the state as a capitalist representative of the "social collectivity" that represented no particular class or interest. To Marx, the state structure emerged from the relations of production. It is not social consciousness or society's collective interest that shapes the state, but rather

35. Martin Carnoy, *The State and Political Theory* (Princeton: Survey, (London: Knowledge and Kegan Paul, 1980), p. 15.

37. As quoted in Alfred Stepan, *The State and Society, Peru in production, and the relationship inherent in that mode will determine* (1978), p. 20.

38. Ibid., p. 20.

the role of the state. The state becomes the political expression of the class structure of the production process. Because the state of bourgeoisie as a class maintain control over the means of production in a capitalist society, the bourgeoisie will expropriate the power of the state.³⁵

Under this Marxian conception, the state as a political structure becomes a function of the economic structure of society, and because of this, the state can not provide neutral procedural guarantees for free political and economic competition as the liberal argument assumes.³⁶ Marx himself did not present detailed analysis to support this conception of the state. However, Engels argued that the state was dominated by the bourgeoisie class and became an instrument of coercion which controlled the proletariat in the class struggle.

"The state in all typical periods is exclusively the state of the ruling class, and in all cases remains essentially a machine for keeping down the oppressed, exploited class."³⁷ To Engels, the state is a committee for managing the affairs of the dominant class, and it is not autonomous but rather a superstructure conditioned by the economic system.³⁸

Lenin, writing before the Soviet Revolution in The State and Revolution, agreed with Marx and Engels that the state in a capitalist society functioned to mediate class conflict. In a capitalist

35. Martin Carnoy, The State and Political Theory, (Princeton: Princeton University Press, 1984), pp. 46-48.

36. Anthony Brewer, Marxist Theories of Imperialism: A Critical Survey, (London: Routledge and Kegan Paul, 1980), p. 15.

37. As quoted in Alfred Stepan, The State and Society: Peru in Comparative Perspective, (Princeton: Princeton University Press, 1978), p. 20.

38. Ibid., p. 20.

democracy, Lenin argued, parliaments incorrectly convince the masses through elected officials that the state represent all aspects of society, when, in fact, all important decisions are made by the capitalist class and reflects their interests. The parliament is a screen to protect the real interests of the state.³⁹ Therefore, the liberation of the exploited class is only possible by a revolutionary action that destroys the apparatus of the state. Because the state is the coercive force of the capitalist class, a violent revolution is required to dislodge the existing capitalist state structures. After the socialist revolution, Lenin argued, there would be no need for a state because there is no longer a class that controls the means of production and no need to repress one group for the benefit of the other.

Lenin advocated a state based upon the concept of "worker democracy" until the socialist revolution was completed. Under "worker democracy" the state would control the means of production for the benefit of the workers. The institutions of state were to be inclusive of mass participation in policy planning and were to serve the interest of all workers. However, once the Czar was overthrown and Lenin became head of state, he "led the Bolsheviks to abolish all democratic forms, including gradually taking power from the Soviets and putting it into the hands of the Central Committee of the Bolshevik party, backed by the Red Guard".⁴⁰ Lenin's socialist state in practice smashed the state structures of capitalism, but it remained coercive, excluding the participation of the workers and

39. Martin Carnoy, The State and Political Theory, (Princeton: Princeton University Press, 1984), p. 60.

40. Ibid., p. 61.

placing state authority in the hands of the vanguard of the communist party.

Rosa Luxembour, writing in 1917, agreed with Lenin's conception of the role of the state as it was presented in The State and Revolution. However, she became highly critical of Lenin's implementation of the state apparatus after the revolution.⁴¹ Luxembour argued that Lenin had abandoned the Marxist idea of a socialist democracy and had replaced it with a party dictatorship. Luxembour envisioned a state supported socialist democracy with mass participation and freedoms of press and assembly without the need of state coercion.

Since the 1960's, there has emerged two leading schools of thought within the Marxist tradition that discuss the role of the state in capitalist societies: the instrumentalist and the structuralist schools. The instrumentalist school is associated with Miliband and focuses its explanation of the state upon the examination of the decision makers in capitalist states and their ties to capitalist economic activity. Miliband in The State in Capitalist Society argued that the state serves the interest of the capitalist class because it is controlled by the capitalist class.⁴² Instrumentalists tend to document the linkages between large corporations and state decision making to the individual actors who are in government decision making positions and who have close ties to corporations. Even such non-Marxist writers as Barnet have pointed out the "revolving door" from business to government and back to

41. Rosa Luxembour, The Russian Revolution and Leninism and Marxism, (Ann Arbor: University of Michigan Press, 1961).

42. Ralph Miliband, The State in Capitalist Society, (New York: Basic Books, 1969).

business again. For example, according to Barnet, between 1945 and 1968 seventy-seven percent of all top-level foreign policy decision makers in the United States government had come to government from the boards of large corporations, were finance bankers, or were lawyers for corporations or banks.⁴³ The instrumental Marxists interpret this phenomenon to mean that the state is not autonomous nor neutral, but it is controlled by and serves the direct interests of the capitalist class. Although cleavages between capitalist interests or between capitalists and the state may at times cause the state to appear to be neutral, over the long run capitalist interests will prevail because of the make-up of those who hold positions of state authority.

The structuralist school within Marxist thought emerged in France and is associated with Althusser and Poulantzas. Taking difference to the arguments of Miliband and the instrumentalist, the structuralist argued that it is the structures of society in general, and the economic system specifically, that determines state policy and activity, not the action of any individual or group of people. Althusser argued that the social structure is a system of objective processes where individuals are merely actors within the structural relationships that exist.⁴⁴ Althusser, thereby, rejects the notion that the state is controlled by capitalist actors and, instead, argued that the state is relatively autonomous from individual interests of the economic dominant class. Poulantzas', Political Power and Social Classes and "The Problem of the Capitalist State" are the major structuralist writings regarding the state. Poulantzas argues:

43. Richard Barnet, Roots of War, (New York: Pelican Books, 1971), p. 179.

44. Martin Carnoy, The State and Political Theory, (Princeton: Princeton University Press, 1984), p. 89.

The relationship between the bourgeois class and the state is an objective relation. This means that if the function of the state in a determinant social formation and the interests of this class coincide, it is by reason of the system itself. The direct participation of members of the ruling class in state apparatus is not the cause but the effect, and moreover a chance and contingent one, of this objective coincidence.⁴⁵

The structuralist explanation focuses on the structures of the state that reproduce a capitalist society. Starting with classes and class struggle, the structuralists examine how "state policy and organization displace the contradictions generated by given economic structures and class interests".⁴⁶ It is the internal functioning of economic structures that is the ultimate basis for the explanation of state action. To Poulantzas, the state is a reflection of the mode of production and its form, and function is determined by the structure of class relations. The state in a capitalist society is a capitalist class state by its structure, and in the capitalist mode of production, the state will serve the interests of capitalism and the capitalist system of production.

The traditional Marxist literature of Marx, Engels, and Lenin is primarily interested in the experience of Europe as it existed at a time when industrial societies were advancing and expanding and when the European powers controlled the international economic arena through colonial mechanisms. The instrumental and structural Marxist

45. Nicos Poulantzas, "The Problems of the Capitalist State," New Left Review, Nov./Dec. 1969, p. 73. Also see: Political Power and Social Classes, (London: New Left Books, 1973). For a critical analysis of Poulantzas' conception of the state in a capitalist society, see: David Easton, "The Political System Besieged by the State," Political Theory, Vol. 9, No. 3, August 1981.

46. Pat McGowan and Stephan Walker, "Radical and Conventional Models of U.S. Foreign Economic Policy," World Politics, Vol. 33, No. 3, April 1981, p. 357.

literatures are also primarily concerned with industrial capitalist nations and attempt to adapt Marxist concepts to the contemporary setting of modern industrial states. During the past three decades, a body of literature known as dependency theory has emerged to explain the political and economic conditions of contemporary developing states within a Marxist framework. Dependency theory arose as an alternative explanation to modernization theory. Originally advanced by members of the United Nations Economic Commission to Latin America and Neo-Marxist scholars, the dependency paradigm attempted to explain why developing countries who had interacted with multinational corporations and had received foreign capital and technological assistance for several years were not experiencing economic development. It was clear that the modernization theorists had not offered an adequate explanation of the relationship between the developed and developing nations and that a new explanation was needed.

Within the modernization paradigm it was assumed that economic development would occur if the developing nations utilized the correct internal mechanisms. Thereby, modernization scholars focused their study upon cultural and economic variables of the internal social system. The dependency theorists believed that the correct focus of study was not the internal social system, but rather the impact of international economic structures of the world capitalist system on the domestic political and economic systems of developing nations. Dependency theorists argued that the internal dynamics of a developing country could not facilitate economic development due to existing international economic structures, and that economic underdevelopment was a function of the less developed nation's inferior position in the international economic system.

The dependency scholars viewed history, specifically colonization, as the original cause of underdevelopment. These scholars advocated that all societies are part of a single integrated economic system that began to emerge as European colonialization began. The early colonial system created a world trade system in which the terms of trade were advantageous to Europe, but disadvantageous to the colonial nations. During the colonial period, the European-dominated trade system began to establish mines and plantations to provide the raw materials that were needed for their industrial economies to develop. This greatly disrupted the indigenous economies and social structures in the colonial countries and gave rise to their subsequent "underdevelopment."⁴⁷ Dependency theorists argue that the contemporary economic, social, political, and cultural institutions in underdeveloped countries are the product of the historical development of the world capitalist system.⁴⁸ This system is characterized by the economic and political dominance of the economically advanced nations and by the dependence of the periphery states upon advanced nations.

A dependent country is defined by Dos Santos as a country whose development is conditioned by the development and expansion of another economy. Dependency comes when a nation's central economy is dependent upon the exportation of raw materials to the developed countries and/or being dependent on foreign ownership of the

47. Paul Baran, "On the Political Economy of Backwardness," The Manchester School, January 1952, pp. 66-84.

48. Andre Gunder-Frank, "The Development of Underdevelopment," in Wilber, ed., The Political Economy of Development and Underdevelopment, (New York: Random House, 1978). For a non-dependency view of the colonial period, see: D.F. Fieldhouse, The Colonial Empires, (New York: Delacorte, 1966).

production apparatus in a country.⁴⁹ Evans defines dependency as a situation in which the rate and direction of capital accumulation are externally conditioned.⁵⁰ Dependency scholars such as Baran and Gunder-Frank argue that the international economic structures, as they presently exist, shape the internal economic structures of the dependent nations to the needs of the developed economies and it is an systematically expropriate the surplus of the dependent economies. The result is the "underdevelopment" of the dependent economies. An equitable distribution of benefits, it is argued, can not occur within the international capitalist system. The international economic structures are under the control of monopoly capital centered in the core economies, and they operate to the detriment of primary product producing periphery nations.

✓ According to dependency theory, as proposed by the early ✓ dependency scholars, the role of the state in the periphery nation is to reinforce the external market structures of the dependent relationship by facilitating foreign investment and by externally be orienting domestic production. The periphery state mechanisms are controlled by a comprador class whose personal vested interest is fostered by the dependent relationship to the detriment of the ✓ population as a whole. In this sense, the explanation of the ✓ periphery state is in coherence with the instrumentalist argument. Here, the periphery state serves the interest of world capitalist economic activity because the state is controlled by the comprador class made up of individuals of the periphery nation's capitalist an association or alliance between international and local

49. Thetonio Dos Santos, "The Structure of Dependence," American Economic Review, May 1970, pp. 231-232.

50. Peter Evans, Dependent Development, (Princeton: Princeton University Press, 1979), p. 27.

class. That is, the dependent state is controlled by local elites who have linkages with the core capitalist class.

The early dependency scholars argued that the dependent relationship would serve the interests of the comprador class in the dependent economy, but that the dependent economy would remain a primary product producer, and the periphery state could not act in an autonomous manner to alter this relationship. However, during the 1960's and 1970's a few periphery nations experienced considerable economic growth, while diversifying their production into manufactured goods. It became necessary to further specify the dependency model in light of this empirical occurrence in order to explain the variables that were acting in some dependent states to allow for their industrialization and economic growth. This phenomenon was not adequately addressed in the early dependency literature.

✓ Later dependency theorists such as Cardoso, Evans, and Wallerstein have addressed the phenomenon of dependent economies that are experiencing development. Cardoso has developed a model that he terms associated-dependent development. He argues that national elites in dependent nations create an alliance with capitalists from the developed nations, and this alliance allows for some economic growth. ✓ However, this growth will be accompanied by inequality of distribution and authoritarian political institutions in dependent nations.⁵¹ Dependent development is not the elimination of dependence, but dependence combined with economic development. Evans argues that dependent nations may develop economically if there exists an association or alliance between international capital, local

51. Fernando Cardoso, "Associated Dependent Development," in Alfred Stepan, ed., Authoritarian Brazil, (New Haven: Yale University Press, 1978).

capital, and the state. This triple alliance is a fundamental factor in the emergence of dependent development.⁵² Evans goes on to argue that dependent development is not a phase all dependent countries will be able to reach: "International stratification is accentuated rather than leveled as those countries in which the local bourgeoisie and international capital can arrive at an alliance become increasingly differentiated from the majority of the Third World."⁵³

Wallerstein terms these nations as the "semi-periphery" and argues that the more advanced periphery nations occupy their own distinct place in the international division of labor. Wallerstein argues that a particular nation may change its position in the international economic order from a primary product producer periphery economy to an industrial manufacturing semi-periphery economy, or vice versa, but these shifts are conditioned by the external economic factors of the world capitalist system.

Wallerstein also argues that the structure of the present world capitalist system needs a semi-periphery, and, thereby, certain periphery nations that suit the structural needs of world capitalism are being elevated to semi-periphery status. The world system needs a semi-periphery for two primary reasons.⁵⁴ First, the world capitalist system is based on unequal reward; therefore, there is always the threat of the oppressed class' rebelling. The semi-periphery eliminates a strict polarization of "haves" and "have nots," creating, what Wallerstein claims, a middle sector in the international

52. Peter Evans, Dependent Development, (Princeton: Princeton University Press, 1979), p. 32.

53. Ibid., p. 33.

54. Emmanuel Wallerstein, The Capitalist World Economy, (Cambridge: Cambridge University Press, 1979), p. 69.

hierarchy of nations. This tends to avert a major crisis within the world capitalist system as the semi-periphery perceives themselves as better off than the states underneath them and gives the illusion that other periphery states can also develop. Secondly, Wallerstein argues that a semi-periphery is necessary to world capitalism to provide low cost labor that will maximize rates of return on investment when core labor becomes too expensive. Wallerstein argues that the primary role of the state in a capitalist world economy is to distort the functioning of market structures in order to augment the advantages of capitalist elites in relation to other segments of society.⁵⁵

According to Wallerstein, the stronger the state apparatus is, the larger is its capacity to distort the market in favor of the interests it represents. The core economies tend to have stronger state apparatus than do periphery economies, and, thereby, they can mold the international market more to their interests. The core states can restrict access to major markets, creating monopoly; they can restrain those who wish to change the present division of labor and distribution of reward through incentives or coercion; and they can manipulate factors of production. "It is the realistic ability of (strong) states to interfere with the flow of the factors of production that provides the political underpinning of the structural division of labor in the capitalist world economy as a whole."⁵⁶ However, the structures of the world capitalist system restrain the power of the state in a relative manner so that the role any particular state plays -- core, semi-periphery, periphery -- in the world economy is ultimately decided by the operations of the world

55. Ibid., p. 291.

56. Ibid., p. 292.

market forces at any particular point in time. These market forces then accentuate the differentiation between the various strata of national economies and institutionalizes them.⁵⁷ According to this characterization of the state, the state is an autonomous actor to a certain degree. The state does have a level of control in affecting the market depending upon its relative strength, but the state can not significantly alter its relation to the world market and facilitate its own economic development if it does not fit the structural needs of the worldwide capitalist system.

Cardoso, Evans, and Wallerstein argue from a structuralist position as they attempt to analyze industrialization in contemporary developing economies. Where industrialization does occur in the periphery, they argue, it is conditioned upon the needs of external market forces and will not occur regardless of state initiatives if it does not fit the needs of the worldwide capitalist economic structures. Therefore, periphery industrialization is dependent development.

A necessary condition for dependent development to occur in a specific periphery economy subsequent to the existence of worldwide capitalist structural need, Evans argues, is that the state in the periphery economy must possess sufficient capacity to facilitate capital accumulation and local industrialization. The state must redirect the global rationality of multinational corporations when it significantly conflicts with the domestic capital accumulation process. This limits dependent development to those states that possess natural resources or labor forces that can be used as a

57. Ibid., p. 21.

bargaining chip with multinationals.⁵⁸ If a state in a periphery economy is weak and can not control the manipulation of internal factors of production or can not bargain adequately with foreign investment in order to increase domestic capital formation, then dependent development will not occur in a given periphery economy. Therefore, a state's capacity is limited to facilitate economic development by the structure of the world system as a whole, and development in the periphery economy, by structural necessity, will occur in a pattern that fits international, not domestic needs.

Dependency theory has been useful in clarifying the historical origins of underdevelopment and in highlighting the economic and political effects of colonialism that remain in many developing nations today. Dependency scholars' focus on the international economic order brings light to several international structural constraints placed upon developing economies. Declining terms of trade, limited access to international capital markets, monopolies on capital and technology, restrictions on the import of finished products to developed country markets are empirical phenomena that constrain the development potential of developing countries. However, dependency theory substantially overestimates the power of the worldwide capitalist system in determining and structuring economic activity within Southern domestic economies. The worldwide capitalist system, manifested in multinational corporation activity, certainly affects Southern economic affairs, and in several cases it has conditioned developing economies to reflect the needs of a global system as opposed to domestic concerns. However, this is not a necessary result of all developing economies as dependency theory

58. Peter Evans, Dependent Development, (Princeton: Princeton University Press, 1979), p. 44.

✓ claims. The dependency theory's focus is on the effect of the international economic system upon the developing economy, and, thereby, it does not adequately examine the potential pressure that the state of the developing country can exert on the international system. This is to underestimate the influence that the Southern states may exercise over their own domestic economic affairs and in their relationship with the international economy. The individual nation state in the developing world, if properly managed, can maintain a relative autonomy from international influences over its own capital accumulation process and economic development pattern if it consciously acts in a manner that represents its own national interest. If leaders of a developing state are not capable of organizing an effective state apparatus, or if they are interested in promoting their own material gains over the welfare of the domestic economy as a whole, the nation state will likely become dependent upon external economic concerns. However, this is not inevitable.

Viewing the periphery state in an instrumentalist manner reduces the peripheral state to an administrative agent of international capitalism and fails to capture and explain the empirical experience ✓ of those periphery states that have experienced growth through the intervention of state elites with nationalist aspirations. This may not be the majority of experiences in the developing world; however, too many dependency scholars make the mistake of assuming that it is sufficient to know the properties of the world system as a whole to explain the functioning of its component states. This assumption becomes a fallacy when ruling elites have nationalistic designs and can effectively manifest these designs in their relations with the international economy.

Viewing the periphery state in a structural sense is to recognize the state as a relatively autonomous actor in its relation with the international economy. However, it also assumes that the overall structure of the international economy will inevitably lead to the further dependence of the developing economy as the production apparatus of the leading sectors of the economy become increasingly dependent upon external economic structures. This is reflected in an increase in the level of dependence on foreign financial institutions, on foreign aid, on foreign investment, on foreign technology, and on the marketing devices of foreign multinational corporations.

Although this may be a tendency in many periphery states, it is not necessarily an inevitable situation. If the state in a developing nation can organize state apparatus in an effective manner, the state possesses the potential to increase its level of domestic capital accumulation and to direct its internal economic development pattern in a relatively autonomous manner. The state in the periphery economy possesses the potential to organize institutions and to formulate policies in a manner that can lead to increased production in the domestic private sector, to the development of technological capacity appropriate to domestic economic needs, and to increased capacity to bargain effectively with international economic actors. However, paramount importance must be placed upon the state to effectively organize its institutions and policies toward the priority of economic development. The state can pursue actively the maximization of domestic capital accumulation and its effective allocation so that it can maintain control over the rate and direction of structural transformation. The state can also increase its control over the pattern of its interaction with the international economy by limiting

its interactions to those that serve the preconceived needs of domestic development. The state can limit imports to only those that are necessary to supply raw materials or technology needed for effective production. The state can also implement policies that promote the diversification of export goods and markets. State policies such as these would lead to a decrease in the level of dependence in significant areas of economic activity and, thereby, alter the developing economy's structural relationship with the international economy.⁵⁹ It is these types of initiatives that can be

^{59.} The difference this study places upon the constructs of dependence and dependency must be distinguished. For the purpose of definitional clarity, see: James A. Caporaso, "Dependence, Dependency, and Power in the Global System: A Structure and Behavioral Analysis," International Organization, Winter 1978. Caporaso argues that dependence is an economic reliance on external actors. The conceptual components of dependence are the size of one's reliance on another, the importance attached to the goods involved, and the availability of these goods (or substitutes) from different sources. Dependence as a construct represents an imbalance in the relationship between two actors. The opposite of dependence is interdependence, not the autonomy of an economic system. While autonomy rests on the idea of self-control, interdependence rests on the idea of mutual control and more equitable economic relations between nations. If a developing nation decreases its level of dependence, it is altering its own structural relations with the international economy.

Caporaso distinguishes the construct of dependency in a different manner. Dependency is a process of incorporation of less developed countries into the global capitalist system and the "structural distortions" resulting therefrom. Dependency can not be as easily defined as dependence because it is a structural phenomenon that can not be reduced to one variable. It is a series of related characteristics centering on international alliances between local and foreign capital, technology, restricted development choices, and domestic distortions that are caused by the incorporation of less developed societies into the international capitalist system. The opposite of dependency is complete independence from external control, requiring policies of isolation or reordering of the overall international economic system.

The dependency framework, operating from a structuralist perspective, rejects the state as an actor as a useful conceptual building block of theory. It does not see the composition of the global system in terms of a collection of nation states, but rather as a structured world capitalist system.

For the purpose of this study, the level of dependence refers to the relative level of external reliance on other actors -- (i.e. the size of one's reliance, the importance of the goods, and the goods availability).

facilitated by state intervention that structuralists do not capture in their model.

A developing economy can remain active and participate in the international marketplace, acquiring needed technology and financing for its development, but the state of the developing economy must be extremely careful of the institutional mechanisms through which these interchanges occur, and it must manage its international linkages carefully so that its interactions are of a nature that suits the needs of the domestic economy.⁶⁰

The State Intervention Perspective

While the liberal and Marxist perspectives have been the major explanations of the role of the state in economic development in the contemporary developing world, a minor but consistent explanation has been the state intervention perspective. The state intervention ✓ perspective contains two basic assumptions. First, it assumes that state structures, policies, and actions are not simply derivatives of social structures whether conceived of in class, level of foreign ✓ economic penetration, or in pluralist terms. Second, the state intervention perspective assumes that the state is capable of utilizing the level of autonomy that it does possess to shape the process of economic development and social change.⁶¹ The state

60. Carlos Diaz-Alejandro, Rich and Poor Nations in the World Economy, (New York: McGraw Hill Book Company, 1978), p. 122.

61. Atul Kohli, et al., "Inequalities in the Third World," Comparative Political Studies, Fall 1984. Also see: Alfred Stepan, The State and Society, (Princeton: Princeton University Press, 1978). E.A.N. Ordlinger, On the Autonomy of the Democratic State, (Cambridge: Harvard University Press, 1981). Theda Skocpol, States and Social Revolutions, (Cambridge: Cambridge University Press, 1979).

intervention perspective emphasizes the significance of regime type and the initiatives that the state can implement to advance its own development goals and to shape society. In the contemporary world setting, there is a progressively increasing trend of the state attempting to control its economic activity. This state intervention has been manifested in such forms as welfare statism, state control of banking and finance, state control over foreign capital and technological inflows, state ownership of industrial infrastructure, and in state managed economies, among many other forms. This state intervention is largely due to the instability of international and domestic capitalist structures when left solely to "market mechanisms," and to the perception that a larger share of benefits can be derived by the domestic economy if market mechanisms are altered. State intervention becomes an activity directed primarily toward shaping the domestic production process and international economic interactions in order to create an environment more conducive to domestic economic development, to coordinate economic development between sectors, and to mobilize mass support for the system by developing mechanisms that supply at least a minimum of necessary goods to the population as a whole.

In arguing for the need of the state to intervene in a developing economy in order to facilitate economic development, it is implied that the world is not a rigidly structured capitalist system. Rather, the international economic order is viewed as a system of nation states that have a highly unequal relationship in the international system. However, each nation state can take internally generated action to alter its structural relationship with the international system and to facilitate and shape, to a degree, its

domestic economic activity. The international division of labor is not preordained and is in part determined by state industrialization and development strategy.⁶²

It is not here argued that the state, particularly the state in a developing nation, has the capacity to be independent in its economic activity. Rather, it is argued that the state in the developing economy has the potential to move its domestic economy to a more interdependent relationship whereby its interactions with the international economy and other nations may be more equal. There are a multitude of constraints both domestically and internationally -- national resource endowment, skill level of the population, climate and geographical conditions, international financial structures, terms of trade, limited access to developed markets, monopolies on capital and state-of-the-art technology, to list a few -- that limit the parameters within which the state may act. However, within these parameters the state has considerable scope within which to act, and it has the potential to control significant factors within its domestic environment. To act in this capacity, the state must actively pursue effective control over domestic economic activity in order to facilitate development. This must be a top priority of the state in a developing economy. The state also possesses the potential to shape the impact of foreign capital and technology entering its economy. The state intervention perspective recognizes the potential capacity of the state to intervene "autonomously" into its domestic economic affairs and to increase its bargaining position with the international economic system. The state intervention perspective

62. Stephan Haggard and Chung-In Moon, "The South Korean State in the International Economy: Liberal, Dependent or Mercantile," in John Ruggie, ed., The Antinomies of Interdependencies, (New York: Columbia University Press, 1983), p. 140.

should focus on the systematic exploration of policies, strategies, and institutional mechanisms available to the state in a developing nation in its pursuit of economic development.

The liberal and Marxist literature (because of the relatively insignificant role they assign to the state in the process of economic development) devote relatively little attention to the initiatives that the state may employ to increase its domestic capital formation, to shape the pattern of investment effectively, and to increase the control that the state may exercise over foreign investment so as to shape foreign penetration in a manner that will maximize benefits received by the developing economy. The liberal school tends to overlook the possibility that a lack of control over foreign investment patterns can have a negative impact on a developing economy. This literature is primarily concerned with how multinational corporations function and with how their activity can be expanded. Marxist literature, on the other hand, tends to devote extensive research to documenting the negative impact of dependence on foreign interaction, but it does not attempt to develop strategies by which developing states can alter their relationship with the international economy. Marxist scholars tend to assume that the developing state is either captured by the capitalist class, or it is a reflection of capitalist worldwide structures and, thereby, not capable of acting in a manner that facilitates domestic development in any manner that is relatively autonomously generated. As Stepan has argued, "These two bodies of literature taken together contributed to the widespread belief that multinational corporations had the power to grow independently of, or in spite of, state policies in Third World countries. There was frequently even the suggestion that

multinational corporations contribute to the erosion of the nation-state."⁶³

To these two propositions, Stepan offers alternative hypotheses. He argues that in Latin America, the growth of MNC activity subsequent to 1945 was greatly aided by state policies of import substitution and by tariff, foreign exchange, and import incentives. If this argument is valid, then it follows that other state policies may be enacted to alter foreign investment patterns and their impact. Stepan also argues that the increase of foreign investment in some developing countries will encourage the creation of policies devoted to the control of foreign investment: "There is thus reason to think that the multinational corporations may well encourage the rise of countervailing bureaucracies in which the state will play a key role."⁶⁴

Contemporary economic development is not merely a process of factors of production, market access, and comparative advantage as liberal theory implies. Likewise, economic development is not merely a reflection of the structured needs of the international capitalist system. Neither the liberal nor the dependency perspectives can account for the significant role that the state can play to facilitate and direct its domestic economic development by mobilizing resources and society toward the goal of economic transformation.

A primary role of the state in its facilitation of economic development is in the formation of domestic capital for investment and its effective allocation to productive investment. There are many factors associated with industrialization. However, none may be as

63. Alfred Stepan, The State and Society, (Princeton: Princeton University Press, 1978), p. 235.

64. Ibid., p. 235.

central as the process of capital accumulation and its effective allocation.⁶⁵ Productive output can not increase if capital is not available for investment into production apparatus. In order to increase productive output, a developing economy must generate an economic surplus in addition to all consumption costs and reinvest this surplus into new machinery, new technology, new forms of labor organization and training, electrical power generation, transportation and communication infrastructure, and other forms of productive investment. This, in turn, should increase output and create a situation where further surplus can be generated. Without the accumulation of capital, other factors of economic development can not be mobilized.

Once capital accumulation and its effective allocation are viewed as the central variables in periphery industrialization, other variables become interpretable in relation to it. The importance of links to the international economy should be seen as a means of building a capital and technological base by which to further expand production.⁶⁶ However, if capital is accumulated by international actors and transferred to the developing economy, two conditions will likely result in the developing economy if the foreign capital is not regulated by the state and is allowed to flow into the developing economy freely. First, when the developing economy relies on foreign investment for financing economic development, the internal production apparatus will come to be owned and controlled by foreign actors. These foreign actors have their own goals based upon global rationalities which often are in conflict with domestic economic

65. James A. Caporaso, "Industrialization in the Periphery," International Studies Quarterly, September 1981, p. 362.

66. Ibid., p. 365.

needs. If foreign actors come to control a significant share of the production apparatus, the domestic economy of the developing nation will almost certainly reflect the needs of the international economy, not the needs of the domestic economy. This will tend to support the claims of dependency theorists. Second, if foreign investors provide the capital for economic development, the returns generated from any production expansion will be controlled by the foreign investors and very likely will be expropriated from the domestic economy.

In order to accumulate capital needed to expand production while maintaining a maximum level of domestic control over key decisions in relation to the pattern of development and the allocation of the surplus generated, it becomes necessary for the state to implement policies that will expand domestic capital accumulation and to see that this capital is channeled to domestic producers. A primary factor affecting the state's capacity to increase its control over the pattern of domestic economic development is the capacity of the state and the domestic private sector to generate domestic capital savings to be used to finance development plans. The greater the degree that the state's development goals can be financed by domestic savings, the greater the degree of control the developing economy can exercise over its development pattern and the less that the domestic economy will be conditioned by external economic considerations. The state can increase domestic capital formation by several mechanisms: an efficient regulation of fiscal and monetary policy, increased tax base, profits from state operated enterprises, increased incentives for private savings, a resistance to implement development projects that require a large level of foreign exchange, increased production and marketing of domestically produced goods, etc. Specific economic

policies implemented by the state can stimulate domestic savings. These resources can then be allocated by the state to industries with the capacity for generating further surplus or to industries with the capacity to produce needed goods for the domestic and export markets.

✓ The state can also increase the level of returns the domestic economy receives from its interaction with the international economy by regulating and monitoring foreign investment, loans, and technological inflows to assure that they fit domestic development needs. The greater the degree in which the state can direct foreign investment, loans, and technology into "preferred sectors" of the domestic economy and keep foreign penetration out of "non-preferred sectors," the greater the benefits the domestic economy will receive from its interaction with the international economy. The state must ✓ define its long-term development plans and identify those sectors that ✓ complement domestic investment and production. The state must then channel foreign investment into "preferred sectors" where domestic technology and expertise are inadequate to meet the demands of that sector and limit or prohibit foreign penetration into sectors where domestic technology and expertise can meet development goals. The state, in effect, must re-direct the global rationality of foreign penetration into its domestic economy so that it fits development plans. Here, international structural needs are re-directed by effective state policies into such sectors as those that produce foreign exchange earning exports or into sectors that are necessary for the integrated development of the domestic economy. Foreign penetration needs to be excluded from "non-preferred" sectors where domestic producers possess adequate technological knowledge to meet domestic demand. If foreign investment is allowed to flow into

sectors where domestic producers have adequate technological expertise, the superior levels of capital and economies of scale of foreign actors will allow the foreign actors to out compete and replace domestic producers. This, in effect, will "denationalize" production and further condition the domestic economy to international structural needs. In "non-preferred sectors," the state needs to channel domestic savings to domestic producers in order to finance the expansion and continual modernization of those sectors. This is necessary if domestic control of those sectors is going to be maintained.

Such regulation of foreign investment into a developing economy will discourage certain foreign investors from investing in that country. Often the "non-preferred" sectors where domestic producers possess adequate technical knowledge are the more profitable sectors for foreign investment in developing nations. Being excluded from these sectors will certainly limit the level of foreign investment in the aggregate. However, the concern of the developing economy is not the level of foreign investment, but rather the inducement of foreign investment into needed "preferred" sectors. In those sectors where development is necessary for the integrated development of the economy as a whole and where domestic producers are unable to expand for technological reasons, the state needs to offer incentives to encourage the inducement of foreign investors. Such incentives as tax holidays, guaranteed repatriation of profits, monopoly rights on the domestic market for limited periods of time, and other incentives can be utilized to induce preferred foreign investors who can fill technological and other gaps where domestic producers lack production capacity.

The state can also increase its bargaining position with foreign investment. Increased bargaining strength will increase the capacity of the state to shape the pattern of foreign investment to fit domestic developmental needs. Various sources of foreign capital are often in competition with each other. If the state is going to allow foreign investment in a particular sector, the state, where possible, should take bids from competing foreign capital. This will be attractive to foreign capital because, in effect, the selected investor will be the only foreign investor in a particular project and will be free from other foreign sources of competition. The state can maximize its advantage on the terms of investment by accepting only the most attractive bid.

As a necessary condition for the state to increase its capacity to control foreign capital, the state elites must be dedicated to a policy of controlling foreign capital. The state must impose a consistent strategy that will facilitate its control over foreign investment in relation to its own development plans. If this is done effectively, it can increase the state's bargaining power with foreign investment because the investment climate will be predictable even though foreign capital will not be able to penetrate the economy in a "laissez faire" manner. This requires the state to have a reasonably effective state apparatus and strong ideological unity in its development priorities.

Often, even with effective domestic capital accumulation policies, the developing economy is critically short of needed investment capital. In order to obtain needed capital to finance development plans, it becomes necessary to obtain loans on the international financial markets. Loans, both public and private, can

be "double edged swords" to the developing economy in relation to the question of domestic control and the maximization of benefits that the developing economy may receive from its interaction with the international economy. Loans can allow the developing economy to finance its development plans with domestic ownership of production apparatus. However, loans can also lead to severe debt problems. In dealing with the inflow of foreign loans, the state of the developing nation must also play a leading role.

Theoretically, foreign loans can allow for less foreign control over a developing economy than direct foreign investment. Direct foreign investment will lead to foreign ownership of production apparatus, while loans will allow for domestic ownership though accompanied by the burden to repay. If the foreign loans flow to productive investments that generate a surplus in excess of the level required to service the loan, the developing economy has acquired the needed capital for investment and has maintained domestic control over that production apparatus. In addition, any profit in excess of the debt service level, or generated subsequent to repayment of the loan, is surplus that is controlled by the domestic economy. However, if the debt can not be repaid and is rescheduled, much of the developing state's control over its domestic economy will be lost to international financial establishments and the terms of debt rescheduling. Loans can allow the developing economy to obtain needed capital for development without requiring foreign investment, thereby increasing the level of domestic control and rewards. However, these loans must be utilized efficiently to generate sufficient surplus to repay the debt. Here, the role of the state becomes one of screening loans and assuring to the highest level possible that foreign loans

flow into sectors where domestic producers have adequate technological capacity to generate the necessary return, and that the funds are, in fact, efficiently utilized. In this manner, foreign capital can be utilized to finance development plans while serving the domestic needs of the economy. Such state policies would allow for the domestic economy to be more internally articulated and less a reflection of international economic structures.

✓ The state intervention perspective with its focus on the role of the state in facilitating domestic economic development and in managing its relationship with the international economy presupposes ✓ the presence of a state dedicated to the policy of economic development. If a state is to direct internal development and alter its structural relationship with the international economy, the state must be committed to that goal, organize its state apparatus to that goal, and effectively implement efficient development strategies.

Such a state is highly contrary to Gunnar Myrdal's description of underdeveloped countries and their "soft states." Myrdal argues, ✓ "The underdeveloped countries are all, though in varying degrees, soft states."⁶⁷ A soft state is characterized as a state that will not or does not possess the capacity to formulate economic development policies and to enforce the policies decided upon due to state authorities being incapable or reluctant to place obligations on people of all social strata. The political leadership of a soft state can not impose obligations necessary to carry out policy decisions due to various types of social indiscipline. This social indiscipline may be due to such reasons as: vested self interest of state leaders, corruption, political weaknesses, lack of authority and power,

⁶⁷. Gunnar Myrdal, The Challenge of World Poverty, (New York: Vintage Books, 1970), P. 208.

deficiencies in legislation and law enforcement, disobedience of bureaucratic officials at various levels to the rules and directives handed down to them, collusion between bureaucratic officials and powerful persons or groups whose conduct they should regulate, among others. In a soft state, where policy is frustrated by the lack of the state's ability to implement its plans, economic development will not effectively advance.

✓ In order for a state to intervene into its economic affairs and to promote the effective implementation of policies, the state must necessarily possess the characteristics of a hard state. Although Myrdal does not specify the characteristics of a hard state, by contrast, a hard state is one that is characterized by the ability to implement its policy by placing obligations upon people and groups and effectively obtaining private sector compliance with government directives by either government compulsion or through material incentives.

Such a state is the one that is described by Chalmers Johnson in his study on the role of the Japanese state in facilitating Japanese economic development over the past sixty years. Johnson highlights the high priority that the Japanese state has placed upon economic development: "For more than fifty years the Japanese state has given first priority to economic development. . . . A state attempting to match the economic achievements of Japan must adopt the same priorities of Japan. It must first of all be a developmental state."⁶⁸

Having established the high priority placed upon economic development, Johnson describes the central position that the Japanese

68. Chalmers Johnson, MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975, (Stanford: Stanford University Press, 1982), p. 306.

state has played in directing Japanese economic transformation from an agrarian to an industrial society. In Japan, the state established target industrial sectors for development, developed strategies to induce entrepreneurial activity in those sectors, and coordinated the private sector to implement the state-designed industrial policy.

A principal concern of policy makers in the Japan was to increase military and industrial capacity in order to preserve national sovereignty from the encroachment of European colonialism. The Japanese state, thereby, placed major emphasis upon industrial expansion with limited foreign control over the production apparatus. The Japanese borrowed technology, production techniques, and experts in several fields from the industrially advanced nations of that era. However, the state attempted to maximize domestic capital for investment and resisted foreign ownership of production apparatus. Foreign ownership was only allowed by the state in those cases where foreign investment was deemed necessary in a particular sector in order to facilitate the development of other important sectors or the economy as a whole.

The Japanese state organized its bureaucracy in a manner that industrial policy could be planned, implemented, and monitored by the state. As a general rule, the Japanese state offered such financial incentives to entrepreneurs as low interest or free financing, monopoly rights, market protection from imports, and tax concessions to induce private enterprises to enter and develop targeted sectors. However, penalties were placed upon producers who failed to produce at adequate levels. Often, the financial incentives granted by the state were revoked if a private enterprise's performance was unsatisfactory. Through incentives and the placing of obligations upon private

producers to perform in a satisfactory manner, the Japanese state shaped and controlled Japanese industrial transformation by inducing the private sector to implement government economic policy.

Drawing from Myrdal's and Johnson's discourse and from the state interventionist perspective, it can be argued that for a contemporary developing economy to transform from agrarian to industrial, the state must be effectively organized toward the goal of economic development. The state must mobilize resources, allocate them to productive investments, and place obligations on the private sector to effectively utilize these resources.

In the examination of economic development in Korea that follows, it will be seen that the Korean state, subsequent to 1961, actively intervened in economic affairs to increase capital formation and to allocate capital investment to private sector producers who were held responsible for the effective use of those resources. The Korean state also played a highly active role in controlling the pattern of foreign capital and technological inflows to fit domestic economic needs as perceived by state economic planners. These policies and the manner in which the state reorganized bureaucratic institutions in order to restructure the relationship between the state and the private sector are the dominant factors responsible for the economic growth and industrial transformation that has occurred in Korea over the past twenty-five years. Korean economic growth and industrial development have been, above all, state-led. The Korean state has substantial authority in planning and implementing development policy and has substantial power in insulating itself from both domestic and external political pressures.⁶⁹ Neither the liberal

69. Stephan Haggard and Chung-In Moon, *op. cit.*, pp. 185-186.

nor the world system perspectives can adequately account for the relative autonomy of the Korean state and its significant impact on industrial transformation. Korean economic development is best understood in terms of the state intervention model whereby the state has acted with a high level of autonomy in defining development goals and in establishing economic and social structures to facilitate the implementation of those goals.

Chapter II: Korean Political - Economy Prior to the Military Coup of 1961

The economy of the Republic of Korea has experienced significant industrial development since 1963. During this period, the economic growth rate has averaged approximately 10 percent per annum, and the structure of the economy has been transformed from an agrarian base with little industrial capacity to a diversified industrial economy centered upon the export of manufactured goods. The central thesis of this study is that effective state intervention into key sectors of the Korean economy has been the primary factor in initiating and shaping the pattern of Korea's industrial transformation. Thus, I will examine the effect of various Korean state strategies designed to increase domestic capital accumulation and to shape the pattern of foreign investment in order to maximize the benefits that the Korean domestic economy would receive from its interaction with the international economic system. Subsequent chapters of this study will be devoted to the support of these claims. However, it is first necessary to provide contextual information on conditions in Korea prior to 1961.

Korean economic development is interesting for several reasons, but its primary interest as a contribution to more general theory on periphery development is that Korea has been able to cope with its dependent position in the international economic system and overcome significant structural and factor endowment constraints since 1961. Prior to that date, Korea's economic situation in relation to the

international economy was not unlike several other former colonial/dependent underdeveloped states in Asia, Africa, or Latin America. In 1961, Korea's economy was in a traditional core-periphery relationship with external dependence upon the United States for aid and with virtually no export trade or manufacturing sector. This chapter will describe the economic conditions leading up to 1961.

To anticipate the argument, it will be established that in 1961 certain antecedent factors that would aid in the facilitation of subsequent development were present. However, the overall condition of the Korean economy was that of a traditional periphery state, and that the likelihood of subsequent development appeared no greater in Korea than in most other periphery states. By almost any measure, Korea, in 1961, offered few possibilities for sustained economic development. Korea had one of the highest population densities in the world, an insignificant resource endowment, and a per capita income of less than U.S.\$80 per year. Its exports equalled less than 2 percent of GNP, and primary products composed 75 percent of exports.¹

The Traditional Korean Economy

Korea remained in the shadow of the international capitalist system throughout most of the years of the worldwide colonial period. It was not until the events of the Sino-Japanese War in 1876 and the Japanese-Russo War of 1904 that Korea's traditional economic system was dismantled and capitalist practices were introduced through colonial subjugation. Then, it was the newly industrializing Japan,

1. Economic Planning Board, Major Statistics of Korean Economy, various years.

not one of the traditional European colonial powers, that was to subjugate Korea. Prior to the annexation into the emerging Japanese Empire, Korea had been a united country led by indigenous rulers with only a few interruptions since 668 A.D. when the Silla kingdom had united the Korean peninsula. From 668 A.D. onward, the Korean peninsula had been an area where all people spoke one language, shared common cultural characteristics and customs, and perceived themselves as one national-ethnic group.

Since the seventh century, there have been several occurrences in Korean history when the Korean peninsula was invaded and the Korean national existence threatened. Korea, geographically located between traditionally larger and more powerful states -- China, Japan, and Manchuria -- has been both the benefactor and victim of its geographical location. The ideologies of Confucianism, Taoism, and Buddhism have passed to Korea from China and left a significant impact upon the Korean philosophical outlook, the government structures, the education system, and the general world view. However, Korea has also experienced human and physical devastation on a seldomly equalled scale due to its location between such powerful states. Korea has experienced over fifty invasions by foreign powers.² Korea was an invasion route for Kublai Khan's army in its attempt to conquer Japan and for numerous Chinese dynastic armies. Hideyoshi devastated the country in the 1590's under the grand design of Japanese dominion of East Asia. In the seventeenth century, the Manchurians conquered and briefly ruled Korea. During many periods in its history, the Korean kings have been forced to pay tribute to the Chinese Court and to live

✓ ². L.L. Wade and B.S. Kim, Economic Development of South Korea: The Political-Economy of Success, (New York: Praeger Publishers, 1978), p. 1.

subjected to Chinese suzerainty. As a result, the Korean heritage has had a high level of foreign influence. However, while numerous other ethnic groups in central and northern Asia were assimilated into the greater Chinese cultural-political system, Korea, with a high degree of national identity and cultural unity, was able to remain a relatively independent and united nation until the events that arose from the Sino-Japanese and Japanese-Russo wars.

Prior to 1900, Korea was an agrarian nation ruled by the Yi dynasty. The majority of the population lived in rural villages that were relatively self-sufficient in food production and other needed goods.³ By 1860, Chinese influence in Korea had declined significantly due to Chinese internal instability and the increasing Western influence in China after the Opium Wars of the 1840's and 1850's. Japan, in 1868, had experienced a revolutionary overthrow of the Tokugawa Shogun, which would mark the beginning of the industrial transformation process in that country under the Meiji Restoration. The Japanese revolution was largely triggered by the increase in Western influence in Japan after the treaty American Commodore Perry signed with the Japanese extending trading privileges to Western powers. With the decline of Manchu power in China and with Japan concerned with internal affairs, Korea tended to withdraw within its own territory, resisting contact with other nations. In the late nineteenth century, the extreme reaches of world capitalist penetration had disrupted traditional society in China and Japan, but it had not yet reached Korea. The Western powers were too occupied

3. Kirk Y.K. Kim, "The Impact of Japanese Colonial Development on the Korean Economy," in C.I. Eugene Kim and Doretta E. Mortimore, Korea's Response to Japan: The Colonial Period 1910-1945, (Kalamazoo: The Center for Korean Studies, Western Michigan University, 1977), p. 87.

with the highly attractive markets of China and Japan to pay significant attention to the small feudal kingdom on the peninsula between these two nations.

Precapitalist Korean political economic structures were in many respects similar to precapitalist structures in Europe. However, in Korea the state maintained a much higher level of central authority. In Korea, the royal family maintained strong centralized government control over economic, military, intellectual, and religious life.⁴ Land was the primary source of economic wealth. Theoretically, all land belonged to the king and was allocated by the king to members of the royal family and other members of the upper class. Legally, land could not be transferred or inherited, but it reverted back to the king's authority upon the death of the retainer. However, in practice, the family holding rights over land was allowed to maintain control over that land as long as they did not fall out of favor with the power structure within the royal family. The aristocracy who retained control over the land were primarily absentee landlords. The surplus from the land was expropriated by the landlord class through an elaborate system of rents and taxes, which at times could be as high as 80 percent of the tenant farmers' crops.⁵

The traditional Korean class structure made up of three classes systematically repressed the emergence of entrepreneurial activity. The elites, or Yangban, were composed of the royal family and the landed elite who were favored by the royal family. Under the Yangban

4. Charles Barone, "Dependency, Marxist Theory, and Salvaging the Idea of Capitalism in South Korea," Review of Radical Political Economics, Vol. XV, No. 1, Spring 1983, p. 53.

5. Edward Mason, et al., The Economic and Social Modernization of the Republic of Korea, (Cambridge: Harvard University Press, 1980), p. 65.

were the farmers known as Yangmin, who composed the vast majority of the population. By the middle of the nineteenth century, the rural labor force was predominantly free, but did not own the land that they worked. Over 40 percent of the farm families rented all of the land they tilled, while only 20 percent of the farm families owned all the land they cultivated.

The lowest class in Korean class structure was composed of merchants and artisans. This class was known as Chonmin. As a class, the merchants and artisans were subservient to the ruling class. The state maintained a strict system of licensing of all merchant activity, and through this system it could control the flow of goods throughout the country.⁶ Industry was virtually non-existent. Everyday needs of the common people were produced in the home, and the exchange of tribute with the Chinese Court adequately provided the royal family and Yangban with manufactured products.⁷ Those goods and handicrafts that were not supplied through trade with China were produced in government factories. With royal family and Yangban needs supplied by these means, combined with the absence of legal protection for the property rights of the common people,⁸ the development of private entrepreneurship or indigenous industry was severely stifled. By 1903, there were a total of ten factories in Korea: four of these were Chinese owned and employed 42 workers; the six Korean owned factories only employed 92 workers.⁹ The Yangban class considered the

6. Daniel Sungil Juhn, "The Development of Korean Entrepreneurship," in Andrew C. Nahm, Korea Under Japanese Colonial Rule, (Kalamazoo: The Center for Korean Studies, Western Michigan University, 1973), p. 115.

7. Ibid., p. 115.

8. Ibid., p. 117.

9. Ibid., p. 115.

pursuit of profits from industrial and commercial activities as below their dignity and socially repugnant. As a result, the Korean factories were owned by the government and employed members of the lower class. Under these class-structural arrangements where the upper classes who possessed wealth refused to be involved in production activity and where property rights for the common people were not protected by the state, the most basic guarantees and incentives required to facilitate the development of industrial entrepreneurship were not present in the traditional Korean economic environment.

In areas of commerce, the Korean economy was also quite limited prior to 1900. Merchants were granted monopoly rights of goods in specific geographical areas. These monopoly rights were generally granted on bribery to government officials and by supplying them with desired goods at nominal prices.¹⁰ Monopoly allowed for a high level of government control over commercial activity, but it did not stimulate merchants to improve their retailing or accounting methods, nor did it develop marketing advantages for Korean merchants once the Korean market was opened to foreign penetration by the Japanese in the late nineteenth century.

The economic conditions in Korea in the late nineteenth century can accurately be described as pre-capitalistic. Agriculture was the primary economic activity, and land tenure was based upon feudalistic ownership structures. In 1910, 84 percent of Korean households were engaged in agricultural occupations.¹¹ Industrial and commercial activities were essentially non-existent.

¹⁰. Ibid., p. 117.

¹¹. Paul Kuznets, Economic Growth and Structural Transformation in the Republic of Korea, (New Haven: Yale University Press, 1977), p. 13.

Korea began to be incorporated into the world economic system in the late nineteenth century by Japanese military force. In 1875, Japan had sent a ship to Korea in an attempt to gain trading concessions from Korea in the same manner that Commodore Mathew Perry had secured them from Japan two decades earlier. However, the Koreans attacked the Japanese ship, thereby forcing it to flee.

In 1876, the Japanese sent a fleet to Korea. This superior military force was able to coerce the Yi Court into signing the Treaty of Kanghwa, granting the Japanese the right to trade in Korea. In the 1880's, similar treaty concessions were granted to the United States, England, and Germany.

However, only Japanese trade grew in a significant manner. This is demonstrated in Table 2.1. Between 1876 and 1881, the combined import-export trade between Korea and Japan equaled less than 10 million Japanese yen. By 1900, this trade had increased to over 23 million yen, and by 1910 it totaled almost 60 million yen annually. This trade was by no means an equal exchange. The trade became structured upon the export of raw materials from Korea and the importation of Japanese manufactured goods to Korea. Japanese goods came to dominate the Korean market and created a significant deficit in the Korean balance of trade. By 1900, this balance of trade deficit would reach over 6 million yen, more than a 1,000 percent increase from 1881. By 1910, when Korea was officially annexed into the Japanese Empire as a colony, the trade deficit would equal 19.9 million yen. This figure was approximately 4 percent of the net value of commodity product and constituted the lion's share of manufactured goods available on the Korean market.¹² The increasing trade deficit,

12. Net value of commodity product is taken from: Edward Mason, et al., op. cit., p. 78. Net value of commodity product is the closest statistic to GNP available for the colonial period in Korea.

the domination of Japanese goods on the Korean market, and the increasing military and bureaucratic dominance of Japan over the Yi government reflected Japan's desire to establish a traditional colonial relationship over Korea and to expand their political and economic control over the Northeast Asian territory.¹³

In 1894, a Japanese military contingent in Seoul seized the palace and forced the Chinese emissary in Korea to sign a document declaring Korea to be an "independent nation." As a result, this officially released Korea from its suzerainty relationship with China and allowed Japan to increase political control over Korea. Then, the Japanese immediately moved to reduce the power of the Korean royal family by placing Koreans who were favorable to Japan in important government positions.¹⁴

Table 2.1
Trade Balance After the Signing of the Treaty of Kanghwa (1876)
(in 1,000 Japanese yen)

<u>Year</u>	<u>Imports</u>	<u>Exports</u>	<u>Korea's Net Balance</u>
1876-1881	5,103	4,603	-500
1890	5,285	3,395	-1,890
1895	6,669	4,866	-1,803
1900	14,777	8,542	-6,235
1904	32,927	7,816	-25,111
1907	41,025	14,113	-26,912
1909	39,781	19,913	-19,868

Source: Bank of Korea, Economic Statistics Yearbook, 1948

In 1904, the Japanese attacked the Russian fleet at Port Arthur in southern Manchuria. This incident was the outset of the Japanese-Russo War. During the war, Korea became a strategic location for

13. Kwan Suk Kim, "An Analysis of Economic Change in Korea," in Andrew C. Nahm, op. cit., p. 101.

14. Paul Kuznets, op. cit., p. 5.

Japan by serving as a staging point and as a "land bridge" for Japan to move to the Manchurian territory. This led to a marked increase of the Japanese military presence in Korea, and the Japanese took control of the limited Korean railways, ports, and military facilities under the coerced consent of the Yi government. Furthermore, the Korean monetary system was reformed to facilitate Japanese financial interests.¹⁵ With the defeat of the Russians in 1905, the Japanese gained full control of the southern half of Manchuria as well as the shipping lanes between Manchuria, Korea, and Japan. On August 22, 1910, a treaty of annexation was signed which officially recognized Korea as a colony of Japan, and the Yi dynasty, which had ruled Korea for 600 years, was abolished.

In explaining the economic development of Korea after 1961, there is little traditional economic heritage of the Yi dynasty that distinguishes Korean society and marks it as a potential candidate for industrial development. Korea had a feudal economy that systematically restricted the growth of entrepreneurial activity and preserved the privileges of the landed aristocracy. However, there were certain political and cultural factors in the traditional Korean society that deserve mention. They were norms and values that would later contribute to the cultural environment that would aid the facilitation of industrialization and economic development. These factors can not be considered as causal variables or even as necessary conditions to economic development; nevertheless, they are important societal conditions that would aid the industrialization process in Korea.

Korea's political heritage differed from the majority of today's developing nations in two ways. First, Korea was not formed into a

15. Kwan Suk Kim, op. cit. pp. 101-102.

political unit as a product of fiat or self-serving interests of a colonial power. It was an indigenous ruled kingdom, the Silla, who created the political boundary of an independent Korea in 668 A.D. This boundary remained essentially intact for 13 centuries, firmly establishing a perception of a national identity among the people. Therefore, there was no need for the Korean state to "create" a national identity among the people after its independence from the colonial power, as most Asian and African colonies needed to.

Second, the traditional Korean governmental structures were of a highly centralized bureaucratic nature whose influence penetrated into the interior of the country, actively intervening in economic and political activities.¹⁶ This has established a tradition whereby the vast majority of economic actors would accept the legitimacy of state intervention in shaping and controlling domestic economic activity. This is not to argue that the Korean political heritage will necessarily lead to popular acceptance of all governmental intervention into economic affairs. This is clearly not the case. However, it does mean that despite political opposition to how the Korean government intervenes and how the economic benefits are distributed, there is little question, even by the most active business community, of the legitimacy of state intervention in and control over primary economic activity. In general, it is accepted that if government intervention into the economy is for the benefit of society as a whole, then government economic intervention is a legitimate government activity.

In addition, there are two important cultural factors of traditional Korean society that have contributed to contemporary

¹⁶. John K. Fairbanks, et al., East Asia: Transition and Transformation, (Boston: Houghton Mifflin Company, 1978), p. 302.

economic development. In conjunction with its long period of national identity, Korea is a homogeneous society where people speak one language, have similar religious beliefs, cultural traits, and social customs. The Korean people, for over a millennium, have perceived themselves as one society, thereby the problem of social integration, which has often been a constraint on development efforts in so many developing nations, has not been a significant problem in Korea.

A second cultural factor that has aided contemporary development in a significant manner is the emphasis and value placed upon education. Traditional Korean society was based upon Confucian principles. Under Confucianism, education was valued highly, and it was the primary vehicle to social mobility in governmental service, social prestige, and increased influence in society.¹⁷ This cultural emphasis on education has persisted to today. The literacy rate in Korea exceeds 90 percent which is rarely matched even in many advanced industrial states.¹⁸ Children, not only of elite families but also of rural and urban working families, are strongly encouraged by their parents to study at home after school hours night after night for several years to prepare for entrance examinations for colleges and technical schools. This value placed upon education, combined with a relatively well organized education system that penetrates to all areas of the country, has aided Korea significantly by providing a qualified work force as the country industrializes and diversifies its production capacities.

17. Ibid., p. 305.

18. International Bank of Reconstruction and Development, World Tables, Vol. II, 3rd ed., (Baltimore: Johns Hopkins University Press, 1983), p. 51.

The Japanese Occupation of Korea

The Japanese colonial occupation of Korea (1910-1945) introduced the Korean agrarian economy to the world capitalist system. Substantial economic growth occurred in Korea during the Japanese occupation. Great gains in agricultural production, mining, industry, commerce, banking, and infrastructure took place during this period. However, the Korean economy was restructured into a core-periphery relationship to meet the needs of Japanese economic conditions. The benefits of this colonial economic growth accrued to the Japanese as the colonial system expropriated Korea's economic surplus to Japan. "The Korean economy was literally an appendage to the Japanese economy serving the needs of the home country and of the Japanese living in Korea."¹⁹ The Korean people, in most all cases, were more impoverished even with the increase in economic growth. Little physical capital remained that would benefit subsequent economic development in Korea after the Japanese economic structures were dismantled in 1945.

Although Japanese rule over Korea was brief in comparison to most Western colonial control over their territories, the impact of Japanese rule on Korean economic transformation was profound.²⁰ The average annual growth rate in GNP during this thirty-five year period was over 4 percent, and per annum manufacturing growth exceeded 10 percent.²¹ This economic growth and structural transformation

19. Charles Barone, op. cit., p. 55.

20. Edward Mason, et al., op. cit., p. 75.

21. Bruce Cumings, "The Origin and Development of the Northeast Asian Political Economy," International Organization, Winter 1984, p. 12.

occurred in three different phases as the economic needs and conditions of Japanese economy became altered.²²

The first phase of the Japanese occupation (1910-1920) saw the Japanese concentrate on increasing agricultural production in Korea, limiting manufacturing production and solidifying their political control over the Korean population. The Japanese implemented three major policies to fulfill these goals: (1) The Japanese governor-general ordered a comprehensive land redistribution in order to increase agricultural production and to capture agricultural surplus; (2) The Japanese enacted and enforced corporation laws which effectively prohibited investment into manufacturing sectors in order to protect the Korean market for Japanese manufacturers and to protect the Japanese market from Korean competition; (3) The Japanese governor-general actively repressed opposition to Japanese rule in Korea by arresting and interning or executing Korean dissidents. After the crushing of a major rebellion of 1919, all effective organized resistance to Japanese rule had been destroyed.²³

The Japanese land survey and redistribution system, enacted and implemented during the early colonial rule, destroyed the traditional Korean land tenure system and gave the Japanese control over most agricultural land. During the first decade of Japanese rule over Korea, there were rice shortages in Japan. These rice shortages had given rise to demonstrations by Japanese urban workers. Between 1915 and 1920, Japan had experienced severe food shortages. In 1918, "rice riots" broke out throughout Japan as the price of food in general, and

22. Han-Kyo Kim, "The Japanese Colonial Administration in Korea: An Overview"; Danial Sungil Juhn, "The Development of Korean Entrepreneurship," in Andrew C. Nahm, op. cit., p. 42 and p. 119. Paul Kuznets, op. cit., p. 29.

23. Paul Kuznets, op. cit., p. 8.

rice specifically, increased substantially. The Japanese state feared that further rice shortages would necessitate an increase in urban wages, thereby decreasing the competitive advantage of Japanese goods. To quell this internal problem, the Japanese required the colonial governments in Korea and Taiwan to increase rice production and exports to the home market. Therefore, the rationale for the land redistribution in Korea was to supply a sufficient level of rice to the Japanese market. Rice production in Korea needed to be substantially increased and Korean rice consumption needed to be decreased. The Japanese perceived that this would require a radical change in land ownership patterns so that the Japanese could gain control over production and surplus.²⁴

Thus, the strategy of the land redistribution was to create large agricultural estates controlled by the governor-general through Japanese landlords. Under the land redistribution system, all land became a commercial commodity. Only those Koreans who could show legal title to the land they farmed could maintain possession of that land. However, the Korean peasantry, being primarily tenant farmers without title, lost all rights to the land that they worked. The land was confiscated by the governor-general and sold to Japanese land development corporations and Japanese immigrants. More than 325,000 acres of land were confiscated, and more than 33,000 peasants were removed from their land according to the official Japanese report. Approximately 191,000 acres were sold at nominal prices to five Japanese corporations -- Oriental Development Corporation, Funi, Takakura, Tasan, and Kumamoto -- and the remaining 134,000 acres were

24. Kirk Y.K. Kim, op. cit., p. 88.

sold to Japanese immigrants and Korean aristocrats who had collaborated with the Japanese.²⁵

Table 2.2
Korean Rice Production and Export: 1912-1933
(in thousand sok)

<u>Year</u>	<u>Total Production</u>	<u>Export</u>
1912	11,600	500
1915	14,100	2,300
1918	13,700	2,200
1924	15,200	4,600
1930	13,700	5,400
1931	19,200	8,400
1932	15,900	7,600
1933	16,300	8,700

Source: Takashi Hatata, A History of Korea, (Santa Barbara: American Bibliographical Center-Clip Press, 1969), p. 117.

The Japanese introduced new seeds, fertilizer, land use techniques, and machinery. In addition, they expanded cultivated area through irrigation and reclamation programs.²⁶ The production of rice in Korea was substantially increased (as shown in Table 2.2), as was the control that the Japanese exercised over rice production. Between 1912, when the land redistribution policy was enacted, and 1933, when the policy had been in full effect for over a decade, rice production had increased approximately 50 percent. A more significant factor, however, was that during this same period, rice exports to Japan had increased over 1,700 percent. Total production for domestic consumption declined more than 68 percent between 1912 and 1933, while the population during the same period increased by 41 percent, from

25. Bong-Youn Choy, Korea: A History, (Rutland, Vt.: Charles E. Tuttle Co., Inc., 1971), p. 155.

26. Kirk Y.K. Kim, op. cit., p. 90.

15.2 million to 21.5 million.²⁷ These statistics highlight the colonial orientation and surplus expropriation of Korean agricultural production after the Japanese land redistribution policy was implemented.

The Japanese themselves were not the cultivator of the land. They were mostly absentee landlords with the Korean peasant serving as a tenant on Japanese owned land. By 1930, the Japanese landlords comprised 5 percent of the rural population but owned 60 percent of the land, while 80 percent of Korean rural families were tenants. Often, the rent on the land paid to the Japanese landlords was as high as 80 percent of production.²⁸

The increase in tenancy and rent coincided with an increase in rice production, but it also coincided with a significant decrease in rice consumption by the Korean population. As rice production in Korea began to reach its limits, the Japanese colonial government decreased the level of consumption in Korea in order to increase exports to Japan. By 1933, 53 percent of Korean rice production was exported. Rice production increased less than 33 percent between 1912 and 1924; however, rice exports increased over 500 percent. As Table 2.3 shows, per capita consumption in Korea decreased significantly during the colonial period.

The Korean population was more impoverished even though food production increased. This is due to the Korean economy's orientation to the needs of Japan. Rice became the principal commodity supplied by Korea to Japan in the first decade of the colonial occupation. The

²⁷ Population figures are taken from: Sang-Chul Suh, Growth and Structural Change in the Korean Economy; 1910-1940, (Cambridge: Harvard University Press, 1978), p. 41.

²⁸ Ibid., p. 89.

self-sufficient food system of the Yi dynasty was, thereby, transformed into a one crop economy highly sensitive to external factors.²⁹

Table 2.3
Per Capita Food Consumption of Cereals and Beans in Korea
(in sok)

	<u>1915-1919</u>	<u>1930-1933</u>
Rice	.707	.447
Millet	.303	.325
Barley	.430	.411
Beans	.190	.142
Other	.402	.343
Total	2.032	1.668

Source: Bong-Youn Choy, Korea: A History, (Rutland, Vt.: Charles E. Tuttle Co., Inc., 1971), p. 158. (30 sok = 5.12 U.S. bushels.)

The second major economic policy of the Japanese colonial government during the first decade of the colonial period was the enactment and enforcement of corporation laws that required that any new manufacturing enterprise in Korea receive a charter from the colonial government.³⁰ The corporation laws served two principal purposes. First, they protected Japanese industries from Korean competition. Second, they restricted the development of import substitution industries in Korea in order to protect Korean markets for Japanese producers. By 1928, Korea and Japan's colony of Taiwan would account for almost a quarter of all Japanese foreign trade.³¹

The Japanese during this period were attempting to develop their economy rapidly. The Japanese national objective was to equal or

²⁹ Kirk Y.K. Kim, op. cit., p. 92.

³⁰ Chul Won Kang, "An Analysis of Japanese Policy and Economic Change in Korea," in Andrew C. Nahm, op. cit., p. 79.

³¹ William Lockwood, The Economic Development of Japan, (Princeton: Princeton University Press, 1968), p. 51.

surpass the military and economic power of European nations in order to protect its sovereignty. This required the expansion of Japanese influence in Asia. Japan was rapidly becoming a major Asian imperial power. Korea was seen by the Japanese as an integral part of that empire. The Japanese were intent on shaping the Korean economic structures in a manner that would complement the Japanese economy. Korean labor, commodity production, and capital surpluses were oriented toward the needs of Japan. Korea's role was to produce the needed foods and natural resources that would aid Japanese economic development and to create markets for Japanese manufactures. The land survey and the corporation laws were the two principal strategies utilized by the Japanese to achieve these imperial objectives in the first decade of colonial control in Korea.

During the second decade of colonialism in Korea (1920-1930), the Japanese continued their "agriculture first program" with the emphasis on rice export. This period also saw an increase in Korean mineral extraction, the development of an infrastructure to support mineral exports, and an increase in light manufacturing.

Increased rice production along with limited rice consumption in Korea had supplied enough rice to end the Japanese rice shortages by the mid 1920's and allowed Japanese urban laborers to enjoy relatively inexpensive food. These agricultural policies continued until 1934. At this time, Japanese domestic rice production had increased, and the Japanese market became oversupplied. In order to protect Japanese farm prices, rice production in Korea was deliberately decreased, causing thousands of Korean farmers off the land. As Kang notes, "This is a typical case of the colonial economic policy set up for the benefit of the ruling country and not for the colony itself. Even

though the amount of the rice consumption per capita was about one half of that of the Japanese, the colonial government terminated the (Rice Output Expansion) plan,"³² rather than allow its continuance so that consumption in Korea could be increased.

During the 1920's, the Japanese colonial government increased its exploitation of Korean mineral resources to meet its domestic industrial needs. Korea became a major supplier of Japanese mineral requirements in iron ore, lead, zinc, and copper. By 1928, Korea was supplying Japanese industry with approximately 400,000 metric tons of iron ore as compared to only 157,706 metric tons produced in Japan.³³ Table 2.4 shows the increase in mineral extraction from Korea during this period.

Table 2.4
Annual Average Mineral Production in Korea

<u>Mineral</u>	<u>Production Unit</u>	<u>Quantity</u>	
		<u>1910-13</u>	<u>1924-28</u>
Gold	Troy ounce	141,414	170,348
Silver	Troy ounce	10,602	52,208
Copper	Pound	2,636	1,239,435
Lead	Pound	-	1,756,639
Zinc ore	Metric ton	-	820,000
Iron ore	Metric ton	119,000	400,000

Source: Moulton, Harold G., Japan: An Economic and Financial Appraisal, (Washington, D.C.: The Brookings Institute, 1931), p. 66.

To support this mineral extraction and to export it to Japan, the Japanese built ports, hydro-electric power plants, and a railroad system. The majority of this infrastructure system was located in the northern section of the Korean peninsula where most Korean mineral deposits were located.

32. Chul Won Kang, op. cit., p. 80.

33. Kirk Y.K. Kim, op. cit., p. 93.

A third major change in the structure of the Korean colonial economy in the 1920's was the introduction of light manufacturing. The Japanese corporations had enjoyed a high rate of capital accumulation during the First World War.³⁴ The domestic Japanese economy was depressed, and the Japanese corporations needed investment opportunities outside of the country. The barrier to investment in manufacturing in Korea was the corporation laws. Now that the Japanese firms themselves wanted to invest in manufacturing in Korea, the corporation laws restricted Japanese corporation expansion, so they were abolished. With the abolition of the corporation laws, textile production and other light industries were introduced into Korea. Manufacturing production in Korea during the 1920's grew at an average annual rate of 8.8 percent.³⁵ Starting at a base of almost zero, this growth rate is not overly impressive; however, it does indicate the beginning of industrialization in Korea -- an industrialization sparked by Japanese economic needs.

Table 2.5
Composition of Korean Production: 1925-1939 (in percent)

<u>Product</u>	<u>1925</u>	<u>1931</u>	<u>1939</u>
Agriculture	72.7	63.1	42
Industry	17.7	22.7	39
Fisheries	5.7	6.9	8
Forestry	3.2	5.3	5
Mining	1.3	2.0	6
Total	100.0	100.0	100.0

Source: Takashi Hatata, A History of Korea, (Santa Barbara: American Bibliographical Center-Clip Press, 1969), pp. 120-123 as cited in Kim, Y.K., "The Impact of Japanese Colonial Development on the Korean Economy," in C.I. Eugene Kim, Korea's Response to Japan: The Colonial Period 1910-1945, (Kalamazoo: The Center for Korean Studies, Western Michigan University, 1977), p. 96.

34. Chul Won Kang, op. cit., p. 79.

35. Ibid., p. 81.

During the third decade of Japanese colonialism (1930-1940), the Japanese established heavy and chemical industry production facilities in Korea, and mineral extraction was increased to meet the needs of the growing Japanese war economy. After the Manchurian Incident of 1931, Japanese forces attacked and occupied all of Manchuria and were preparing for an attack on China proper. Korea became the staging point for the supply of Japanese troops on the Asian continent.

Military imperatives required the Japanese to invest in industrial production in Korea in order to send armaments and other supplies directly to their troops in Manchuria. Between 1929 and 1941, the total value of mining and manufacturing in Korea increased from 133 million yen to 600 million yen, an increase of over 450 percent.³⁶ Much of this was in heavy industries related to armament production. In 1912, only 12,000 Koreans worked in factories; by 1940, nearly 300,000 Koreans worked in factories.³⁷ At this time, the Korean industrial infrastructure was among the most developed in the Third World,³⁸ having over 3,524 miles of railway³⁹ and large modern port facilities in Pusan, Wonsan, and Inchon, and several hydro-electric power sites.

In 1931, the most significant production sector of the Korean economy reflected Japan's "agriculture first" policy. As shown in Table 2.5, in 1931, agricultural output composed 63.1 percent of total output, while industry composed 22.7 percent. As shown in Table 2.6, food processing accounted for over 50 percent of industrial output.

36. Sang-Chul Suh, op. cit. Edward Mason, et al., op. cit., p. 76.

37. Edward Mason, et al., op. cit., p. 77.

38. Bruce Cumings, op. cit., p. 13.

39. Kwan Suk Kim, op. cit., p. 109.

At this time, the chemical industry accounted for 9.4 percent of industrial output and the iron and steel industry accounted for 5.8 percent. By 1939, these economic structures were significantly altered, with agriculture accounting for only 42 percent of total output while industrial output increased to 39 percent, and, more importantly, the industrial output shifted to heavy industry. In 1939, food processing composed only 22 percent of industrial output, while the chemical industry now composed 34 percent and iron and steel increased to 9 percent of total output. The Japanese colonial structures had introduced the industrial process to Korea, even though the benefits were oriented toward the core economy.

Table 2.6
Composition of Korean Industry: 1930-1939 (in percent)

<u>Industry</u>	<u>1930</u>	<u>1936</u>	<u>1939</u>
Food processing	57.8	45.2	22.0
Textiles	12.8	12.7	13.0
Chemical	9.4	22.9	34.0
Iron & Steel	5.8	4.0	9.0
Ceramics	3.2	2.7	3.0
Printing	3.1	1.8	1.0
Lumber & Construction	2.7	2.7	1.0
Gas	2.4	5.6	2.0
Machine tools	1.3	1.0	4.0
Other	1.5	1.4	11.0
Total	100.0	100.0	100.0

Source: Same as Table 2.5.

This transformation of the Korean colonial economy from a predominantly agricultural producer to an industrial-manufacturing periphery economy in the 1930's had several underlying reasons, but they were related to Japanese imperial expansion. As mentioned previously, Japanese domestic food production had increased to the point where large scale rice exports from Korea were no longer

necessary. The colonial government's cuts in Korean rice production freed a large portion of the Korean work force, creating a surplus of labor. After the Japanese imperial army invaded and took over Manchuria in 1931, the Korean peninsula and the adjoining Manchurian territory now became, in effect, one large Japanese colony. The Japanese began to manufacture goods in Korea that were necessary to support military expansion into the Asian continent. According to Cumings, Korea at this time began to take on semiperiphery characteristics.⁴⁰ Korean workers, merchants, soldiers, and bureaucrats were sent to Manchuria to occupy middle positions between Japanese overlords and the Manchurian people. Industries were established in Korea that were needed to support the expanding Japanese economic and military domains. Primary products were transported from Manchuria to Korea where power and other infrastructure existed and began to be processed in Korea. These enterprises were all organized and managed by Japanese corporations, banks, and the colonial state structures.⁴¹ The impact of Japanese expansion into Manchuria and of the rising needs of the emerging Japanese war machine significantly contributed to the expansion of light industry and the introduction of heavy industry into the Korean colonial economy.

In the attempt to incorporate the Korean population into the Japanese Empire, the Japanese expanded the educational system in Korea. Although the Koreans were forced to take Japanese names, speak Japanese, and show reverence to the Japanese emperor in the schools, it can not be denied that basic academic skills were increased at this

40. Bruce Cumings, *op. cit.*, p. 13.

41. *Ibid.*, p. 13.

time throughout the Korean population. This, of course, would later aid the economic development process. As stated earlier, the Koreans have traditionally placed a high level of emphasis on education. The Japanese utilized this tradition to increase educational skills through the implementation of Japanese educational structures. Primary schools increased in number from 715 in 1921 to 2,600 in 1937. By 1945, over a million Korean students were enrolled in primary schools, over 50,000 in high schools, and over 7,000 in universities. By the time Korea gained its independence in 1948, over 25 percent of the population had completed several years of formal education.⁴²

Other important institutional developments also occurred in Korea under Japanese rule. The financial system was separated from the Korean Imperial House and established on more modern principles. A monetary system was developed, and communications were modernized. After independence, the Korean educational system, banking system, bureaucracy, and the developing private corporations would have striking structural resemblance to the Japanese systems.

It can not be denied that the Japanese colonial period in Korea increased production output in agriculture, industry, and mining. However, the benefits of those developments were directly oriented toward the needs of the Japanese economic and political conditions. While Koreans were progressively impoverished and their consumption levels decreased significantly, the Japanese government expropriated economic surplus from the Korean colony. Tax income from the Korean economy received by the Japanese increased from 11,347,000 yen or 2.2 percent of the net value of commodity product in 1913, to 71,485,000 yen or 4.7 percent of the net value of commodity product in 1938.

42. Edward Mason, et al., op. cit., p. 81.

Income from other Japanese government enterprises in Korea increased from 13,047,000 yen or 2.5 percent of the net value of commodity product in 1913, to 258,214,000 yen or 17 percent of the net value of commodity product in 1938.⁴³ By 1939, nearly 90 percent of the manufacturing sector was Japanese owned.⁴⁴ At the individual level, the average Korean savings account deposit declined from 6.89 yen in 1909, to 3.41 yen in 1933, while Japanese saving deposits in Korea increased from 20.79 yen to 56.01 yen over the same period.⁴⁵

Japanese colonial policies in Korea did not coincide with the needs arising in Korea, but served the needs of the Japanese Empire.⁴⁶ The Japanese governor-general offered monopoly rights to Japanese corporations. Approximately 200 million yen was invested between 1926 and 1939 by Noguchi and Mitsubishi corporations alone. The Japanese government guaranteed a minimum 7 percent return on any investment over 5 million yen in textile or other labor intensive industry.⁴⁷ By 1944, 99 percent of the chemical industry, 98 percent of metal works, 100 percent of utilities, 97 percent of food processing, 90 percent of construction, and 84 percent of the textile industry were Japanese owned and managed.⁴⁸

43. Joungwon Alexander Kim, Divided Korea: The Politics of Development 1945-1972, (Cambridge: East Asian Research Center, Harvard University Press, 1975), p. 24. Net value of commodity figures are taken from: Edward Mason, et al., op. cit., p. 76.

44. Kwan Suk Kim, op. cit., p. 110.

45. Joungwon Alexander Kim, op. cit., p. 24.

46. Yun-Shik Chang, "Planned Economic Transformation and Population Change," in C.I. Eugene Kim and Doretta E. Mortimore, op. cit., p. 53.

47. Daniel Sungil Juhn, "Nationalism and Korean Businessmen," in C.I. Eugene Kim and Doretta Mortimore, op. cit., p. 48.

48. Daniel Sungil Juhn, "The Development of Korean Entrepreneurship," in Andrew C. Nahm, op. cit., p. 127. Edward Mason, et al., op. cit., p. 76.

With the surrender of the Japanese in 1945, the Japanese colonial system collapsed. In Korea, troops from the Soviet Union accepted the surrender of the Japanese north of the 38th parallel of latitude, and American troops accepted the Japanese surrender south of that line. The physical infrastructure of Japanese colonial industry and agriculture remained in place. However, during the colonial period Japanese nationals filled almost all levels of bureaucratic and private management and technical positions. In 1939, only 15 percent of all management and technical positions in Korea were held by Koreans.⁴⁹ This, of course, did not allow Koreans to gain the necessary skills to operate government agencies or private enterprises after the Japanese left.

Table 2.7
Composition of Population and Land in North and South Korea: 1945

	<u>South</u>	<u>North</u>	<u>All Korea</u>	<u>Share of</u> <u>South in all</u> <u>Korea (%)</u>
Total land(km ²)	108,366	118,366	226,732	47.8
Population(1,000)	17,041	8,859	25,900	65.8
Arable land(km ²)	22,300	24,175	46,475	48.1
Rice paddies	13,293	5,684	18,977	70.0
Dry fields	9,007	18,491	27,498	32.8

Source: Kwang Suk Kim and Micheal Roemer, Growth and Structural Transformation: Studies in the Modernization of the Republic of Korea 1945-1975, (Cambridge, Mass.: Harvard University Press, 1979), p. 22, as cited in Mason, et al., op. cit., p. 87.

In addition, the division of the peninsula at the 38th parallel severed the economy into a mineral rich, industrial north and a more populated, agricultural south. As seen in Table 2.7, the south comprised only 47.8 percent of the land, but over 65.8 percent of the

⁴⁹. Edward Mason, et al., op. cit., p. 77.

population. Although the south had only 48 percent of the arable land, due to better climate conditions, it contained the principal rice fields and issued greater yields than the northern farmlands. As seen in Table 2.8, almost 60 percent of total agricultural output was in the south. In contrast, 75 percent of the mining and 54 percent of the manufacturing were produced in the north. Manufacturing in the south was principally food processing, printing, and wood products, while the manufacturing in the north included 90 percent of manufactured metal products, 82 percent of chemicals, and 64 percent of gas and electrical output in 1939.

Table 2.8
Net Commodity-Product in South and North Korea: 1939-1940
(million Korean yen at 1939 market price and percent)

	<u>South</u>	<u>North</u>	<u>All Korea</u>	<u>Share of South in all Korea (%)</u>
Agriculture	496.3 (59.9)	333.3 (46.7)	829.6	59.8
Forestry	65.8 (7.9)	58.7 (8.2)	124.5	52.9
Fishery	80.2 (9.7)	46.8 (6.6)	127.0	63.1
Mining	28.9 (3.5)	90.6 (12.7)	119.5	24.2
Manufacturing	157.9 (19.0)	183.7 (25.8)	341.6	46.2
Total	829.1 (100)	713.1 (100)	1,542.2	53.8

Source: Same as Table 2.7 pp. 137-139, as cited in Mason, et al., op. cit., p.88.

Due to the lack of trained Korean managerial and technical manpower, the severing of the country and economy, and the loss of the Japanese colonial system as a market, the economy in Korea could not be sustained. The Korean economy collapsed immediately after the Japanese surrender. By 1947, the number of manufacturing firms in south Korea had fallen from over 10,000 to 4,500; employment in manufacturing fell 41 percent; and manufacturing output fell to only

15 percent of the 1939 level.⁵⁰ Goods and food available on the Korean market were extremely limited. Inflation soared. Public utilities, communications, and transportation systems became inoperable due to the lack of trained personnel to manage and operate them.⁵¹ Although Japanese colonialism in Korea had increased overall production levels, its core economy orientation gave the Korean economy little real benefit after the colonial rulers were repatriated and independence was attained.

Table 2.9
Composition of Manufacturing Production Between North and South
Korea in 1939 (current million Korean yen and percent)

	<u>South</u>	<u>North</u>	<u>All Korea</u>	<u>Share of</u> <u>South in all</u> <u>Korea (%)</u>
Textiles	171.0 (24.1)	30.4 (3.9)	201.4	84.9
Metal	13.6 (1.9)	122.5 (15.5)	136.1	10.0
Machinery	38.4 (5.4)	14.8 (1.9)	53.2	72.2
Ceramics	12.1 (1.7)	31.2 (4.0)	43.3	27.9
Chemical	91.2 (12.9)	410.6 (52.0)	501.8	18.2
Wood product	13.7 (1.9)	7.4 (0.9)	21.1	64.9
Printing	17.2 (2.4)	2.2 (0.3)	19.4	88.7
Processed food	213.6 (30.1)	114.8 (14.5)	328.4	65.0
Gas & Electric	11.1 (1.6)	19.4 (2.5)	30.5	36.4
Misc.	127.5 (18.0)	35.8 (4.5)	163.3	78.1
Total	709.4 (100)	789.1 (100)	1,498.5	47.3

Source: Zenkoku Keizai Chosa Kikan Rengokai, Chosen Keizai Nenpo, (Seoul, 1942), as cited in Mason, et al., op. cit., p. 89

By the end of the Korean War in 1953, very little of importance in terms of physical capital, infrastructure, and industrial capacity remained from the colonial period.⁵² The only factor remaining from the colonial period that would aid Korea's subsequent economic

⁵⁰. Ibid., p. 77.

⁵¹. Bong-Youn Choy, op. cit., p. 199.

⁵². Edward Mason, et al., op. cit., p. 77.

development was that Korea had a relatively well educated work force and approximately 300,000 experienced industrial laborers. However, this accounted for less than 1.5 percent of the population. Therefore, the industrial infrastructure introduced during the Japanese occupation could not be significantly utilized nor integrated into the economy of an independent south Korea, and it can not be considered as a significant explanatory variable of subsequent economic development.⁵³

The Struggle for Power and the Economic Policy of the
Korean Republic: 1945 - 1961

With the defeat of the Japanese in 1945, the United States established a military government in south Korea (USAMGIK) officially on September 9, 1945. USAMGIK held ultimate authority until August 15, 1948, when the Republic of Korea was established and recognized by the United States and the United Nations. The stated goals of the USAMGIK were: (1) to establish a free and independent Korea as had been agreed by the Allied Powers at Cairo and Potsdam; (2) to make Korea strong enough to be a stabilizing factor in Asia; and (3) to make Korea a "show case of democracy" in Asia.

The objectives of the USAMGIK toward Korean economic development were never clear. However, one thing was obvious: The American military government did not intend to participate actively in the economic development of south Korea. It was believed, until 1947 when

⁵³. Kwan Suk Kim, "An Analysis of Economic Change in Korea," in Andrew C. Nahm, op. cit., p. 111. Edward Mason, et al., op. cit., p. 77.

the Soviet Union refused to allow a reunifying election under the auspices of the United Nations, that the two Koreas would be reunited, and that the electrical power and industry of the north would be reintegrated with the agriculture and light industry of the south. Therefore, there was no need for the USAMGIK to develop an independent, economically viable, south Korea. Accordingly, the American military government was principally concerned with providing necessary aid to meet immediate needs of the population -- to prevent starvation and disease, to increase agricultural output, and to maintain law and order.⁵⁴

The principal policy implemented by the USAMGIK with long reaching economic effect was a land redistribution program. During the colonial occupation, Japanese land corporations and private Japanese came to hold large tracts of Korean farmland. With the departure of the Japanese landholders, these lands became available for redistribution. Also, during the 1945-1947 period, guerilla warfare and general unrest were prevalent in Korean rural areas. This social instability was principally due to the reemergence of the political power of the Korean landlord class who had been able to maintain control of their land during the colonial period through collaboration with Japanese officials. At this point, land reform was viewed by the USAMGIK as a means of pacifying rural dissidence and of maintaining social stability.

The military government created the New Korea Company, Ltd. to conduct a survey of all formerly Japanese held land and to administer the redistribution of this land to Korean farmers. The land redistribution was structured so that no one farmer would be able to

54. Edward Mason, et al., op. cit., p. 168.

purchase over 2 chongbo (about 5 acres) although the average purchase was less than one-half chongbo. The price that the farmers were to pay for the land was to be equal to three times the estimated yearly output of the land paid over a 15 year period.⁵⁵ The intent of the land redistribution program was to include a maximum number of farm families in the redistribution. The USAMGIK hoped to appease the interests of the farming class, which was the largest social class in Korea at this time, thereby obtaining political stability in rural areas. Large land holdings that were held by Korean landlords were not included in the USAMGIK land redistribution in order to expedite the implementation of the reform. However, the USAMGIK indicated that these large landholding would be redistributed in the future, and later they pressured the First Korean Republic to establish a provision in its constitution that would provide for further land reform.

In March 1948, the sale of former Japanese held land began. By September, 487,621 acres had been sold to over a half million tenants. This represented more than 96 percent of the former Japanese land holdings.⁵⁶ This initial land reform began a process of relatively equal land tenancy in Korea. When the subsequent land reform of large land holdings held by Korean nationals occurred in 1949-50, Korean land tenancy was one of the most equidable in Asia.⁵⁷ These land

55. Anne O. Krueger, The Developmental Role of the Foreign Sector and Aid, (Cambridge: Harvard University Press, 1979), p. 20.

56. Edward Mason, et al., op. cit., p. 169. For further details regarding Korean land reforms, see: Mason, et al., op. cit., chapter 7.

57. See: Edward N. Muller and Mitchell A. Seligson, "Inequality and Insurgency," American Political Science Review, Vol. 81, No. 2, June 1987, pp. 425-449. Muller and Seligson, in Table A-1, compute a Gini coefficient on land concentration for 85 countries. Included in this table are 13 Asian countries. Of Asian countries, only Singapore has a lower Gini coefficient than Korea. Korea's Gini coefficient is .31, which is 1.69 standard deviations below the mean for Asian countries. Of 61 developing countries for which Muller and Seligson

reforms virtually eliminated the landlord class in Korea and installed an agricultural system of small family run farms. Tenancy in Korea was reduced from approximately 75 percent of all farms in 1945 to about 33 percent by 1950.⁵⁸ A three hectare ceiling was placed on all Korean land holdings.

These land reforms had two long reaching political effects. First, with relatively equal distribution of land and the significant reduction in tenancy, the expectations and needs of the rural population were largely satisfied. This, in turn, contributed to rural political stability and governmental support from the rural population. Throughout the Rhee Syng-man and Pak Chung-hee administrations, and even today, the opposition to the government is largely confined to the urban population. Second, the final phase of the land reforms in 1950 virtually eliminated the landlord class as a political force. That is, the landlord class, which in many developing countries uses political influence to maintain an agricultural oriented economic status quo and to retard government policies oriented toward urban industrial concerns, was abolished. The elimination of a powerful landed class allowed the Korean government in the 1960's and 1970's to pursue industrial programs without significant opposition from landed interests.

The USAMGIK had originally been established as a caretaker government until Korea was reunited. It was intended that a United Nations' supervised election would bring a democratic government to Korea. However, in 1947, the Soviet Union refused to allow an

compute a Gini coefficient for land concentration, Korea's coefficient lies 1.71 standard deviations below the mean.

58. Anne O. Krueger, op. cit., p. 21.

election in the northern half of the peninsula. In April 1947, Secretary of State Marshall sent a letter notifying the Soviet Union that the United States was considering establishing an independent state in south Korea. This was an attempt to bring the Soviets to negotiations on the election issue. However, it produced no alteration in the Soviet position. By January 1948, the United States was under pressure from south Koreans who desired independence and from the American public who wanted the American soldiers repatriated. The United States at this time submitted the issue to the United Nations and advocated that an election be held in May of 1948 in all areas of Korea where it was possible to hold an election. Independent governmental authority would be granted to the victors of that election. The Soviet Union refused permission for the United Nations to include the north in the election. On May 10, 1948, an election was held in the south under U.N. auspices and supervision for seats in a national assembly. This national assembly would be authorized to form an independent government. On August 15, 1948, the USAMGIK passed its authority in the south to the new government of the Republic of Korea.

After the fall of the Japanese in August 1945, several political parties were formed and registered in south Korea. The American military government had allowed considerable political expression. More than 300 political parties had been registered. However, the principal political alignments were centered on three groups: (1) Those who had remained in Korea and economically prospered during the colonial rule; (2) Supporters of the Korean Provisional Government in exile. (This group was factionalized between those who supported the leaders of the Shanghai Provisional Government and those who supported Rhee Syng-man.); and (3) Korean communist movement supporters.

The first group principally consisted of Koreans who had served in the Japanese colonial bureaucracy or police force, or who had held large tracts of land. In 1945, the USAMGIK, seeking a stable transition of power after the Japanese defeat, solicited and accepted the cooperation of those Korean nationals who had been involved in government and economic activities under the Japanese colonial regime. The USAMGIK filled the highest decision making positions with their own personnel, but they retained middle level Korean officials who had been active in the Japanese colonial bureaucracy in an attempt to maintain bureaucratic efficiency. The USAMGIK also retained the majority of Koreans who had worked in the Japanese colonial police force. Eighty-five percent of the Koreans who served in the colonial police force became members of the USAMGIK police force. By 1948, over fifty percent of police officers had previously served under Japanese rule.⁵⁹ The military government, during the first phase of land reforms in 1948, also allowed Korean landowners who held land under the Japanese to maintain control over their land. This was principally allowed in an attempt to expedite land reform and to maintain agricultural production levels. In 1945, it was perceived by U.S. authorities that the land owning class could also help maintain stability in rural areas. However, this perception would prove to be a fallacy due to the Korean population's perception that these landlords were Japanese collaborators and oppressors of the Korean people during the colonial period. However, with American recognition and with accumulated wealth and authority, these bureaucrats, police,

59. Joungwon Alexander Kim, op. cit., p. 55.

and landlords became powerful actors in the Korean political arena during the U.S. military occupation.⁶⁰

The most visible leaders of this group were Kim Song-su, the owner of the Dong A Ilbo (East Asian Daily News); Song Chin-u, the president of the Dong A Ilbo; and Chang Tok-su, the chief editor of the Dong-A Ilbo. These men were all educated in Japan during the first decade of the occupation. They argued that independence for Korea must come slowly after Korea developed a strong economy and an educated people. The newspaper was often critical of the Japanese rule, and Song Chin-u even spent six month in a Japanese prison in 1926-1927 for his advocacy of Korean nationalism. However, by 1945, these men were among the wealthiest men in Korea and owned, in addition to the newspaper, textile mills, private schools, a university, and several business enterprises.

A second major political group in Korea in 1945 consisted of members of the Korean Provisional Government (K.P.G.) in exile. The K.P.G. came into existence in Shanghai after a major uprising of Koreans against the Japanese in 1919. Many of the leaders of this uprising fled Korea and established the K.P.G. in Shanghai. The K.P.G. continued to exist from 1920 to 1945 in Shanghai, but its leadership was always ambiguous as many of their members and leaders were not present in Shanghai. A large representation of the K.P.G. was in the United States. Regardless of the lack of unity in its leadership, a large proportion of Koreans considered the provisional

60. The material in this section has been taken from: interviews and discussions with professors from Kangwon National University and Yonsei University; Joungwon Alexander Kim, op. cit.; Gilbert Brown, Korean Pricing Policies and Economic Development in the 1960's, (Baltimore: Johns Hopkins University Press, 1973); and Edward Mason, et al., op. cit.

government and its leaders as the legitimate successor government to the fallen monarchy.

The principal leaders of the government in exile were Rhee Syng-man, Kim Koo, and Kim Kyu-sik. Rhee Syng-man represented the Korean Provisional Government in the United States. Rhee was born in 1875 and was educated in an American missionary school. In 1904, he traveled to the United States to attend George Washington University where he received a B.A. in 1907. He then received an M.A. from Harvard and a Ph.D. in international law from Princeton in 1910. Thereafter, except for a brief visit to Korea in 1911, Rhee lived in the United States until 1945.

Rhee held broad popular support in Korea and had several claims to legitimacy as a leader. First, he could trace his ancestry to a distant relative of the last Yi monarch. Under the traditional Korean system, this would have made him eligible to assume the throne had the monarch so designated him. Second, he was well educated. Third, he was active in the nationalist movement from a very early time, gaining wide national recognition. In 1894, he joined in the Independence Club, an organization of Christians in Seoul who opposed the rising influence of the Japanese after the Treaty of Kanhwa. In 1898, he became a leader in the Independence Club and led a demonstration of 8,000 people in Seoul, demanding the removal of Russian and Japanese advisers from Korea. Rhee was arrested and spent several years in prison. While in prison he wrote, The Spirit of Independence, in which he predicted the Japanese takeover of Korea and called for a national resistance to protect Korean sovereignty. In 1904, he was released from prison and traveled to the United States.

In 1904, Rhee represented the Korean government at the Portsmouth Conference in New Hampshire. This conference led to the

agreement that ended the Russo-Japanese War in 1905. Rhee appealed to President Theodore Roosevelt and Secretary of State Taft to intervene on Korea's behalf and to preserve Korean sovereignty. However, his appeals were ineffective. After the Portsmouth Conference, the Japanese took control of the Korean peninsula and of Manchuria. At Portsmouth, the United States agreed secretly not to interfere with Japanese activity in Northeast Asia if Japan would not interfere with American activity in the Philippine colony that America had taken from Spain in 1898.

During the 1919 uprising in Korea, Rhee was in the United States. However, Rhee had become acquainted with Woodrow Wilson and other international leaders and attempted to use his influence with these leaders on Korea's behalf. When the provisional government was established in Shanghai shortly after the 1919 rebellion, it appealed for international recognition. A delegation from the Korean Provisional Government was sent to the Versailles Treaty Conference in Paris. As a strategy to gain international support for the Shanghai group, Rhee was named as the provisional government president because of his international recognition. However, living in the United States, Rhee never exercised presidential authority within the K.P.G. When he returned to Korea in 1945, his claim to leadership of the Korean Provisional Government in exile was highly challenged by those who had operated the organization in Shanghai.

The principal challenger within the provisional government to Rhee for political authority in Korea in 1945 was Kim Koo. Kim Koo was also active in nationalist political resistance to the Japanese. In 1894, he led a peasant rebellion aimed at driving foreigners out of Korea. Later in 1894, the Japanese sent troops to Korea and took

control of the Korean government. The Korean queen refused to cooperate with the Japanese and would not give public recognition to their military presence in Korea. In 1895, a Japanese soldier killed the queen. Kim searched out the Japanese soldier who he believed had killed the queen, and he himself killed the soldier in 1896. He was arrested but escaped, gaining a national reputation for avenging the death of the queen.

Kim Koo remained active in the anti-Japanese movement in Korea until the uprising in 1919. At this time, he escaped to China and was instrumental in establishing the K.P.G. in Shanghai. He first held the post of police chief, then he became home minister of the provisional government. In 1927, Rhee was impeached as leader of the Shanghai K.P.G.; Kim Koo became the new president. Rhee refused to recognize his impeachment because there was no provision in the K.P.G. constitution for impeachment, but Kim Koo continued to lead the exiled government in Shanghai. In the 1930's, the K.P.G. began to receive financial assistance from the Chinese Nationalists, and Kim Koo was recognized by Chiang Kai-shek as the leader of the Korean government. In 1945, Kim Koo returned to Korea, claiming to be the legitimate leader of the K.P.G.

Kim Kyu-sik was also an active nationalist who fled Korea after the 1919 uprising. Kim Kyu-sik represented the K.P.G. at the Peace Conference in Paris in 1919 and gained national prominence for his attempt to promote Korean nationalism. Kim Kyu-sik, like Rhee, also held a Ph.D. from Princeton University. In exile in Shanghai he held the post of foreign minister and later vice-president in the K.P.G.

The leader of the communist faction in south Korea in 1945 was Pak Hon-yong. Pak was active in the nationalist resistance movement

and fled Korea after the 1919 uprising. He formed the Korean Communist Party in Shanghai in 1921. In 1922, Pak returned to Korea and tried to form a communist party. He was arrested and served a short prison sentence. In 1925, He secretly formed the Korean Communist Party, but later in the year the Japanese discovered the party and rearrested Pak. He was released from jail in 1929 and traveled to the Soviet Union where he studied at Lenin University. In 1933, he returned to Korea but was arrested and served another prison sentence. Upon his release in 1939, Pak began to reorganize the communist party in Korea. In 1941, the Japanese again began to arrest communists in Korea, and Pak fled to the mountains. Until 1945, he remained in the mountains, leading a small band of communist guerrilla fighters.

The political situation in Korea after the Japanese surrender was chaotic. The Koreans who had held political influence and authority under the Japanese rule carried the taint of collaboration with the Japanese. They were wealthy and held key posts in the bureaucracy and police force. However, they could not gain political legitimacy in the eyes of the population and had to struggle with the other political contenders merely to hold on to their positions and vested interests. Rhee was in a position that would allow for popular legitimacy. However, he had been outside of Korea for forty years and did not possess the financial resources and the organizational capacity inside Korea that would be necessary to capture a position of leader. The members of the Korean Provisional Government in Shanghai also had claims of legitimacy in the view of the Korean people, but they also lacked financial resources and internal organizational mechanisms. Pak Hon-young and the communists had returned to Seoul

immediately after the Japanese surrender and began to organize a Communist People's Republic that attempted to rule Korea from August 15, 1945 to September 9, 1945, when the American military arrived and displaced them. The communists were a common threat to all other political groups. They had remained in Korea to fight the Japanese directly, and this could challenge the claim to leadership of Rhee and Kim Koo. The communists also threatened to expropriate the assets of and purge those who had benefited during the colonial period.

On September 16, 1945, one week after American forces occupied Seoul, the Korean Democratic Party was formed by the bureaucrat-police-land owner alliance, but due to their lack of legitimacy in the eyes of the Korean people, they named Rhee who was still outside of Korea at this time as their party chairman. Rhee returned to Korea in October. Rhee needed funding and organizational support in order to emerge as the leader of any future Korean republic. However, he needed to appear as not becoming too closely associated with those seen as Japanese collaborators. Upon his return, Rhee began to negotiate with the Korean Democratic Party. In December, 1945, Rhee called a special meeting of bureaucrats, landowners, and businessman who had accumulated fortunes during the Japanese colonial period. Under Rhee's proposal, an "Economic Contributors Association" was formed to raise funds to feed the poor and to finance efforts aimed at gaining independence as soon as possible. Most of the people present at this meeting contributed money to "show their patriotism."⁶¹ At this time Rhee became aligned with those who had been active in the Japanese colonial economic and political structures. Rhee never became a member of the Korean Democratic Party, but he accepted their

61. Joungwon Alexander Kim, op. cit., p. 59.

political support in return for not advocating their purge from power or the expropriation of their wealth. For Rhee, this alliance would provide the financing he would need to organize his political machinery for any upcoming election as well as give him the organizational support of the bureaucracy, the police, the rural landowners, and urban businessmen.

On May 10, 1948, a U.N. supervised election was held in the southern portion of the Korean peninsula. The election was for seats in a national assembly which was to select a president. Then, the president and national assembly would form the principal political institutions of an independent republic. The Korean Democratic Party took 33 percent of the seats in the national assembly. The K.D.P. supported Rhee for the presidency. The National Society Party, the party Rhee formed and in which he served as the chairman, took 23 percent of the seats. Independents, many of them allied with K.D.P. and Rhee, took 20 percent of the seats. Rhee was overwhelmingly elected as chairman of the assembly after the assembly was convened and became president on August 15, 1948, when Korea became independent.⁶² The only opposition to Rhee's presidency was a handful of communist supporters of Pak Hon-young.

Upon independence, Rhee's political support in the national assembly appeared strong. However, he was more of a compromise leader than one who enjoyed a true consensus. Rhee's supporters were highly fragmented into various blocks, and Rhee could not directly control the actions of most of these blocks. The bureaucracy supported Rhee as the leader of the assembly and as president because he did not threaten their positions with purges as did the communists and some of

62. Ibid., p. 82.

the former provisional government officials. However, the bureaucracy, by 1948, controlled most of the nation's financial resources and attempted to use these to influence Rhee's actions. All Japanese property, other than the Japanese held land that had been distributed to farm families by the USAMGIK's land reform, was held by the bureaucracy. The Korean Financial Association, an agency of the government, was responsible for regulating and distributing the limited consumer goods available in Korea at this time. The government banks were responsible for the majority of loans flowing to industry. By 1948, 65 percent of all bank deposits were government deposits.⁶³ The K.D.P. members who needed Rhee for legitimacy but who did not want Rhee to exercise independent power hoped to control him principally through the tremendous financial power of the bureaucratic agencies. The police faction in the K.D.P. also supported Rhee largely because he did not threaten their positions with purges. However, the police were a relatively autonomous agency with considerable coercive power. If the police leadership so desired, a coup from within their ranks was a real possibility. The landowners had financed much of Rhee's political activity between 1945-1948, but similar to the bureaucracy and police, they were politically autonomous and could organize independent bases of support in rural areas.

The members of the new assembly who had been active in the provisional government in Shanghai had popular claims to legitimacy, but they were not as willing to compromise with the K.D.P. membership and, thereby, they could not muster the support of the bureaucracy, landowners, and police, as Rhee could. Without this support, they lacked the financial and organizational resources necessary to win the presidency.

63. Ibid., p. 85.

Rhee was also challenged by a hostile faction of communists under the leadership of Pak Hon-young. Shortly after independence, in October 1948, there was an attempt by communist supporters within the military to overthrow the new government. This rebellion in the military was violently put down by a better trained and organized police force. After this rebellion, hundreds of suspected communist supporters in the military and bureaucracy were purged, arrested, or executed. Many suspected communist supporters in society were arrested or fled to north Korea. Among those who fled was Pak Hon-young, who was later executed in north Korea. This rebellion and subsequent purges virtually eliminated the communist party as a political force in south Korea, but it strengthened the position of the police within the K.D.P. and the position of the K.D.P. in the national assembly.

From his election as president of the republic in August 1948 until the outbreak of the Korean War in June 1950, Rhee's principal political concerns were focused on his remaining in power, while he attempted to wrestle political authority from the national assembly and the bureaucracy. The general assembly was dominated by Kim Song-su and his supporters in the K.D.P. The K.D.P. sought to form a European style parliamentary system with a weak presidency. Under this political structure the interests of the bureaucrats, landowners, and businessmen, who controlled the K.D.P., could be directly articulated in a parliamentary body. Under a parliamentary system, members of the K.D.P. would be guaranteed the most influential cabinet positions autonomous of Rhee's oversight. Rhee, on the other hand, fought to establish a political system patterned after the presidential system in the United States. An American style

presidential system would grant Rhee the authority to appoint cabinet members and other key bureaucratic positions. This would allow him to gain control of key governmental institutions. During the negotiations for independence, the USAMGIK had refused to allow independence until a constitution was written and ratified by key political groups. The K.D.P. leadership argued for a parliamentary system at this time, but Rhee refused to serve as president unless the president held substantial power. Needing Rhee in order to form a legitimately acceptable government and to gain independence, the K.D.P. leadership yielded to Rhee's demand. However, after independence was granted, the K.D.P. continually attempted to undermine Rhee's authority.

By 1949, the national assembly became openly hostile to Rhee. The K.D.P. began to move for a constitutional convention that would rewrite the existing constitution and establish a parliamentary system. In March 1950, the constitutional convention issue was scheduled to come to a vote in the national assembly. However, Rhee was able to form an alliance with key bureaucratic and police officials and enlisted their support in his power struggle with the national assembly. In January 1950, the bureaucracy and police organized demonstrations against constitutional change. It was also widely believed that the police coerced several national assemblymen to abandon the K.D.P. leadership. On the day of the vote, over one-third of the K.D.P. assemblymen were either absent or abstained from the vote, and the legislation to establish a constitutional convention was defeated.

With the support of bureaucracy and police, Rhee moved to eliminate the power of the land owning class within the K.D.P. His

strategy to undermine the land owners' authority was to implement a land reform that would eliminate all large land holdings. This would decrease the financial resources and the political base from which the land owners organized the support of the rural population. Of course, Rhee's major obstacle in implementing this land reform came from the landowners in the K.D.P. The landowners held key positions in the K.D.P. and controlled the national assembly. To make the land reform financially attractive to them, Rhee offered government bonds which were immediately redeemable as payment for industries formerly owned by the Japanese. The bonds offered were in excess of the actual value of the land and could be converted into very lucrative holdings. It was also widely believed that Rhee solicited the support of the police in "lobbying" the land owners to accept the proposed land reform. When it was clear that the police and the bureaucracy supported Rhee on the constitutional and land reform issues, the power of the land owners within the K.D.P. was severely weakened. In February 1950, the K.D.P. placed its support behind the proposed land reform.⁶⁴

The land reform placed a three hectare ceiling on all Korean land holdings.⁶⁵ By the beginning of the Korean War, June 25, 1950, the vast majority of land holdings in Korea had been redistributed and conformed to the three hectare ceiling. The political effect of the land reform was the virtual elimination of the land owning class' power within the national assembly. With the elimination of the landlord class through real land reform, the rural population largely became supporters of Rhee. Tenancy was reduced from approximately 75

⁶⁴. Ibid., p. 128.

⁶⁵. Leroy P. Jones and Il Sakong, Government, Business and Entrepreneurship in Economic Development: The Korean Case, (Cambridge: Harvard University Press, 1980), p. 210.

percent of all farms in 1945 to about 30 percent in 1950.⁶⁶ During the war, the majority of industrial sites in south Korea were destroyed or damaged beyond repair. This undercut the economic base of the former land owners who had converted their government bonds for industrial holdings and terminated their ability as a group to challenge Rhee's authority.

From independence in 1948 to the end of the Korean War in 1953, Rhee could not focus his political authority upon economic development issues. From 1948 to 1950, his fragmented base of political support required him to focus his energy on his political survival. His political activities were principally oriented upon his struggle with the landowners in the K.D.P. over the constitutional delegation of authority. Faced with this political battle, the Rhee regime did not pursue policies oriented toward economic activity. Immediately after Rhee's successful emergence from his political battle with the land owners, the existence of the south Korean state became directly threatened by the onslaught of the north Korean military.

The Korean War from June 1950 to July 1953 brought extensive human casualties and severely disrupted the economy. During the war, the communist forces of north Korea advanced the length of the peninsula, capturing all of Korea except the southeast corner near the port city of Pusan. Then, the United States under the U.N. command entered the war and defeated the communists in the south. United States forces, combined with the south Korean army and United Nations forces, then attacked northward and captured most of north Korea. At this point, the Chinese entered the war and fought their way southward, retaking many areas in the south, including Seoul. A

66. Anne O. Krueger, op. cit., p. 21.

second major counter offensive was launched by the U.N. command and pushed northward to near the 38th parallel. The recurring waves of warfare totally destroyed the Korean economy.

Casualties within the Korean civilian population are conservatively estimated at approximately one million out of a population of approximately 20 million.⁶⁷ Over two-thirds of the casualties died. South Korean military casualties were listed at 320,000, or 40 percent of the military.⁶⁸ Over 1.5 million refugees entered south Korea from the north. Physical damage in 1950 alone was estimated at 1.8-2.0 billion dollars. This figure was greater than the entire 1950 GNP.⁶⁹ In Seoul, over 80 percent of industry, 75 percent of offices, and over 600,000 or 50 percent of dwellings were substantially damaged.⁷⁰ Approximately 68 percent of all industrial establishments, 40 percent of all buildings, and 37 percent of all machinery were destroyed or damaged beyond repair.⁷¹ The communication, transportation, and electrical infrastructures were heavily damaged. After the war, the state of south Korea and Rhee's presidency remained, but the economy was in shambles. Little of importance in industrial capacity or infrastructure remained from the

67. Bank of Korea, Annual Economic Review, 1955.

68. United Nations Security Council Document S/3079, as cited in Gilbert Brown, Korean Pricing Policies and Economic Development in the 1960's, (Baltimore: Johns Hopkins University Press, 1973), p. 35.

69. W. Reeves, The Republic of Korea: A Political and Economic Study, (London: Oxford University Press, 1963), p. 103, as cited in Leroy P. Jones and Il Sakong, op. cit., p. 35.

70. Roy W. Shin, The Politics of Foreign Aid: A Study of the Impact of U.S. Aid in Korea from 1945-1966, (Ph.D. Dissertation, University of Minnesota, 1969), p. 51, as cited in Leroy P. Jones and Il Sakong, op. cit., p. 35.

71. Bank of Korea, Annual Economic Review, 1955.

Japanese colonial period.⁷² The people were living in massive poverty.

Between 1953 and 1960, the Rhee regime's economic policy was virtually limited to the attempt to rebuild pre-war industrial infrastructure and to encourage limited ventures into import substitution production of consumer goods. Both of these endeavors were principally financed through foreign aid. During this period, manufacturing production increased 18 percent per year.⁷³ However, the starting base was so low that the percentage growth rate becomes misleading.

The financing for reconstruction came principally from the United States and the United Nations aid funds. Between 1953-1960, United Nations assistance amounted to \$120 million, and U.S. bilateral aid exceeded \$1.7 billion.⁷⁴ This assistance financed over 70 percent of Korean imports, and financed almost 50 percent of government expenditures.⁷⁵ This left the Rhee government and the Korean economy heavily dependent on aid and gave American economic advisers considerable political influence over all Korean economic decisions.⁷⁶

During this period there was little government effort to accumulate domestic savings or to expand export production.⁷⁷ The Rhee government argued that Korea did not possess the capacity to

72. Edward Mason, et al., op. cit., p. 77. Leroy P. Jones and Il Sakong, op. cit., p. 35. Kwan Suk Kim, in Andrew C. Nahm, op. cit., p. 111.

73. Gilbert Brown, op. cit., p. 36.

74. Edward Mason, et al., op. cit., p. 93.

75. Ibid., p. 94.

76. Anne O. Krueger, op. cit., p. 75.

77. Edward Mason, et al., op. cit., p. 95.

generate domestic savings nor foreign exchange earning exports, and the government did not establish an economic policy other than to attempt to maximize aid.⁷⁸ Virtually all capital formation was financed by foreign aid. During the 1953-1957 period, aid equalled 10 percent of GNP and financed 90 percent of capital investment.⁷⁹ Government economic strategy was directed toward the maximization of aid inflows to pay for imports and toward an inward-looking industrial policy that encouraged the production of consumption goods for the domestic market. Foreign aid as a percentage of imports increased from 58 percent in 1953 to 86 percent in 1957.⁸⁰

A low currency exchange rate, which encouraged imports and discouraged exports, helped create a widening foreign trade gap. This, in conjunction with a large government budget deficit, increased the capacity to absorb foreign aid. The Rhee government used these gaps as evidence of the need to supply Korea with more foreign aid goods, and then it controlled the right to grant import licenses to political supporters. Because of the overvalued exchange rate, prices of imports were artificially low, and these goods could demand a high sales price on the goods scarce Korean market. Import licenses were, thus, very lucrative to the holder. The Rhee government issued import licenses to key supporters in order to gain political advantages.⁸¹ In addition, the government placed high tariffs and other import restrictions upon specific goods to protect the domestic consumer industries being established principally by Rhee supporters who were

78. Larry Westphal, et al., op. cit., p. 5.

79. Anne O. Krueger, op. cit., p. 80.

80. Ibid., p. 67.

81. Ibid., p. 161.

profiting through the import licensing scheme.⁸² Between 1953 and 1957, the Korean economy grew at a 5 percent per annum rate; however, when U.S. aid was cut in 1958 the economy began to stagnate as investment levels were greatly reduced.

Exports during the Rhee regime were negligible. In 1955, manufactured exports equalled only .4 percent of GDP, while total exports were 1.4 percent. By 1960, manufactured exports increased to only 1.2 percent of GDP, while total exports equalled 3.4 percent.⁸³ Net capital imports were six times greater than exports in 1955 and ten times greater from 1955 to 1959. In 1953, total exports were valued at \$40 million. After this point exports declined and did not reach the 1953 value until 1961.⁸⁴

Table 2.10
Economic Aid Received: 1953-1960 (million U.S. dollars)

	<u>1953</u>	<u>1955</u>	<u>1957</u>	<u>1958</u>	<u>1960</u>
U.S. Bilateral	12.8	205.8	368.8	313.6	245.2
United Nations	188.4	30.9	14.1	7.7	0.2
Total	201.2	236.7	382.9	321.3	245.4
Total imports	345.4	341.4	442.1	378.2	343.5
Aid as % of imports	58.3	69.3	86.6	85.0	71.4
Imports as % of	12.9	9.8	12.0	10.7	12.6
GNP(current prices)					
Imports as % of	N.A.	11.2	14.3	11.7	10.4
GNP(constant prices)					
Current accounts	N.A.	8.7	10.5	8.7	9.3
deficit as % of GNP					

Source: Bank of Korea, Economic Statistics Yearbook, 1960 and 1975, IMF.

✓ The Rhee government never formulated a specific national economic policy nor did it acknowledge the necessity of organizing

⁸². Leroy P. Jones and Il Sakong, op. cit., pp. 274-278.

⁸³. Anne O. Krueger, op. cit., p. 62.

⁸⁴. Ibid., p. 57.

state institutions to facilitate an increase in industrial production. The Rhee government refused to take any measures to increase national savings, rather the government maintained low interest rates that assured an excessive demand for credit and discouraged savings. The overvalued exchange rate the government maintained along with relatively low tariffs encouraged imports and served as a disincentive to export production. High levels of government spending and low tax rates created chronic government fiscal deficits. However, the Rhee government refused to take action to increase savings or to decrease imports or government spending.⁸⁵ The Rhee government's economic policy was virtually barren of legislative or executive policy designed to develop the economy or to improve the economic lot of the Korean people.⁸⁶ In short, the aid maximization policy of the Rhee government would not allow for internally generated economic growth, rather these policies were principally intended to maintain the loyalty of key political supporters.

Following the Korean War, the military developed into the largest and most powerful institution in Korea. During the 1950's, approximately \$7 billion of military aid was received by Korea. Along with the military aid, a wide range of training was given to the south Korean military. The top military leaders attended staff colleges and training schools in Korea and the United States. Junior officers ✓ attended lower level military training schools. The army became a powerful institution and operated on modern management and

85. David C. Cole and N. Lyman, Korean Development: The Interplay of Politics and Economics, (Cambridge: Harvard University Press, 1971), p. 170.

86. Richard Allen, Korea's Syngman Rhee, (Tokyo: Charles Tuttle Publishers, 1960), p. 240.

organizational principles.⁸⁷ However, the power structure of the military leadership was factionalized. Two principal groups controlled the top military positions. These groups were both led by generals from northern Korea who had served in the Japanese army and who had come to the south shortly after 1945. One faction was led by generals from the northeastern area of the Korean peninsula, and the other was led by generals from the northwestern area of the peninsula. Underneath these general officers was an officer corps of lower ranked generals and colonels who were mostly from southern areas of the peninsula. These officers were trained in Korea after 1945, and many of them had been trained as military officers during the late Japanese rule. They had been field officers during the Korean War and saw a large degree of combat duty. However, by the late 1950's, these junior officers had moved up in rank as high as they could as long as the northern officers held the highest level positions.

President Rhee was able to keep the leadership in line by rewarding cabinet positions to each faction, playing off the groups against each other in military duty assignments, and by rewarding both groups with fiscal allocations.⁸⁸ However, the junior officers had two major grievances. The first grievance was resentment over rank and promotion.⁸⁹ This problem was twofold. First, the Korean army was created quickly from nothing. In 1945, there was no Korean army. In 1950, the military consisted of 100,000 men. By 1955, the military consisted of 700,000 men. An army that is created this quickly creates senior officers from what men are most qualified at the time

87. Gilbert Brown, op. cit., p. 40.

88. Joungwon Alexander Kim, op. cit., p. 135.

89. Ibid., p. 216.

of the military's creation. Most of the senior officers in 1950 were the same senior officers in 1960, although they were only a few years older than the junior officers. The first class of officers trained by the U.S. military after 1945 included many of the northern generals and numbered approximately 100 men. Within eight years, 69 had reached the rank of Brigadier General. In contrast, only 140 out of 1,801 officers of the eighth class had reached the rank of colonel 12 years after graduation.⁹⁰ The second problem with the rank and promotion grievance was that the senior officers only received six weeks of training before they were sent to the field, while the eighth class had over a year of training before they went to the field. Being better trained and having had considerable combat experience, yet being outranked by the northern generals, was a major grievance within the middle ranks of the officers corps.

Another major grievance of these lower ranked officers was that they were also aware of high levels of corruption within the higher ranks. Their superiors were gaining considerable levels of personal wealth, while these field level commanding officers had to make do with shortages of supplies. The junior officers alleged that money appropriated to the military was embezzled by senior officers or went into Rhee's Liberal Party coffers.⁹¹

The economic system in the late 1950's was undermined by corruption at the highest levels of the Korean government. Financing for imported commodities using American aid became restricted by government licensing practices to industries that would "donate" funds to Rhee's Liberal Party. This kickback system became complex and

90. Ibid., p. 217.

91. Ibid., p. 218.

extensive, pervading the entire economy. For example, in the 1956 presidential election, it was said that the Commerce Bank was pressured by Rhee's Liberal Party to loan 17 billion hwan to twelve industries which in turn handed the money to the Liberal Party for campaign funds. The same system was employed in the 1958 election. Later, the bank president was rewarded by a position in the cabinet.⁹²

By 1958, political opposition to Rhee's regime was increasing among the urban population. Economic development had not proceeded past the reconstruction stage. GNP per capita was less than \$83. During the early years of Rhee's presidency, key bureaucratic and cabinet posts were largely held by former independence movement leaders and educators. By 1958, neither of these groups were represented. Rhee surrounded himself with supporters who concentrated on maintaining political power through police tactics that would control the rising public opposition. The economy and the efficient use of resources were left to take care of themselves even though the population was demanding economic progress and the elimination of the corrupt practices that had developed.⁹³

In March 1960, a presidential election was held. The official election result was believed to have been manipulated by Rhee supporters. Opposition members walked out of the national assembly. In Masan, several students were killed by police for demonstrating against the election returns. Students in Seoul began to demonstrate, and on April 19, over 125 students were killed by police.⁹⁴ Martial law was declared, but the police refused to use force upon the

92. Ibid., p. 152.

93. Gilbert Brown, op. cit., p. 41.

94. Ibid., p. 41.

demonstrators after the slaughter in Seoul. On April 20, many members of Rhee's cabinet resigned in face of the police rebellion against their authority. Without police and bureaucratic backing, Rhee no longer had the means to enforce his authority. On April 27, Rhee resigned.

A caretaker government took power until an election was held in July 1960. The opposition Korean Democratic Party won the election. However, immediately after the election the K.D.P. broke into factions. One faction was led by Yun Po-sun who became president. The other faction was led by Chang Myon who became prime minister.

The student rebellion against Rhee was centered on the principles of political freedom and economic development. Chang proclaimed a policy of economic development and dismantled the Rhee government's police-state mechanisms. However, factional strife within the K.D.P. and arguments within the general assembly over economic policy stalemated the effectiveness of the government and led to further economic decline. The demonstrations and public opposition to the government that marked the final year of the Rhee regime's rule did not recede. With further economic decline and increasing double digit inflation, workers began to join the students in protesting government policy.

✓ In May 1961, Korean society was in chaos. The economy was in a shambles; the political leadership was unable to establish coherent policy; and the constant threat of invasion from the north loomed everpresent. Before dawn on May 16, 1961, a military faction, led ✓ principally by members of the eighth officers class, overthrew the government in a relatively bloodless coup.

At this point, Korea was a classical dependent economy with "soft state" characteristics. Korea's fiscal expenditure and imports

were totally dependent upon American aid. The export sector comprised less than one percent of GNP, and seventy-five percent of exports were primary products. The economy was caught in the vicious cycle of national poverty -- low income-low savings-low investment-low productivity-low income. In 1961, the GNP per capita was less than \$81 in current prices. The investment ratio was 10.9 percent of GNP. However, domestic savings comprised less than 13 percent of total investment.⁹⁵ The structure of the economy was dominated by agriculture. Less than 14 percent of GNP was manufactured products.⁹⁶

The Korean colonial experience had introduced Korea to the world capitalist system as a colony with an economic structure oriented to the economic needs of Japan. With the fall of Japan and the division of the Korean peninsula, political independence was gained. However, by 1953, the infrastructure left by the Japanese was destroyed and the Korean economy became totally dependent. The Rhee government did not formulate an economic development plan, and it was incapable of placing obligations on people of all social strata in order to facilitate economic development. Furthermore, corruption became a primary characteristic of all principal economic activity. As Myrdal has argued, these were the principal characteristics of a "soft state" -- a state that is incapable of overseeing and facilitating economic transformation.⁹⁷

95. Economic Planning Board, A Handbook of Korea, (Seoul: Korean Overseas Information Service, Ministry of Culture and Information, 1980), p. 565.

96. Ibid., p. 567.

97. Gunnar Myrdal, Asian Drama: An Inquiry into the Poverty of Nations, (New York: Twentieth Century Fund, 1968), Vol. I, p. 66, and Vol. II, pp. 895-1,000. Also see: The Challenge of World Poverty, (New York: Vintage Books, 1970), chapter 7.

In 1961, Korea was one of the poorest nations in the world with one of the highest population densities. Korea had very few national resources. A question of considerable importance to the study of international development is the question why there was such a significant reversal in economic performance after 1961. What conditions were altered within Korea that allowed the Korean economy to grow at a rate of almost 10 percent per year for the next twenty-five years and to transform from an underdeveloped agrarian society with vast levels of poverty into an industrial diversified economy with relatively high standards of living for all strata of society by Asian and developing world standards.

Prior to 1961, Korea's economic performance was poor and the state showed little interest in developing industry or export production. However, it is necessary to note that certain economic foundations were in place in Korea in 1960 that would help sustain economic development if they were to become properly organized. First, by 1960, import substitution policies had created some industrial capacity in light consumer goods. Particularly, a textile industry had reached an advanced "infant stage." With an abundance of labor and knowledge in light consumer production, proper government policy could exploit rather easily Korea's comparative advantage in labor intensive industries. If these labor intensive industries were promoted properly, Korea could rather quickly expand its labor intensive industries into export production. This would allow Korea to expand employment and its capacity to earn foreign exchange relatively quickly. Second, a few Korean corporations, such as Hyundai, Samsung, Lucky-Gold Star, and Sunkyoung, had already come into existence and were led by men who had considerable entrepreneurial

✓ potential. With capital to finance their corporate expansion and with government assistance to help promote their expansion into new industrial ventures, these corporations could expand from small local producers into export producers with highly diversified production abilities. Third, educational opportunities had expanded under the Rhee government. The Korean work force in 1960 was highly literate by developing world standards. A large, relatively well educated work force would allow the corporations to expand rapidly in labor intensive sectors. Fourth, land reforms had been successfully carried out, giving the Korean economy a relatively equal income distribution as well as having destroyed the political power of the landed class. Without a powerful landed class, rural political forces and interests were not capable of influencing government decisions and unduly interfering with the advancement of industrial policies.⁹⁸ What was missing in Korea in 1960 was the policy and institutional mechanisms of a "hard state" -- a government highly dedicated to economic development with the capacity to implement the types of policies that would facilitate domestic capital formation and shape the pattern of investment to fit the needs and the comparative advantages of the economy; a state that would effectively develop systematic economic development policy and place obligations on all strata of society to facilitate the implementation of that policy.

98. Edward Mason, et al., op. cit., p. 462.



Chapter III: The State and the Industrialization Process

On May 16, 1961, a relatively bloodless coup engineered by Major General Pak Chung-hee and Lt. Colonel Kim Jong-pil toppled the civilian government of Chang Myon. The new government, led by a military junta calling itself The Supreme Council for National Reconstruction (S.C.N.R.), declared that the motives for the military takeover were to eliminate rampant corruption in the government and society, to defend the nation against communism, and to eradicate widespread poverty and starvation. In the spring of 1963, under pressure from the United States and in an attempt to increase domestic legitimacy, an election for the presidency was proposed. In August 1963, General Pak Chung-hee resigned from the military to run for the presidency as the civilian candidate of the Democratic Republican Party (D.R.P.). The D.R.P. provided the political mechanism through which the military junta could maintain its control over the state subsequent to the establishment of a civilian government. In October 1963, a presidential election was held, and Pak was elected as president.

At the time of taking power as a civilian president, Pak reaffirmed the government's commitment to defend the nation and to modernize the economy as the primary goal of his regime. Pak declared that the government would act quickly to institute bold economic reforms in order to eliminate the nation's poverty, to mold a self-sufficient economy that could provide the means to higher living standards, and to provide the industrial base that would produce

strategically important goods necessary to preserve south Korea's national security in relation to the "geopolitical realities" that confronted the nation.

During the rule of Pak Chung-hee, May 1961 through October 1979, the Korean economy experienced a high rate of sustained growth. GNP at current prices was only \$2.2 billion in 1960. This figure increased to \$5.36 billion by 1970, and by 1979 it equalled \$62.4 billion. Per capita GNP increased from \$81 in 1960 to \$1,662 in 1979.¹ Real GNP growth between 1966 and 1979 averaged 10 percent per annum.

During the same period, the Korean economic structure experienced an industrial transformation. In 1964, agriculture and fisheries comprised 46.8 percent of GNP, while mining and manufacturing constituted only 17.3 percent. By 1972, agriculture and fisheries' share of GNP declined to 26.4 percent of GNP, while mining and manufacturing increased to 23.1 percent.² By 1979, agriculture and fisheries' share of GNP decreased to 18.5 percent, while mining and manufacturing increased to 28.7 percent.³

Much of this economic growth and structural transformation was generated through export production. In 1960, exports equalled approximately 1 percent of GNP, and less than 25 percent of exports were manufactured goods. By 1964, exports equalled \$119 million or 4 percent of GNP, and manufactured goods comprised 54.9 percent of exports. Of these manufactured exports, heavy, chemical, and

1. Economic Planning Board, Korea Statistical Yearbook, (Seoul: Economic Planning Board), various years.

2. Economic Planning Board, op. cit.

3. Korean Traders Association, Major Statistics of Korean Economy, (Seoul: Korea Traders Association, 1984), p. 27.

electronic goods equalled less than 10 percent of total exports. By 1972, exports reached \$1.6 billion in value or 15 percent of GNP, with manufactured goods comprising 87.7 percent of exports. In 1972, heavy, chemical, and electronic industries comprised 21.3 percent of total exports. Between 1965 and 1972, exports increased 36.3 percent annually. By 1979, exports exceeded \$15 billion in value or 24 percent of GNP, with manufactured goods comprising over 90 percent of exports, and heavy, chemical, and electronic exports comprising 38.5 percent of the total exports.⁴

Following Pak's assumption of power, significant economic reforms were implemented. These reforms accompanied a major reorganization of the bureaucracy and significant alterations in the relationship between the state and society. The bureaucratic reorganization and economic policy reforms carried out by the Pak government need to be examined in order to determine the role that these state initiatives played in the facilitation of Korean industrial development, that is, to what degree has the intervention of the state been responsible for Korean economic performance.

In this type of examination, relevant variables are often unquantifiable. It, thus, becomes extremely difficult to identify the accurate explanatory power of any one variable in a multivariate analysis under *ceteris-paribus* conditions. This analysis, therefore, will not test hypotheses. Rather, it will examine, first, the rise of the military government to power in Korea and the primary alterations in state and societal structures subsequent to the formation of the government. The manner in which the Pak regime solidified its power base, reorganized bureaucratic structures, and altered the state's

4. Economic Planning Board, *op. cit.*

✓ relationship with society laid the foundation from which industrial development policy was built. Then, with an understanding of the relationship between the state, the bureaucracy, and the private sector, this chapter will proceed to an explanation and analysis of the primary state economic interventions that characterize and dominate the Korean industrialization process. These principal state interventions include sectoral planning of economic development, the development of state institutions that effectively accumulate resources and control the allocation of capital to fit the investment needs of development plans, and state mechanisms to shape the pattern of domestic industry, labor force activity, and foreign capital inflows to fit the implementation needs of development plans.

✓ It will be seen that the Korean economic development model highly resembles the Japanese industrial transformation process implemented under the Meiji rulers, and it is, in reality, an adaptation of the Japanese model to Korea's specific political-economic environment. Further, this analysis will agree with, and, in many ways, proceed from three propositions forwarded by Leroy Jones and Il Sakong in their volume for the Harvard Study Group on Korean Economic Performance, Government, Business, and Entrepreneurship in Economic Development: The Korean Case. The propositions propose that: (1) the Korean government has not followed a laissez-faire strategy towards the economy. Rather, it has been highly interventionist in stimulating economic activity through direct government participation in resource allocation and through stimulating, forcing, or cajoling private enterprise to perform according to government plans; (2) these state activities have been effective in altering and shaping the pattern of private decisions,

resource allocation, and economic outcomes; and (3) these state intervention activities have been effective in that they have had a positive net impact on economic growth.⁵ The capacity of the state to intervene effectively in economic affairs has been the dominant characteristic that marks the Korean economic development experience.

The Reorganization of the State and Its Relationship
to Society

Immediately after seizing power in May 1961, the military junta proclaimed martial law and formed a ruling body called The Supreme Council for National Reconstruction (S.C.N.R.). The S.C.N.R. possessed executive, legislative, and judicial authority, and it was controlled by Pak Chung-hee and Kim Jong-pil, the leaders of the coup. The first concern of the S.C.N.R. was to solidify their base of power and to eliminate opposition to their rule. The S.C.N.R. perceived the need to purge all opposition in order to maintain the reigns of power and to implement several bold reforms in the political system, the economy, and in society. The military, the bureaucracy, and commercial sectors of society all threatened the rule of the new regime.

First, the S.C.N.R. moved to purge the military of all high level officers who had served under Rhee and Chang Myon. The leaders of both the "northeast" and "northwest" factions of the military were removed and replaced by the promotion of middle level officers who

⁵ Leroy P. Jones and Il Sakong, Government, Business, and Entrepreneurship in Economic Development: The Korean Case, (Cambridge: Harvard University Press, 1980), p. 288.

were loyal to Pak or Kim Jong-pil. Along with the high level officers, all middle level officers who the new rulers perceived not to be loyal to the regime were purged. In all, over 2,000 military officers were arrested or "retired." Forty of these were generals.⁶ Many of the members of the S.C.N.R. and the officers promoted into the higher level command positions had been classmates of Kim Jong-pil in the eighth graduating class of the Korean military academy. These new commanding officers owed their new positions of power to Pak and Kim, and they were expected to be dedicated to the policies and goals of the new regime.

Using the military as a base of power, the new regime moved quickly to eliminate opposition to their rule in other key sectors of society. All political activity was outlawed. The National Assembly was dissolved, and all leading politicians of the Korean Democratic Party were arrested. Fifteen separate political parties were shut down. Strict censorship of the press was enforced, and over one thousand newspapers and periodicals were closed down.⁷ The new rulers also declared that bureaucrats under the Rhee and Chang regimes had been corrupt and inefficient, and they needed to be removed from their positions in order to protect Korean security, to develop the economy, and to maintain law and order. Some 41,000 bureaucratic officials were dismissed.⁸

The S.C.N.R. quickly formed the Korean Central Intelligence Agency (K.C.I.A.). Kim Jong-pil became the first director of the

6. Jounghwon Alexander Kim, Divided Korea: The Politics of Development 1945-1972, (Cambridge: Harvard University Press, 1975), pp. 221-230.

7. Ibid., p. 227.

8. Ibid., p. 234.

K.C.I.A. The K.C.I.A. became the primary institution for gathering both external and internal intelligence as well as becoming the principal coercive organ of the regime. One of the first acts of the K.C.I.A. was to purge society of suspected communist sympathizers. The S.C.N.R. quickly enacted severe anti-communist laws. An estimated 2,000 "communist sympathizers" were arrested in the first few months after the coup.⁹

Along with the military, the National Assembly, and the bureaucracy, the S.C.N.R. moved to take control of domestic private business. In the summer of 1961, the S.C.N.R. enacted the "Illicit Accumulation of Wealth Act." This law provided the legal framework for the arrest and punishment of civil servants and private businessmen who had taken advantage of their official positions or access to those in governmental positions in order to accumulate personal wealth between 1953 and May 1961. Under this ex post facto law, the leading businessmen were arrested including the founders and chairmen of Lucky-Gold Star, Samsung, and Ssangyong corporations, the three largest businesses in Korea in 1961. Those arrested were threatened with the total confiscation of their assets and with prison sentences.

However, the new military regime was dedicated to industrial development. If the Pak regime seriously desired to implement a national industrialization process, they would need the entrepreneurial skills of the few experienced businessmen who were active in Korea at that time. The "Illicit Accumulation of Wealth Act" was intended to provide the military regime with the means to capture financial control over the business activities of these entrepreneurs and their

9. Ibid., p. 231.

business ventures in order to ensure their compliance and cooperation with the implementation of government economic policy in the future.

After the arrest of the business leaders on the illicit accumulation of wealth charges, several of these businessmen were summoned to a meeting with Pak Chung-hee. An agreement was reached where criminal charges would be dropped and the businessmen could continue the operation of their enterprises. However, the businessmen were required to forfeit all their holdings in banks and other financial institutions to the government. This placed all financial institutions under the direct control of the state and allowed the state to control the allocation of investment capital. All future business expansion became dependent upon state approval. Through this financial control, the state could assure the compliance of the business sector with state industrial development plans. If the private sector refused to follow government directives, they would be denied the capital necessary for investment. In addition, the businessmen arrested were required to pay fines to the government and to develop new industrial enterprises designated by the government.¹⁰ The issue was officially settled in December 1964, when all charges were dropped in exchange for cash payments of fines which totaled \$16 million.¹¹ By this time, the government was in control of all financial institutions, and the businessmen had already embarked on ventures specified by government economic development plans.

This episode established the basic structural relationship between the state and the business sector in Korea. The government would control banking and the allocation of capital for investment.

¹⁰. Leroy P. Jones and Il Sakong, op. cit., pp. 69-70.

¹¹. Ibid., p. 281.

Funds allocated would not follow market mechanisms, but, rather, they would fit the pattern designated by government development plans. The business enterprises that would develop industries favored by government plans would receive government allocated financing at artificially low terms and would not be required to put up collateral (state-business sector relations will be discussed in detail later in this chapter). This initial interaction between the Pak government and domestic business created a relationship that placed business in a subordinate position to government economic directives. When the military came to power, the business sector had, for the most part, been benefactors of the policies of the Rhee government. They could not be considered by the new rulers as allies or as supporters. However, with the shortage of entrepreneurs in Korean society, these businessmen would be necessary to carry out government industrialization policies that the military rulers desired. Through arrest and the threat of total confiscation of their assets, the government demonstrated their power superiority. Through the actual confiscation of financial institutions, the government gained the capacity to effectively control private business operations through the extension or denial of financial resources. A pattern of state-business relations was created whereby business was in a subordinate role to government and was induced into becoming a government ally as their business success and survival became closely tied and dependent on the successful implementation of government economic policy.

The Pak government perceived a strong relationship between economic development and national security as well as with their legitimacy to rule in the eyes of the Korean population. Both Pak Chung-hee and Kim Jong-pil had served in army intelligence units, and

they were very aware of the economic and military advances that had occurred during the 1950's in north Korea. At this point, north Korea was experiencing economic development at a much more rapid rate than the south. This was viewed by the new rulers as a threat to national security. This threat to national security had been a primary factor leading to the decision to stage the military takeover of the government. The need to industrialize in order to promote national security has been the driving force in leading to industrialization in many nations. This was a driving force in Stalin's industrialization programs as well as in Taiwan and China. In the case of Japan, the Meiji revolution and the subsequent industrialization were largely a response to defend Japanese national sovereignty against the threat of foreign dominance. The new regime in Seoul perceived a growing vulnerability as the industrial gap between the south and north increased. This vulnerability threatened national survival and served to place industrialization as the highest priority of the new government.

✓ As important as industrialization and economic modernization was for national security interests, economic advancement also became a necessary factor in the military regime's gaining support from the Korean population. The military regime could not claim legitimacy through any traditional means. There was no established tradition of military rule in Korea. Traditional rulers had been members of the aristocracy related by blood to a royal lineage since the fourteenth century. The traditional rulers gained legitimacy through blood lines and education in the customary Confucian manner. Military leaders had usually served as advisors and defenders of the courts, servants of the royal house, and held relatively low esteem by the public. The

leaders who had emerged after independence gained their legitimacy principally through a nationalist identity based upon anti-Japanese activity. The new military rulers could claim neither form of legitimacy. General Pak was of a peasant origin and had to bear the taint of a Japanese collaborator. He was educated under the Japanese colonial school system, and, as a young man, he enrolled in the Japanese military college of Manchukuo. He graduated from Manchukuo in 1942 at the head of his class and was selected to attend the prestigious Japanese Imperial Military Academy in Tokyo from where he graduated in 1944. He served as an officer in the Japanese army until 1945. After the war, he returned to Korea and joined the new Korean army. In 1948, he was accused of involvement in an alleged communist inspired uprising within the military. Pak was sentenced to death. However, he was released from jail and re-commissioned in the army when the war broke out in 1950. By the end of the war, he had advanced to the rank of Brigadier General.

Lacking popular legitimacy to rule in both a traditional and a nationalist anti-Japanese sense, Pak and the military rulers viewed economic development as their principal means to gaining legitimacy. If economic development were to be successful and the security of the nation increased in conjunction with rising living standards, the military regime believed that they would gain the support of the population.¹²

12. For discussions of regimes in other nations that attempt to use economic development as a means of gaining popular legitimacy, see: Edward C. Epstein, "Legitimacy, Industrialization, and Opposition in Exclusionary Bureaucratic-Authoritarian Regimes," Comparative Politics, Vol. 17, No. 1, October 1984, pp. 37-52. Epstein characterizes the importance that the bureaucratic-authoritarian regimes in Brazil, Chile, and Uruguay have placed upon economic performance as a means of institutionalizing regime authority and power. Stephan White, "Economic Performance and Communist Legitimacy," World Politics, Vol. 38, No. 3, April 1986, pp. 462-482. White argues that economic performance is the single most important factor upon which communist regimes have sought popular legitimacy.

Another factor that necessitated the high priority placed upon economic development by the military rulers was the high degree of military and economic dependence of Korea upon the United States.¹³ Considerable resentment of Korea's dependent relationship existed among the officers who took part in the coup.¹⁴ During the years of the Rhee presidency, American generals held command over all major decisions of the Korean military. In the economic sphere, the extremely high level of aid dependence placed American economic advisors in key decision making positions. The new military leaders viewed economic modernization and industrialization as the means to regaining Korean control over major military and economic decisions.¹⁵

For these principal reasons, the Pak government viewed economic development as a highest priority.¹⁶ According to Pak Chung-hee's public statements, national defense was dependent on economic development. Pak stated, "National power accumulation for the unification of the nation by winning over communists is ultimately dependent on the success or failure of economic construction."¹⁷ Pak also argued that the primary concern of people in Asia was not with democracy or political freedoms, but with the eradication of poverty and starvation: "In human life, economics preceeds politics or culture."¹⁸ Pak believed that the Korean people would support

13. Yoo J.H., National Planning for Development: The Case of Korea, (Unpublished Ph.D. Dissertation, University of Michigan, 1968), pp. 165-167.

14. Joungwon Alexander Kim, op. cit., p. 218.

15. Ibid., pp. 248-249.

16. Leroy P. Jones and Il Sakong, op. cit., p. 42.

17. Ibid., p. 43.

18. Park Chung-hee, The Country, the Revolution, and I, (Seoul: Chongno Book Center, 1970), p. 26.

military rule as legitimate if it lead them away from the starvation and poverty that engulfed them. In relation to American aid, Pak argued that aid was generous with consumer goods, but "it did not provide productive facilities that Korea would require to modernize its economy and to create a self-sufficient industrial base."¹⁹

Pak and the military leaders repeatedly expressed their commitment to economic growth. This commitment was transformed into action by the government's restructuring of bureaucratic institutions in a manner that would facilitate economic growth, and through active support for economic oriented bureaucrats, technocrats, and private industrial entrepreneurs at the highest government levels.²⁰ The new government viewed themselves as the developers of a new Korean national identity based upon industrialization. The survival of the state, its ability to exercise its sovereignty, and the survival of the regime were all viewed by the military rulers as dependent upon economic growth and industrial transformation.

Pak clearly saw his mandate as one of bringing about economic development. However, how was industrialization to be brought about in a nation where traditional prerequisites of industrial development did not exist? Korea had very few forward looking entrepreneurs. The bureaucracy was inefficient, corrupt, and not oriented toward economic development. Natural and financial resources were very limited.

To Pak and the new military leaders, these constraints were to be overcome in a similar manner to which Meiji Japan overcame similar problems three quarters of a century earlier. The Meiji leaders overcame these constraints through reorganization of state apparatus

19. Ibid., p. 31.

20. Leroy P. Jones and Il Sakong, op. cit., p. 43.

and the implementation of industrial development under state direction.²¹ As in Meiji Japan, it would be necessary for the new regime in Korea to reorganize the structures of the state and its relationship to society. The state would assume the role of the planner and designer of economic transformation and enforce its decisions over private economic activity. State institutions would be restructured so that economic planning would be conducted at the highest bureaucratic levels and coordinated in a vertical manner with other state institutions responsible for overseeing implementation of government plans at the micro level. Economic planning would involve the systematic targeting of industrial sectors and the nurturing of their development through state assistance. Planning would progressively move from the basic industries of labor intensive production to more complex heavy and chemical industries. This would allow for the concentrated use of resources in order to develop specific industries that fit the state's perception of Korea's comparative advantage.

Immediately following the military takeover of the Korean government in May 1961, the S.C.N.R. announced plans to restructure government institutions and to reorder their responsibilities in order to facilitate effective economic decision making and to coordinate economic development activities among the various bureaucratic ministries. The S.C.N.R. divided its members into committees which began to function as a cabinet. General Lee Chu-il was appointed as chairman of the Finance and Economic Committee, and General Yoo Won-shik was appointed to chair the Commerce and Industry Committee.

²¹ Chang Dal-joong, Economic Control and Political Authoritarianism: The Role of Japanese Corporations in Korean Politics 1965-1979, (Seoul: Sogang University Press, 1985), pp. 80, 91, 104.

General Yoo was a graduate of the economics department of Tokoku University in Japanese held Manchuria in the 1930's. General Yoo was a strong advocate of state induced economic planning as a means of creating rapid economic growth.²² These two committees were delegated the task to develop governmental bureaucracies that would initiate economic planning and facilitate its implementation. Civilian economists were appointed to special sub-committees of the S.C.N.R. to prepare plans and to suggest organizational proposals. These civilian economists were under the control of, and reported to, General Yoo.

✓ On July 22, 1961, the Economic Planning Board (E.P.B.) was created by the S.C.N.R. The E.P.B., designed to be similar to the Japanese Ministry of International Trade and Industry (MITI) in function, was given broad powers and responsibilities to initiate planning and to oversee its implementation. The E.P.B. was to become the principal bureaucratic institution to design and oversee economic activity in Korea. The E.P.B. was granted the authority to: (1) develop comprehensive economic development plans; (2) formulate and execute the national budget; (3) develop capital formation; (4) assign responsibility for operational decisions to appropriate ministries; (5) coordinate economic policy between ministries; (6) control the allocation of funds of all capital investments; and (7) oversee the inducement and regulation of foreign investment and technical inflows.²³ The Bureau of Statistics and the Bureau of Budget were transferred from the Ministry of Home Affairs and the Ministry of

22. Yoo J.H., op. cit., p. 58.

23. Information on the organization of the economic bureaucracy in Korea was primarily taken from: Yoo J.H., op. cit., p. 58 and pp. 108-118; Leroy P. Jones and Il Sakong, op. cit., pp. 46-58; L.L. Wade and B.S. Kim, Economic Development of South Korea: The Political-Economy of Success, (New York: Praeger Publishers, 1978), pp. 219-240.

Finance respectively to the E.P.B. in an attempt to increase the capacity of the E.P.B. to implement effectively future development plans. The E.P.B. control over the budgetary process would allow the E.P.B. to allocate funds in a manner that would fit planning initiatives. The E.P.B. control over the gathering of statistics would increase the capacity of the E.P.B. to have up-to-date and comprehensive data to facilitate decision making. The Foreign Capital Inducement Bureau was established within the E.P.B. in October 1961 in order to develop a foreign capital inducement policy in an attempt to increase the capacity of the state to induce foreign investments into sectors and projects consistent with the successful implementation of development plans.

The E.P.B. was to become the government's dominant institution in the economic development process by planning, budgeting, and allocating resources to other state institutions and society and by controlling foreign inflows and coordinating activities between ministries. To emphasize the higher status of the E.P.B. over other ministries and to aid in the coordination of activities and the mediation of inter-ministry disputes, the director of the E.P.B. was given the rank of Assistant Prime Minister (later changed to Vice Prime Minister, then Deputy Prime Minister) as opposed to the rank of minister. The Assistant Prime Minister would head the E.P.B. as well as serve as the leader of the cabinet in the absence of the Prime Minister. Mr. Kim Yu-taik, an economist and former Minister of Finance, was appointed as the first Assistant Prime Minister and given the task of developing the first five year plan. The formal authority of the E.P.B. placed it at the top of the bureaucratic power structure, and this, in conjunction with the political support the

E.P.B. received from the presidential office, empowered it to institute bold reforms and to coordinate economic policy with the other ministries and private industry.

✓ To further facilitate the coordination among various economic ministries, the government formed the Council of Economic Ministers. For the next two decades, this council would meet on a twice weekly basis. The council was composed of the Prime Minister as chairman, the Deputy Prime Minister and Director of E.P.B., and the Ministers of Finance, Commerce and Industry, Agriculture and Fisheries, Transportation, Communications, Foreign Affairs, and the presidential special assistant without portfolio in charge of economic affairs.

✓ Matters on the agenda of the council included: (1) economic problems that required deliberation by the cabinet and president; (2) economic development planning; (3) financial and monetary policy; (4) coordination problems between and among the various agencies that concerned economic matters; and (5) other economic problems that the members felt needed the attention of the conference as a body.²⁴ The Council of Economic Ministers became the principal forum for economic problem solving and for coordinating policy initiatives. These meetings allowed for input and feedback into the planning process from the individually concerned ministries. At these meetings, responsibilities and obligations were delegated to the various ministries in conjunction with the development plans formulated by the E.P.B. The ministers were regularly required to give progress reports on specific programs and projects to the council and to present and discuss major problems in development plan implementation. Important decisions regarding the coordination and implementation of development

24. L.L. Wade and B.S. Kim, op. cit., p. 223.

plans were agreed upon at this forum. Decisions that could not be agreed upon by the economic ministers at these conferences were referred directly to the president for final arbitration.

The economic ministries themselves were reorganized into bureaus and offices that were specific task oriented. These bureaus and offices were delegated tasks by the respective ministers' office and held responsible for the effective completion of these tasks. The individual ministries were granted considerable authority and political assistance from the presidential office in their respective sectors in order to achieve the objectives assigned to them, but they were held responsible for the achievement of the tasks. Through the reorganization of bureaucratic structures, the government established a system whereby economic objectives and policies were designed at the highest levels and chains of command emanated downward to ensure implementation.²⁵

✓ There is a tendency in liberal and Marxist literatures to grant relatively little explanatory power to bureaucratic institutions and other political factors in facilitating economic development. However, Korean economic development has been in a large part due to the capacity of the state to develop, coordinate, and oversee the implementation of state designed economic policy. In Korea, since 1961, economic policy has been formulated and articulated in a highly centralized manner through the medium of bureaucratic institutions. Powerful presidential authority and effective coordination among executive agencies have provided the government with the means to pursue a comprehensive development strategy and experience remarkable results.²⁶

²⁵. Leroy P. Jones and Il Sakong, op. cit., p. 47.

²⁶. Ibid., p. 240.

The major emphasis that the military government placed upon economic development and institutional structural reorganization to facilitate economic development marks the major distinctions between the government under Rhee Syng-man and under Pak Chung-hee. Rhee did not place a high priority on economic development and, thereby, did not see the need to structure bureaucratic institutions in a manner that would effectively formulate and implement economic policy. Rhee relied on political parties, youth groups, and cronies to play key economic roles, largely to his and their personal benefit. Pak, on the other hand, was an experienced military man who was familiar with hierarchial relationships and who had much experience at delegating authority and responsibility through organizational chains and who relied on organizations to accomplish tasks. Pak knew how to use his staff and placed major emphasis on bureaucratic organizations as his chosen instruments of control over economic policy. The bureaucracy possessed the capacity for effective decision-making and policy implementation once the government leaders oriented policy and bureaucratic structure toward economic development and provided the bureaucratic institutions with necessary political guidance and support. "In moving from Rhee to Pak, the bureaucracy was not simply reoriented and somewhat reorganized, but shifted to the forefront of the economic decision-making effort."²⁷

According to Leroy Jones and other scholars who have studied Korean bureaucracy and economic development under Pak Chung-hee, Korea provides a concrete example of a "Myrdalian hard state."²⁸ Myrdal

²⁷. Ibid., p. 48.

²⁸. Ibid., pp. 132-140. Paul W. Kuznets, "The Korean Economy in the 1980's," Political Leadership and Economic Development: Korea and China, edited by Yoo Se-hee, (Seoul: The Institute for Sino-Soviet Studies, Hanyang University Press, 1983), p. 144. Chang Dal-joong, op. cit., p. 88.

✓ argued that a "soft state" existed where policies decided upon by the state could not be enforced and where the state could not enforce obligations placed upon all strata of society. Contrary to the environment in a "soft state," successful implementation of economic development plans requires the state to place obligations on people of all strata of society and to enforce these obligations. The Pak government established both economic policy and the bureaucratic mechanisms to enforce the implementation of policies. According to a study conducted by the Harvard Study Group, this proposition was empirically established. In a survey of 196 businesses established prior to 1961 and in operation in the 1970's, the question was asked, "Once the government has made a decision affecting business activity, how effective is it at assuring compliance? What about under the Rhee government?"²⁹ Seventy-eight percent of the respondents answered that the bureaucratic institutions under Pak always implemented a policy decided upon and that it was impossible to avoid compliance. Sixteen percent of respondents claimed that a policy decided upon was almost always implemented and sometimes possible to avoid. Contrary to these findings, only three percent of respondents claimed that policy under Rhee was always implemented and compliance was impossible to avoid, while seventeen percent responded that policy under Rhee was sometimes implemented. From these findings and other analysis, Jones concluded that the Rhee regime fit Myrdal's description of a "soft state," while the Pak regime's commitment to economic development and its effective state mechanisms that assured compliance with economic policy decisions was a dominant characteristic behind Korean economic performance in the 1960's and 1970's.³⁰

²⁹. Leroy P. Jones and Il Sakong, op. cit., pp. 132-140.

³⁰. Ibid., pp. 136-137.

Pak recognized that effective state mechanism to coordinate and induce economic performance was a necessary prerequisite to achieve his "mandate of development." This recognition of the need for effective state structures as a necessary instrument for the implementation of economic policy was consistent with the arguments of Myrdal. However, to Pak, effective state structures also required authoritarian state powers. Parliamentary democracy, according to Pak, with the many pluralist interests that needed to be satisfied to assure its functioning and the lengthy political debate it entailed, would constrain the establishment of consistent economic development priorities and be wasteful of the few precious resources Korea possessed.³¹ According to Pak, to facilitate economic development in Korea, the state apparatus needed to be oriented to that end alone, with institutions that would oversee the implementation of those ends. In the course of formulating policy, qualified experts should be consulted and listened to, and debate could be vigorous. However, in a similar vein as Lenin's concept of democratic centralism, Pak maintained that "once a policy has been decided upon, those who participated in a decision should adhere to it faithfully, whether they approve of it or not."³² Once a policy was agreed upon, government institutions needed to be unified to assure that the goals of the policy could be achieved, and those responsible could be held accountable for their achievement. With such a centrally controlled planning and implementation strategy, parliamentary democracy with its vigorous debate and compromising tendencies was viewed by Pak and the military leaders as a constraint on rapid economic expansion.

31. Chang Dal-joong, op. cit., p. 88.

32. Park Chung-hee, To Build a Nation, (Washington, D.C.: Acropolis Books, Ltd., 1971), p. 124.

In attempting to understand the process of industrial transformation that occurred in Korea during the administration of Pak Chung-hee, one first should be aware of the principal features that shaped the industrialization of Japan from the Meiji revolution in 1868 onward. Previously, the Japanese colonial legacy in Korea was discussed. Although the division of the Korean peninsula and the Korean War effectively severed and destroyed the industrial infrastructure and manufacturing facilities left from the colonial period, the Japanese colonial experience left a tremendous impact on Korean economic development philosophy and policy. This becomes particularly manifest in Korean development policy subsequent to the 1961 military revolution. The similarities in state institutional structures, state-private industrial linkages, and state-foreign economic policy between the Japanese and Korean experiences are significant.

It should be remembered that Pak Chung-hee was heavily influenced by the Japanese. He was educated in their colonial schools and at the Imperial Military Academy. In the Japanese education setting, Pak became aware of the Meiji economic reforms that transformed the feudal-rural economy of Tokugawa Japan into an industrial power.³³ Pak, once in the presidency, surrounded himself with economic advisors who had also been educated by the Japanese. Many of these economic advisors including General Yoo Won-shik had studied economics at Japanese universities in the 1930's. These advisors were aware of cultural and economic similarities between Korea in 1961 and Meiji Japan -- homogeneous society, strong sense of national pride among the population, a large available work force that

33. Chang Dal-joong, op. cit., pp. 80, 91, 104.

was relatively well educated, a need to develop the economy to preserve national independence and to counter an external military threat, a long tradition of a strong central state apparatus that regularly intervened in economic affairs, the lack of a forward-looking entrepreneurial class, a lack of natural resources, and limited domestic savings. Many prerequisites of economic development were not present in Korea nor were they present in Meiji Japan. However, these missing prerequisites were generated by the Meiji state during the course of Japanese development.

Many of Pak's economic advisors, the architects of Pak's economic policies, were of a similar background to Choi Man-hwan. Choi received a graduate degree in economics from Waseda University in Tokyo. During the 1946-1961 period, Choi had been an economics professor, first at Korea University, then at Seoul National University. In 1961, Choi became an advisor to the military government. According to interviews with associates of Choi conducted for this study, Choi had been approached by the Rhee government to serve as an economic advisor. However, he was opposed to the Rhee regime's policies that aimed at the maximization of aid and to the corruption within the regime. Choi had advocated an industrialization program that would be driven by labor-intensive manufacturing and export promotion. These policies were rejected by the Rhee government. Choi admired Japanese economic performance and believed that a similar program would be successful in Korea. When the military took power with its strong commitment to economic growth, Choi became an advisor to the government. He advocated limits be placed on consumption and increased taxes to generate domestic savings. He was also a strong supporter of normalizing diplomatic and

trade relations with Japan, which had been severed since 1945, in order to induce Japanese capital and technology into Korea and to create markets for Korean exports. Choi believed that Korea's comparative advantage lay in cheap, well-disciplined labor that could be mobilized to produce manufactured exports.

Choi and other economists trained by the Japanese were fully aware of the primary state-societal linkages in Japan. The industrialization of Japan was not a market-rational approach as in Western nations where economic activity was dependent upon the market for stimulation. The industrialization of Japan followed a plan-rational approach. Under a market-rational approach, the state's principal function is to maintain structures that allow for competition in the marketplace once opportunities for the development of new sectors and products are presented by the market. However, under the plan-rational strategy followed by Japan, the state becomes the dominant economic actor by establishing substantial national economic goals and by offering incentives and punishments to induce and compel the private sector to achieve the established national goals. The plan-rational approach necessitated extensive state intervention into economic affairs.³⁴ In Japan, industrial sectors were targeted by the state for development in an orderly sequence. Industries targeted by state planners had resources and other assistance channeled to them through administrative mechanisms. Private industry was then held responsibility for achieving state established production goals. Ultimately, the plan-rational strategy resulted in relatively consistent and effective economic policy that allowed Japan to industrialize and to significantly increase its

34. Ibid., pp. 41, 91.

national power in a very short period of time. The relationship between the state and private industry developed into a symbiotic relationship with each dependent upon the other. However, the capacity of the state to direct economic expansion through the allocation of resources placed private industry in a position of responsive dependence.³⁵

In 1853, when American Commodore Matthew C. Perry sailed his fleet into Tokyo Bay and forced the opening of Japanese trade and the granting of special trade privileges to Americans, the Japanese Tokugawa Shogunate was in an irreversible decline. The Opium Wars and their devastating effect on the Ching government in China had given notice to the Japanese that the Western powers, with their advanced military capacity and their industrial economies, were colonizing and conquering East Asia. When Perry demonstrated the power of his cannons and his "ship that could advance into the wind without sails," the Japanese realized that they would be soon subjugated to Western domination and, perhaps, direct colonial control. The traditional institutions of feudal Japan could not provide the impetus needed to resist effectively Western penetration. Subsequent to Perry's arrival and the humiliating treaty forced upon them, modernizing elements within the Japanese society rebelled. A revolution led by samurai and financed by merchant families like the House of Mitsui successfully overthrew the Shogun and took control of the government in 1868. The new government, determined to modernize Japanese economic and military capacity, believed that the state must adopt policies to develop

35. Ibid., p. 90.

industry and commerce as the means of increasing national strength.³⁶ Only rapid industrialization would allow the Japanese to maintain sovereignty and to realize self-determination. Industrialization became the priority of the state as it was the means to accomplish the highest national strategic goals.

One of the unique characteristics of the Japanese industrialization experience was that it was not the result of a long period of a rising entrepreneurial class. Rather, Japan in 1868 had very little industrial or entrepreneurial activity. Unlike Europe, where an entrepreneurial class evolved over a long period of time to lead the Industrial Revolution, Japanese industrialization was advocated by a military oriented semi-feudal class who rebelled, won political control, and established a strong central bureaucracy. Their political inheritance was autocratic and paternalistic, and they perceived the need for sweeping economic and military reforms. Reforms were necessary to break the feudal hold on Japanese society in order to industrialize and to fend off encroaching Western domination. The subsequent Japanese industrial transformation was initiated and guided from the highest levels of the state apparatus. The Meiji leaders moved quickly to establish a highly centralized political structure that took command of the economy. Over a twenty year period of trial and error, the government established the basic principles of Japan's "catch-up quickly" economic policies, and the industrialization process under a Japanese model had begun to take form. In less than forty years, the Japanese had transformed their

36. Kenneth B. Pyle, The Making of Modern Japan, (Lexington, Mass.: D.C. Heath and Company, 1978), pp. 77-78. E.H. Norman, "Japan's Emergence as a Modern State," in John Dower, Origins of the Modern Japanese State: Selected Writings by E.H. Norman, (New York: Pantheon Books, 1975), p. 24. Chang Dal-joong, op. cit., p. 19.

feudal structures into a burgeoning industrial economy and had begun to rival the Western powers for colonial control of East Asia. By 1920, the Japanese became the hegemonic economic and political power in Asia. Pak Chung-hee and the leaders of the military government desired a similar experience in Korea.

In examining the rapid and successful economic transformation in Japan, six principal characteristics come to the forefront to shape the parameters of the Japanese model. These six principal characteristics, although adapted to meet the unique political-economic environmental needs of the Pak regime and the Korean society, became the principal characteristics of the Korean industrialization process after 1961. The remainder of this chapter will examine these six principal characteristics that highlight both the Japanese and Korean economic development models.

1. A Central Planning Institution that Develops and Coordinates Industrial Development Strategy

Chalmers Johnson claims that nurturing the economy was a major priority of the Japanese state. To the Meiji leaders, any other course of action would lead to dependency, poverty, and the breakdown of the social system.³⁷ In order to nurture the economy, the Japanese state has been active in national planning and overseeing the implementation of industrial strategy. The Ministry of International Trade and Industry (MITI) and its predecessors (the Ministry of

³⁷. Chalmers Johnson, MITI and the Japanese Miracle: The Growth of Industrial Policy 1925-1975, (Stanford: Stanford University Press, 1982), p. 207.

Commerce and Industry and the Ministry of Municians) have served the Japanese state as the principal bureaucratic agencies in economic planning and organization. The MITI has always taken a leading role in economic activity in order to achieve the primary economic goal of rapid growth.³⁸ In Japan, economic development was an end in itself. The plan-rational approach to this end took on strategic qualities and its implementation strategy was the MITI's primary responsibility. According to Johnson, the MITI has controlled Japanese planning by possessing the authority and capacity to target industrial sectors for development and by selecting the means by which those sectors will be developed. This central planning ministry is staffed by a small but elite group that is made up of the best economic managerial talent available. The MITI is characterized by its direct control over government investment funds that are channeled to the financing of targeted industries, by its think tank facilities that are utilized to solve economic problems, and by its vertically structured bureaus that implement policy at the micro level. MITI does not have direct control over such areas as labor, agriculture, construction, transportation, or commerce. Individual ministries have jurisdiction and are responsible for policy implementation in these areas. However, the MITI is responsible for coordinating activities among these agencies in order to meet the requirements of centralized plans. The MITI also has the capacity to influence the policy of other ministries through budgetary control.³⁹

The Economic Planning Board in Korea was established and granted authority to perform similar functions to those performed by the MITI

38. Chang Dal-joong, op. cit., p. 41.

39. Chalmers Johnson, op. cit., pp. 305-322.

in Japan. Comprehensive development planning carried out by the E.P.B. has played a major role in establishing industrialization goals and in coordinating resource allocation to targeted sectors of the Korean economy. Korean economic planning has consisted of a series of five year economic development plans. The first plan was enacted in January 1962. This first plan was hurriedly designed without the benefit of reliable statistical data or a sophisticated planning apparatus. However, it clearly demonstrated the government's commitment to economic development⁴⁰ and began a process of centrally controlled allocation of resources to key sectors designated by government planners on which subsequent industrialization could be built.

The principal strategy underlying the first plan was to place emphasis on the development of economic infrastructure, the development of light industry especially in export sectors, and the increase of agricultural output. The rate of GNP growth was targeted at 7.1 percent. The target growth in agriculture was 5.7 percent, in manufacturing 15 percent, and social services at 5.4 percent.⁴¹ Investment during the plan period totaled \$2.47 million. Of this, 58 percent was allocated to power facilities and other infrastructure projects, 26 percent to manufacturing development, and 16 percent to agriculture.⁴² The development plans in the area of infrastructure development were successfully implemented, and by 1964 the nation became self-sufficient in power generation for the first time since

40. Leroy P. Jones and Il Sakong, op. cit., p. 49.

41. See: Kim Seung-hee, Foreign Capital for Economic Development: A Korean Case Study, (N.Y.: Praeger Publishers, 1970), pp. 160-173. Park Sung-jo, et al., Economic Development and Social Change in Korea, (Frankfurt: Campus Verlag, 1980), pp. 40-44.

42. Leroy P. Jones and Il Sakong, op. cit., p. 54.

1945.⁴³ Investment into the agricultural sector increased output through increased use of fertilizers, irrigation, pesticides, hybrid seeds, and through land reclamation projects. The manufacturing sector, particularly light manufactures where low cost, well-educated labor gave Korea a comparative advantage was stimulated by export incentive measures and grew rapidly. Exports, led by light manufactured goods, grew at an annual rate of 38 percent over the plan period to equal \$138 million in 1966.

The value of development planning does not inhere in the targets that are established. The targets are in themselves meaningless if funds to finance their development are not provided. However, development planning can be important for the direction it gives to economic policy by indicating appropriate courses for investment patterns and other related policy measures. In Korea, economic development plans became the guiding arm of investment activity and established the course for economic policy.⁴⁴ The allocation of investment funds were guided by the state to fit economic development targets, and these investment patterns led to structural alterations in the Korean economy. In 1960, the plan base year, the agricultural sector accounted for 36 percent of GNP; mining and manufacturing, 14.7 percent; and social overhead and other services, 49.3 percent. By 1966, agriculture accounted for 34.9 percent of GNP; mining and manufacturing, 20.5 percent; and services, 44.6 percent.⁴⁵

The first five year plan can be considered successful in the sense that most of targets were reached. GNP growth rate was targeted

⁴³. David Cole and N. Lyman, Korean Development: The Interplay of Politics and Economics, (Cambridge: Harvard University Press, 1971), p. 211.

⁴⁴. Park Sung-jo, et al., op. cit., p. 45.

⁴⁵. Ibid., p. 41.

at 7.1 percent annual growth, and 7.8 percent was attained. Agriculture was targeted at 5.7 percent growth, and 5.6 percent was achieved. Manufacturing sectors achieved their target of 15 percent annual growth. Exports were targeted to increase by 28.8 percent per annum, and a growth rate of 38.6 percent was achieved.⁴⁶

✓ In conjunction with the first five year plan, the government enacted the Foreign Capital Inducement Act in 1962. This law attempted to attract desired foreign capital and technology through state guarantees and incentives. The law also allowed the state and private domestic industry to borrow capital from abroad after receiving government approval from the Economic Planning Board. Approval for direct foreign investment and technological inflows would be based upon a positive list. Only those sectors and projects listed on the positive list were open to foreign penetration. The positive list included those sectors and projects targeted by development planners in which Korean domestic producers lacked the requisite technical or marketing skills for the development of that sector or project.

The Pak regime realized a need for foreign capital, technology, and marketing skills in order to initiate development of several industrial sectors. However, in 1961 there were no foreign invested firms in Korea, and the state of the investment climate offered little incentive to induce needed foreign investors. At the same time, the Korean state, desiring to increase the level of national autonomy in economic and military affairs through industrialization, sought to control the level of foreign ownership of the means of production. The Foreign Capital Inducement Act was the legal foundation of a state

⁴⁶. Economic Planning Board, cited in The Korean Economy, (Seoul: Korea Exchange Bank, 1984), p. 283.

strategy to induce and regulate foreign investment. This state strategy to induce and regulate foreign capital will be analyzed in more detail later in this study. Here, it is necessary merely to state that the Foreign Capital Inducement Act and its positive list were closely related and periodically adjusted to complement overall development plans. Later, it will be seen that the Korean industrialization strategy has limited effectively foreign investment to only those specific sectors where the state planners have perceived a need for foreign input. This strategy has allowed for a very high level of Korean national ownership over the means of production.

Table 3.1
Targets and Achievement of Five Year Plans: Annual Growth Rates
(average increase rate)

	<u>1st plan</u>		<u>2nd plan</u>		<u>3rd plan</u>		<u>4th plan</u>		<u>5th plan</u>	
	(1962-66)		(1967-71)		(1972-76)		(1977-81)		(1982-86)	
	T	A	T	A	T	A	T	A	T	A
GNP growth rate	7.1	7.8	7.0	9.6	8.6	9.7	9.2	5.8	7.5	8.6
Agriculture	5.7	5.6	5.0	1.5	4.5	6.1	4.0	-.6	2.6	3.8
Manufacturing	15.0	15.0	10.7	21.8	13.3	19.0	14.3	10.5	11.0	10.2
Services	5.4	8.4	6.6	12.6	8.5	8.4	7.6	6.0	7.3	9.2
GNPC	4.2	5.0	4.7	7.3	7.0	8.2	7.5	4.0	5.9	5.9
Fixed investment	14.6	24.7	10.2	17.9	7.6	13.2	7.7	10.1	9.0	8.3
Exports	28.8	38.6	17.1	33.8	22.7	32.7	16.0	11.1	11.4	10.5
Imports	8.7	18.7	6.5	25.8	13.7	12.6	12.0	10.5	8.4	4.2
Employment rate	4.7	3.2	3.3	3.6	2.9	4.5	3.2	2.3	2.5	1.9

Source: Economic Planning Board, Major Statistics of Korean Economy, various years.

** Remarks: T - Targeted percentage, A - Achieved percentage

The second five year plan (1967-1971) was prepared with more data and complex analysis than the first plan. Considerable experience was gained by the Korean planners in the first five years of the Pak government. The second five year plan utilized a reasonably accurate input-output matrix and a sophisticated dynamic

projection model for testing the consistency of the overall plan as well as for estimating sectoral investment and import requirements.⁴⁷ The planning process for the second plan essentially involved the continuation of the objectives of the first plan with the utilization of more accurate data and higher savings rates to allocate more efficiently funds to meet desired ends. In the government's attempt to assure implementation of the plan, the Bureau of Budget within the E.P.B., which was responsible for the annual budgeting process, worked in close cooperation with the Planning Bureau of the E.P.B. This greatly enhanced the capacity of the government to implement the plan as budget allocations and government investments were coordinated to fit targeted growth sectors.

The principal targets of the second plan were to continue the build-up of industrial infrastructure and other social overhead, to expand export production both in output levels and in diversification, and to develop heavy and chemical import substitution industries. During the period of the second plan, two oil refineries came into operation, and intensive efforts were undertaken by the state to develop an iron and steel production complex and to expand output capacity in the cement, machinery, chemicals, and petrochemical industries.

The second plan targeted GNP growth at 7 percent per annum, with growth rates of 10.7 percent in mining and manufacturing, 10.2 percent in fixed investment, and a 17.1 percent annual increase in exports. The total investment rate was targeted at 19.1 percent of GNP by the end of the plan with 60 percent of the total coming from domestic savings. The allocation of investment funds targeted 16.3 percent of

47. Leroy P. Jones and Il Sakong, op. cit., p. 50.

total investment to agriculture, 30.7 percent to manufacturing (principally to producers of light industrial exports and to targeted import substitution projects in the iron and steel, machinery, chemical, and petrochemical sectors), and 53 percent to social overhead projects such as power production, transportation, and communication infrastructure. However, as the plan developed, it became apparent that the rapidly growing export sector was outgrowing the industrial infrastructure necessary to operate it. The E.P.B. in the third year of the plan altered its investment ratio to fit changing requirements. The actual allocation of investments during the second plan saw only 9.5 percent of investment go to agriculture and 23.8 percent to manufacturing, while 66.7 percent was allocated to social overhead.⁴⁸ The ratio of investment allocations by industrial sectors was similar for both of the first two five year plans. This highlights the general continuity of the plans. However, during the second plan, manufacturing investment tended to be more concentrated in large capital intensive import substitution projects as the sophistication of manufactured goods production increased.

The investment criteria utilized by the E.P.B. were not based upon cost-benefit analysis. Rather, investment allocation was principally influenced by government decisions at the planning level and allocated to industries viewed by government planners as those most likely to: (1) earn foreign exchange; (2) limit the level of needed imports; (3) create jobs; and (4) create forward or backward linkages with targeted industries. Bottlenecks or surpluses in particular sectors can be major problems created by such a politically controlled investment strategy. In an attempt to limit inefficient

48. Ibid., p. 54.

allocation of investment funds, the E.P.B. continually updated input-output tables in order to improve sectoral-model demand projections from which investment allocation by sectors was guided. The allocation of investment funds could be relatively and easily manipulated by the E.P.B. principally because all major financial institutions were owned and under direct control of the government.⁴⁹ Government control over financial institutions was the primary mechanism that the Korean government utilized to facilitate the implementation of economic plans. Without the capacity to control investment allocation patterns, the implementation of centrally devised economic development plans would have faced severe constraints. A principal reason for the successful implementation of Korean development plans has been the ability of the government to channel funds directly in a pattern that fits targeted sectoral development.

In implementation of the second five year plan, the Korean economy exceeded all major targets. The GNP growth rate averaged 9.6 percent rather than the targeted 7 percent. The manufacturing sector grew at an annual rate of 21.8 percent, doubling the 10.7 percent targeted. Exports grew at an annual rate of 33.8 percent, which doubled the targeted 17.1 percent. Fixed investment was targeted at a 10.2 percent annual increase, but it actually grew at a rate of 17.9 percent a year. Domestic savings for 1971, the last year of the second plan, were targeted at 11.5 percent of GNP, but they actually reached 14.6 percent of GNP and averaged 14.5 percent per annum over the course of the plan.⁵⁰

49. Kim Seung-hee, op. cit., p. 164.

50. Economic Planning Board, Major Statistics of Korean Economy, (Seoul: Economic Planning Board), 1985.

The second five year plan was led by the rapid growth of labor intensive export industries which allowed the export sector to grow from \$175 million in 1965 to \$1.13 billion in 1971. These increased export earnings allowed the state to increase funding to targeted heavy and chemical import substitution industries. During the second five year plan, several major import substitution industries were initiated, laying the groundwork for future expansion of heavy and chemical exporting sectors. As mentioned previously, two oil refining facilities and a petrochemical complex were undertaken early in the plan period as sufficient capital was available as well as sufficient internal demand. An iron and steel complex was begun later in the plan period as Japanese capital in grants and "soft term" loans became available to Korean planners as a result of the diplomatic normalization treaty that was signed between Japan and Korea in 1965. As terms of the treaty, Japan agreed to transfer to the Korean government \$300 million in grants, \$200 million in the form of public loans, and \$300 million in commercial credits over a ten year period beginning in 1966.⁵¹ In 1969, the Japanese government extended \$123 million of these grant and loan funds to the Korean government for the construction of the Pohang Iron and Steel Complex.⁵²

With the Pohang Complex under construction in the early 1970's, the Korean government fostered a plan to begin to develop an automobile industry. The plan called for a staged development of the industry, first developing a capacity to build a few parts and an assembly line to put together imported engines and drivetrains, then slowly expanding production capacity as domestic technological knowhow

51. Chang Dal-joong, op. cit., p. 50.

52. Ibid., p. 55.

expanded. By the late 1970's, Korean automobile producers had expanded to full automobile production, and in the 1980's this original import substitution industry began to export its product.

Also, in the early 1970's, a shipbuilding industry development plan was formulated by government planners and funds were allocated by the government to finance its development. Both the automobile and shipbuilding development plans were targeted for development by the government in order to increase demand for the newly created government owned and operated Pohang Iron and Steel Complex, to meet domestic demand for cars and ships, to create jobs, and to eventually become export producers and foreign exchange earners.

In addition to the automobile and shipbuilding industry development plans, the Machinery Promotion Law was enacted during the period of the second five year economic development plan. The Machinery Promotion Loan Fund was established in conjunction with the Machinery Promotion Law in order to provide financing for the development of this sector. At this time the government also enacted the Electronic Industrial Promotion Law to develop the electronic industry. The Electronic Industrial Promotion Law targeted the development of electronic consumer goods as an import substitution industry. However, the law also contained significant economic incentives to producers to diversify electronic goods production and to increase the quality and value added of their products in order to establish a Korean electronic goods export sector.⁵³

As a result of state initiatives to channel financing and to provide other incentives to heavy and chemical sectors, these sectors accounted for 44.3 percent of manufacturing output and 40 percent of

53. Park Sung-jo, et al., op. cit., p. 47.

total manufacturing exports by 1971, as compared to 34.8 percent and 27.8 percent respectively in 1965, the base year of the second five year plan.⁵⁴ The development of these heavy and chemical industries was initiated by direct state involvement. The government targeted industries where state planners perceived adequate domestic demand could be generated to justify a given project and then allocated investment funds for the project. The state constantly monitored the implementation of projects and targeted forward and backward linkage industries to augment demand and to eliminate bottlenecks and other inefficiencies as they developed.

✓ The third five year plan was enacted in 1972. The third plan continued to place emphasis on the further development of the heavy and chemical industries and on export promotion. The plan targeted a 8.6 percent GNP growth rate, with manufacturing growth targeted at 13.3 percent. Total investment was targeted at 24.9 percent of GNP with domestic savings equalling 19.5 percent of GNP and foreign savings equalling 5.4 percent. The investment shares were to be allocated 11.8 percent to agriculture, 25.8 percent to mining and manufacturing, and 62.4 percent to social overhead and other services. By 1976, all targets, except the domestic savings rate, were exceeded. Despite the worldwide recession during the plan period, Korea sustained a 9.7 percent GNP annual growth, with manufacturing growing at a 19 percent rate. Domestic savings during the plan period only equalled 17 percent of GNP. With petrodollars being available on international capital markets, Korea increased its foreign borrowing, and foreign savings increased to 11.8 percent of GNP. Investment

⁵⁴. Economic Planning Board, Major Statistics of Korean Economy, (Seoul: Economic Planning Board), 1985.

Table 3.2
Economic Structure and Growth Rate by Sector

Year	<u>Economic Structure</u>					<u>Growth Rate by Sector</u>		
	<u>GNP</u> <u>growth</u> <u>rate</u>	<u>GNP</u> <u>per</u> <u>capita</u>	<u>Agri.</u> <u>& Fish.</u>	<u>Mining</u> <u>& Manufac.</u>	<u>Service</u>	<u>Agri.</u> <u>& Fish.</u>	<u>Mining</u> <u>& Manufac.</u>	<u>Service</u>
1964	9.6	103	46.8	17.3	35.8	15.6	10.5	3.5
1965	5.8	105	38.0	20.0	41.9	- 1.0	18.3	9.7
1966	12.7	125	34.9	20.5	44.6	11.6	15.3	13.0
1967	6.6	142	30.6	21.0	48.4	- 5.6	20.2	14.6
1968	11.3	169	28.7	21.6	49.7	1.3	23.4	15.3
1969	13.8	210	27.9	21.7	50.4	10.5	19.2	14.2
1970	7.6	243	26.5	22.4	50.7	- 1.4	19.6	9.5
1971	8.8	285	26.7	22.2	51.0	3.1	16.5	9.4
1972	5.7	316	26.4	23.1	50.5	2.9	12.9	4.8
1973	14.1	396	24.5	25.8	49.7	6.2	28.7	13.0
1974	7.7	535	24.5	26.4	49.0	7.4	14.7	5.1
1975	6.9	591	24.4	27.1	48.5	4.9	12.2	5.6
1976	14.1	800	23.5	28.4	48.1	9.4	22.0	12.8
1977	12.7	1028	22.0	28.6	49.4	2.6	15.7	15.8
1978	9.7	1406	20.2	29.2	50.6	- 9.2	20.2	12.1
1979	6.5	1662	18.5	28.7	52.8	6.7	9.3	5.0
1980	- 5.2	1605	14.2	29.7	56.1	- 21.7	- 1.5	- 1.8
1981	6.2	1735	15.8	29.5	54.1	24.5	7.6	0.6
1982	5.6	1800	14.5	28.8	56.6	4.1	3.6	7.3
1983	9.5	1884	13.9	28.8	57.3	6.3	10.8	9.8
1984	7.6	1998	13.6	29.9	56.6	0.4	14.4	5.9
1985	7.5	2159	12.8	30.5	56.7	4.8	3.9	7.8

Source: Economic Planning Board. Major Statistics of Korean Economy, various years.

allocations very closely matched plan targets. Actual allocations of investment funds saw 11.5 percent of total investment go to agriculture, 25.8 percent to mining and manufacturing, and 62.7 percent to social overhead and other services.⁵⁵

✓ In conjunction with the third plan, the government enacted the Heavy and Chemical Industry Development Plan in 1972. This plan called for intensive efforts to improve technology and output in iron and steel, electronics, petrochemicals, shipbuilding, automobiles, and machine tools. The government established the National Investment Fund which mobilized public employee pension funds and a substantial share of private savings in government controlled savings banks. These funds were managed by state controlled banks and channeled into heavy industrial projects favored by the government at very low interest rates which in most cases became negative in real terms.⁵⁶ With these attractive financial arrangements and other government granted privileges such as tax incentives and low cost utility rates, private industry was induced to expand the heavy and chemical sectors further.

✗ This government initiative was not without other economic costs. The low interest rates for capital intensive heavy and chemical projects created a chronic excess in demand for available financial capital. This stimulated the expansion of the money supply and added to inflation, which in turn increased labor costs and hurt the international competitiveness of Korean labor intensive exports. An overestimate of world trade prospects by government planners led to

55. Economic Planning Board and other government sources as cited in Leroy P. Jones and Il Sakong, op. cit., p. 54.

56. Kim Ki-hwan, The Korean Economy, (Seoul: Korea Development Institute, 1985), pp. 11-12.

excessive investment into shipbuilding and created structural imbalances in the heavy industry as a whole. In the late 1970's, Korean heavy industry was producing under capacity due to overestimated demand. These financial policies favoring heavy and chemical sectors also limited available funds for technological advancements in textile, footwear, and other light industrial sectors. The low interest rates offered to heavy and chemical sector investment required the government to reduce the interest rate that the state banks paid on savings, thereby causing the national savings rate to decline slightly.⁵⁷ Despite these inefficiencies, the government did successfully induce industry into targeted sectors, and heavy and chemical output increased rapidly. Between 1971 and 1976, the period of the third plan, steel output capacity increased from 911 to 4,530 thousand metric tons; the shipbuilding industry increased its capacity from 190 to 2,600 thousand gross tons; and petroleum refining capacity increased from 265 to 435 thousand B.P.S.D.

In the shipbuilding sector, the Hyundai yard was opened in 1974, and shortly after it was followed by the opening of the Daewoo and the Samsung yards. Services were continually expanded in conjunction with the government shipbuilding development plan. By 1980, services included shipbuilding, repair, conversion, offshore oil structures, and construction of dredging equipment. By 1985, Korean shipbuilding services were among the most efficient and technologically advanced in the world, generating over \$5 billion dollars of foreign exchange, approximately 16.7 percent of total Korean exports.⁵⁸ This made Korea the second largest ship exporter in the world.

57. Ibid., p. 12.

58. The Korea Herald, "Trade and Industrial Supplement," May 4, 1986.

The steel industry grew at an annual rate of 12.9 percent between 1965-1980, and a 7.5 percent rate from 1980 to 1985. Except for specialty steel, all domestic demand for steel in the automobile, shipbuilding, machinery, and construction markets is now satisfied by Korean producers. In 1983, 13.7 million metric tons of steel were produced in Korea.

In the petrochemical sector, the government was heavily involved in the planning and construction of the first plant in 1968. This plant was targeted in the second five year plan as an import substitution industry. Subsequent petrochemical plants were targeted by the government but owned and developed by private industry. By 1972, six different petrochemical plants and a naphtha cracking center were operational. By 1985, the petrochemical sector included 25 enterprises, 36 production sites, 2 naphtha crackers, and 3 aromatic extraction plants. All of these enterprises were granted various government privileges as initial inducements. Total petrochemical production in 1968 was \$4 million. By 1984, this production was valued at \$2.5 billion. In 1968, 88 percent of petrochemicals used in Korea were imported. By 1984, the import share for domestic demand of petrochemicals equalled only 28 percent or \$840 million.⁵⁹

The industrial machinery sector has also increased significantly, even though important high technical machinery sectors are still largely dependent on imports. Notwithstanding, the Korean machinery industry, guided by government policy, has shown marked increases in output. In 1970, the output of industrial machinery amounted to approximately \$20 million. This was 29 percent of the total output of general machinery and less than .5 percent of

59. Ibid.

manufacturing output. In conjunction with the Heavy and Chemical Industry Development Plan in 1973, the government encouraged the promotion of the machinery industry by providing low cost funds and by assisting producers to identify and license appropriate technology in this sector. By 1984, the machinery industry total output exceeded \$12 billion. In 1984, export of industrial machinery exceeded \$1 billion or 3.7 percent of total export. Between 1980 and 1984, the export of industrial machinery increased almost 20 percent annually.⁶⁰

The Korean development of the heavy and chemical sectors was primarily the result of government planning and government guided implementation of plans by orienting financial and other state incentives to these targeted sectors. By 1985, Korea was relatively self-sufficient in these sectors. Heavy and chemical manufactures equalled 55 percent of total manufactured output, and almost 50 percent of Korea's \$30 billion dollars of exports were heavy industrial or chemical products.

Another major objective of the third five year plan was to develop the rural sector of the economy. The rural sector had continuously received increased investment funds in absolute terms during the first two plans, but these relatively minor increases were totally overshadowed by the investment levels in social overhead and manufacturing. This discrepancy in investment levels caused the growth rate of the rural sector to lag far behind manufacturing. By 1971, income levels in urban areas far exceeded those of rural areas. The neglect of the rural sector created social, economic, and political problems for the government.

Socially, it created conditions for an increasing discrepancy in income distribution, which, in turn, triggered a massive migration

60. Ibid.

from farming to industrial areas as people sought higher income levels. The overall population increased from 25 million in 1960 to 36.4 million in 1977, a 46 percent increase. However, during the same period, urban population increased over 236 percent from 9.3 million to 22 million.⁶¹ This migration level exceeded the rate by which jobs were being created, and the urban areas became overcrowded with unemployed people.

Economically, the rural sector could not meet domestic demand in food grains. An achievement of self-sufficiency in food grains, which government planners perceived to be within the capacity of the Korean rural sector, would allow for the discontinuance of grain imports, thereby aiding the balance of payments and freeing foreign exchange for the importation of needed manufacturing equipment. By 1971, P.L.A. 480 grain aid shipments from the United States had almost been eliminated, and Korea was paying world market prices for most imported grains. Imported grains at market prices were becoming a large drain on foreign reserves.

Politically, the Pak government, as with the Rhee government, enjoyed its greatest political support from the rural population. Urban areas were the principal areas of political opposition. However, Pak's industrialization program gave little return to rural areas, and his political support in these areas was decreasing, while unemployment was fanning opposition in urban areas. For social, economic, and political reasons, the gap between urban and rural development needed to be rectified by 1971.

The third plan identified self-sufficiency in food grain as a goal and the development of the rural sector as a strategy. Under the

61. Hakan Hedberg, The New Challenge: South Korea, (Seoul: Chongno Book Center Company, 1978), p. 28.

second plan, 9.5 percent of investment went to agriculture, but the growth rate of the sector was less than 3 percent. The third plan allocated 11.8 percent of investment to agriculture. In conjunction with this increase, the state bureaucratic-structural mechanisms were altered to develop the rural sector. The Saemaul-Undong (New Village Movement) was initiated in 1971. Under central government direction, Saemaul-Undong established agricultural extension centers throughout the country. These extension centers, with local government support, introduced new lines of seeds and fertilizers to farmers, designed new drainage and new irrigation systems for crop fields, introduced better livestock care techniques, designed new portable water systems in villages, aided in electrification programs, created rural education centers, and suggested new crops that farmers could market. The government offered expertise, construction equipment, and needed materials. The local residents provided the labor.

In a true "hard state" fashion, the central government penetrated all areas of the rural sector, providing capital, knowhow, and equipment. State bureaus were established to organize the rural population and to implement policy using rural labor. The movement was heavily promoted by the state, and all village leaders were either attracted to the movement by the opportunity it offered, or were otherwise heavily pressured by the government to join the movement. The movement was very successful at mobilizing the rural population and in improving rural living standards and agricultural output in a relatively short period of time. The movement program greatly increased per acre productivity in both paddy fields and up-land areas.⁶² During the plan period, from 1971 to 1976, rice yields

62. Park Sung-jo, et al., op. cit., p. 51.

Table 3.3
Composition of Exports: 1964 - 1984

	<u>Total exports</u> <u>in \$1,000,000</u>	<u>Manufactured</u> <u>goods as % of</u> <u>total export</u>	<u>Light Industry</u> <u>products as % of</u> <u>total export</u>	<u>Heavy & Chemical</u> <u>products as % of</u> <u>total export</u>
1964	119.0	54.9	45.5	9.4
1965	175.0	62.3	51.7	13.7
1966	250.3	62.4	56.3	10.2
1967	320.2	70.0	63.8	8.6
1968	455.4	77.3	69.6	9.0
1969	622.5	79.0	67.8	13.5
1970	835.2	83.6	69.6	12.8
1971	1,067.6	86.0	72.0	14.2
1972	1,624.1	87.7	66.5	21.3
1973	3,225.0	88.2	63.4	23.8
1974	4,460.4	90.2	54.1	32.5
1975	5,081.0	88.3	57.4	29.5
1976	7,715.3	89.8	58.7	29.1
1977	10,046.5	87.5	53.6	32.2
1978	12,710.6	89.8	54.5	34.7
1979	15,055.5	90.1	51.4	38.5
1980	17,504.9	92.3	49.4	41.5
1981	20,992.6	92.9	49.3	45.3
1982	21,616.1	93.7	45.0	50.8
1983	24,222.5	94.4	41.1	54.8
1984	29,245.0	96.0	40.8	55.3

Source: Economic Planning Board. Korea Traders Association.

increased from 3,998 to 5,215 thousand metric tons annually. Irrigated rice fields were increased from 81 percent to 86 percent of total fields. The use of mechanical cultivators increased from a total 17,000 to 128,000. Rural electrification increased from 856,000 households to 2.3 million. In 1971, 33.2 percent of rural homes had electricity; by 1976, 90.7 percent were with electricity. Over 2 million homes were given roofing and heating improvements during the third plan. Total farm household income increased over 30 percent in real terms between 1972 and 1976. Diseases which are most common in rural areas showed significant declines largely due to better nutrition, improved housing conditions, and the development of rural health centers. Tuberculosis prevalence declined from over 4 percent to 3 percent; parasitic infection declined from 55.4 percent to 40 percent; and infant mortality rates dropped from 50 in 10,000 to 40.⁶³

The Saemaul-Undong, with other related agricultural reforms, allowed for agricultural output levels to reach self-sufficiency in most major food grains in years when climatic conditions are normal. This has aided the balance of payments situation and allowed for significant increases in rural living standards. This has also led to increased political stability in rural areas. There is no major political dissent directed against the government in rural areas.

The fourth five year plan (1977-1981) was similar to the previous plans in that it aimed at high growth rates financed principally by export expansion in all manufacturing sectors. The plan called for limiting consumption and increasing the level of

63. Economic Planning Board, A Handbook of Korea, 1980. For more detailed information on the Saemaul-Undong, see: Michael Keon, Korean Phoenix: A Nation From the Ashes, (Englewood Cliffs, New Jersey: Prentice Hall International, 1977), pp. 93-102, or A Handbook of Korea (Seoul: Korean Overseas Information Service, Ministry of Culture and Information, 1983), pp. 599-634.

domestic savings, and it aimed at achieving an equilibrium in balance of payments in order to decrease foreign capital dependencies. The plan also called for the heavy and chemical industries to "mature," that is, to reach a level of self-sustaining growth so that the privileges of being a target industry -- low financial terms, tax breaks, monopoly rights, and cheap utilities -- could be withdrawn from these sectors. This would allow for the targeting of new higher technology sectors for development in the next five year plan. These policies were, for the most part, successfully carried out during the fourth plan period. When the fifth five year plan was implemented in 1982, heavy and chemical industries were no longer receiving the special privileges of a "target" industry (although domestic market protection and monopoly or oligopoly of market share were common in all heavy and chemical sectors), and sectors such as computer electronics, fiber optics, digital machinery, and other "hi tech" industries were receiving substantial government granted privileges to induce their development.

During the fourth five year plan, the second oil shock of 1979 significantly slowed down Korea's economic growth. Korea had to pay higher levels of foreign exchange for imported energy than had been planned, and depressed markets in Western countries reduced the demand for Korean exports. Further constraining Korean economic growth during the period was the assassination of Pak Chung-hee in October 1979. Following the assassination a year of political instability, marked by violent clashes between factions within the military as well as between the military and society, led to a marked decline in all economic indicators. In 1980, the GNP declined 5.2 percent; industrial production, 1.8 percent; and domestic savings, 8 percent.

Despite this severe setback in 1980, over the period of the fourth plan, GNP averaged a 5.8 percent annual increase and manufacturing output grew 10.5 percent annually.⁶⁴

During the fourth five year plan, fixed investment grew 10.1 percent to equal 29.4 percent of GNP by 1981. Of total investment over the entire plan period, 78.4 percent was formulated domestically. Looking at the financing during the twenty year period that covers the first four five year plans, one finds a major shift in the structure of investment sources. During the first five year plan, less than 47 percent of investment capital was domestically formulated. During the second plan, 60 percent of investment came from domestic sources. During the third plan, 76 percent of investment was domestically formulated.⁶⁵ Here, during a period of rapid industrialization, there is a general trend toward self-sufficiency in capital investment. A movement toward self-generated economic growth had taken place.

The fifth five year plan, 1982-1986, was planned and implemented under the government of Chun Doo-hwan. Chun had been a Major General when Pak was assassinated in 1979. In the following year, he led a coup and became the president of the country. With Chun's rise to the power, most military and political leaders under Pak Chung-hee were purged from the government and replaced by those who were perceived to be loyal to Chun. However, the leadership in the economic oriented bureaucracies remained stable. The fifth five year plan remained similar to previous plans in that it emphasized high economic growth rates (targeted at 7.6 percent annually) driven by export expansion.

⁶⁴. Economic Planning Board, Major Statistics of Korean Economy, (Seoul: Economic Planning Board), 1985.

⁶⁵. Ibid.

✓ The difference between the fifth and the previous plans was that the fifth plan targeted highly technical sectors for development and attempted to balance growth by developing the small and medium industrial sectors. Financial and technical support systems were targeted to be altered to facilitate the growth of independent research and development institutes and to aid small and medium businesses. The fifth plan also called for the focus of economic management to be gradually altered to reduce the level of government control over economic activity by encouraging liberalization of market mechanisms in the banking and import sectors. Korean government planners recognized that as the economic structure became more complex, there was a diminishing return in the efficiency of strict sectoral planning. The contemporary Korean economy with a GNP per capita at \$2,000 and a wide diversity of production capacity could not ✓ be as efficiently managed by the government as the more simplistic economic structures of the past.

At the early stages of industrial development, centralized economic decision making tended to have advantages over free market mechanisms in facilitating the efficient accumulation and allocation of scarce resources to develop basic industrial sectors. At early stages of industrial development, Korean planners argued that strict government control of financial resources, in conjunction with effective planning, would act as a stimulus to accelerate growth. However, as the economy developed and became more complex, central ✓ economic decision making became increasingly less efficient. At this more advanced stage of industrialization, when infrastructure was relatively developed and basic industries were operational and competitive, the increased use of market mechanisms would encourage

increased competition, technical innovation, and efficient resource utilization, while a centrally controlled economy would tend to encourage structural imbalance. Recognizing the constraints of planning sectoral growth in a relatively diversified economy, Korea's fifth five year plan relied less on numerical targets and tended to emphasize the development of highly technical industries through increased government research and development funding to private industry. The fifth plan allowed a greater level of private sector involvement in determining the flow of financial resources as the market was being allowed to play a larger role in determining new projects and the expansion of present projects.

Here, we have examined the role of central economic development planning in the Korean industrialization process. However, planning can only provide guidelines to follow. It can not, of course, assure development of the economy. The real issue of economic development is not only effective planning, but also the means by which the plan is implemented. If government planning is to alter the economic situation of a nation, the plan must be reflected in the actions of industrial enterprises. State institutions must develop mechanisms that facilitate the implementation of development plans by mobilizing necessary resources and effectively allocating those resources to develop planned industries. A major characteristic of Korean economic development has been the state's ability to accumulate and effectively allocate resources in accordance with the objectives of development plans.

2. Financial Institutions and Policies that Coordinate Capital Accumulation

In Japan, the central bank was established and placed under the direct control of the Ministry of Finance in 1882.⁶⁶ The central bank was mandated to coordinate monetary policy with the industrialization goals of the government. Shortly after the establishment of the central bank, specialized banks were created. According to the Minister of Finance at that time, Count Matsukata, a sound financial system in Japan required the existence of banks with specialized functions to handle foreign exchange transactions, to provide long term financing in order to develop industry, agriculture, and domestic commerce, and to mobilize the domestic savings of the lower economic classes. The Yokohama Species Bank was established to control foreign exchange transactions and was closely supervised by the government. The president and the vice-president of the bank were required to be authorized by the Minister of Finance prior to their appointment and were accountable directly to him. Once the Yokohama Species Bank was in operation, the government established subordinate financial institutions that would work in conjunction with the species bank and provide long term financing at low rates for the development of industries targeted by the government.

In 1900, the Industrial Bank of Japan was established specifically to provide long term loans to develop state planned industries. The Industrial Bank loans were, for the most part, issued to new large scale industries targeted by government planners, such as

66. Information on financial institutions and organizations in Meiji Japan is taken from: G.C. Allen, A Short Economic History of Modern Japan, (London: Unwin, Ltd., 1972, 3rd ed.), chapter III, "Financial Foundations, 1881-1914," pp. 47-60.

public utilities, iron and steel production, shipbuilding, railways, chemical industries, machinery production, and other industries deemed by the government as necessary for Japan's industrialization process or for national security purposes. The Industrial Bank also served as a channel for foreign capital inflows into Japan and was responsible for distributing foreign capital loans to Japanese industry and for raising funds abroad through the sale of its own debentures and those of other Japanese public undertakings. The government also established commercial banks in all prefectures of the country and guaranteed bank debentures. These government controlled commercial banks were designed to mobilize savings by taking deposits and paying government established interest rates and by issuing national bonds and bills of exchange. The commercial banks were intended to mobilize the savings of all classes of people and to place them directly under government control.

These specialized banks were organized and controlled directly by the Ministry of Finance. The Minister of Finance approved the appointment of all high level bank officers and could dismiss them at his discretion. These specialized banks became instruments of national purpose which facilitated the mobilization of capital and allocated those resources in accordance with government industrialization plans. Over the years, the Japanese industrial firms (zaibatsu) developed their own banks, and the role of government owned and controlled banks was greatly reduced. However, at the beginning of the industrialization process when organized savings necessary for the financing of major new industries needed to be generated, the state intervened directly to mobilize and allocate capital to facilitate its goal of industrialization.

In Korea, from 1945 to 1963, the formal financial sector showed no significant growth. The size of the formal financial sector was relatively small in comparison to the unregulated, or curb, money markets. A few savings banks and a few life insurance companies were the only financial intermediaries serving the nation's formal financial needs. The normal rate of interest on bank time deposits were kept at 12 percent per year during the 1950's.⁶⁷ These rates were not only very low compared to the rates of 25-35 percent paid on the curb market, but also negative in real terms when adjusted for inflation. This provided very little incentive for the generation of domestic savings.

By 1963, the military government had solidified its power base and had begun to pursue an active industrialization policy. In order to finance industrial development plans, the government implemented major changes in the organized financial sector. It was following these changes that Korean domestic savings began to increase. The most significant financial policy changes were the reorganization of the banking structure, the reform of government fiscal policy, the restructuring of interest rates, and the tax mobilization reform. These financial reforms were largely responsible for the significant increase in domestic savings levels, which, in turn, led to increased investment. These state implemented financial policy reforms became an important instrument of the state in its pursuit to implement development plans.

Under the Rhee government, gross domestic savings were negligible. Investment was financed largely by net transfers from foreign interests, principally foreign aid. In 1956, gross domestic

67. David Cole and N. Lyman, op. cit., p. 262.

savings equalled 2.9 percent of GNP; in 1959, 3.6 percent; and in 1960, .1 percent. A significant turnaround occurred after 1965. In 1966, gross domestic savings increased to 11.8 percent of GNP; in 1969, 18.8 percent; and by 1973, to 22.8 percent of GNP. This growth in savings can be attributed to both private and government savings increases. Private savings grew after interest reform measures in 1965 from .2 percent of GNP in 1965 to 7.1 percent in 1969. Government savings increased from approximately 4 percent of GNP in 1965 to over 7 percent in 1969.⁶⁸

Shortly after taking power in 1961, the military government reorganized the structure of financial institutions in order to take control of principal financial transactions and to finance the first five year plan more effectively. Under the "Illicit Accumulation of Wealth Law," all commercial banks became the property of the state and placed under the direct control of the Ministry of Finance. The Bank of Korea, the central bank of Korea which was established by the Bank of Korea Act of 1950, had its charter amended in 1962. This amendment strengthened government control over the bank's monetary policy. Under the 1950 act, the Bank of Korea was relatively autonomous of government influence. The 1962 amendment placed the Bank of Korea under the control of the Monetary Board. The Monetary Board was to be chaired by the Minister of Finance, and all other members were appointed by the president or by the Ministers of Agriculture, Commerce and Industry, or the E.P.B. To assure government control of the Monetary Board, any requests of the Minister of Finance that was rejected by a majority of the board would revert to the president for

68. Shahud Yusuf and R. Kyle Peters, Savings Behavior and Its Implications for Domestic Resource Mobilization: The Case of the Republic of Korea, (Washington, D.C.: World Bank Staff, Working Paper No. 628, 1984), pp. 4-8.

a final decision. The 1962 amendment, in effect, placed the central bank under the control of the Ministry of Finance in cooperation with the president and assured that the central bank followed central government financial policy.

Between 1962 and 1965, a series of specialized banks were established much in the same manner that Count Matsukata had established the specialized banks in Meiji Japan. These Korean specialized banks were designed to provide special financial support to the development of "strategically" important industrial sectors. These specialized banks included the National Agriculture Cooperative Federation to provide comprehensive services to farmers, the Small and Medium Industry Bank to provide the financing for smaller industries, and the Citizens National Bank to aid capital mobilization in all areas of the country. In 1967, the government established the Korean Exchange Bank. The Korean Exchange Bank was designed to attract foreign currency which would be utilized to facilitate the financing of the expanding export sector. The Korean Development Bank was reorganized in 1962 and designed to make loans to long term investments promoted by the government, particularly to infrastructure development and capital intensive targeted industries. In order to assure that loan funds were utilized as intended, loan proceeds were transferred into a credit control account in the name of the borrower and could only be withdrawn when documentation was produced to assure the proper use of the funds.⁶⁹ In 1974, the National Investment Fund was established and managed by state controlled banks to assist the financing of chemical and heavy industries under the third five year plan.

69. Business Korea, September 1984, pp. 51-55.

The restructuring of financial institutions and the creation of specialized banks were carried out under central government initiative and control. The purpose was to formulate capital, both domestic and foreign, and to channel these funds to designated sectors and projects targeted by government development plans. Loan decisions in Korea are only to a very limited extent made by financial institutions. Rather, bank credit is extended to enterprises recommended by the government. Financial institutions act principally as instruments to allocate resources to government preferences. The government can control financial institution allocations by the Minister of Finance's control over the appointment and removal of top level financial institution management.⁷⁰

Failure to mobilize domestic savings had been an outstanding negative characteristic of the Korean economy prior to 1963. The low per capita income, high inflation rate, low interest rates, and excessive government deficit spending resulted in the low domestic savings rate. However, to implement the aggressive development plans of the government, significant increases in investment levels would be necessary. There was general agreement on the part of government planners that the combination of inflation and low ceilings paid on savings by the financial institutions were the principal disincentives to savings.⁷¹ In an attempt to increase domestic capital formation, the Pak government implemented reforms intended to increase both private and government savings. Interest rate reforms were implemented to increase private savings, which equalled only 4.7 percent of GNP in 1960. Fiscal and tax collection reforms were

70. Leroy P. Jones and Il Sakong, op. cit., p. 102.

71. David Cole and N. Lyman, op. cit., p. 178.

implemented to increase government savings which were -2 percent of GNP in 1960.⁷²

In its attempt to increase private domestic savings, the government implemented an interest rate reform in October 1965. This interest rate reform raised interest rates paid at government controlled commercial banks from 9 percent to 18 percent on three month deposits, and from 15 percent to 30 percent on 12 month deposits. The rediscount rate of the Bank of Korea was raised from 11.5 percent to 21 percent, and other securities were raised from 16 to 23 percent.⁷³ The level of increase in interest rates was arrived at principally by comparison with the prevailing interest rate paid by the curb market and set slightly lower. The government expected that the new rates would attract funds from the curb market principally due to the fact that bank deposits would be less risky. It should be noted that there was a saving tradition in Korea prior to 1965. The unofficial financial market, or curb market, which paid interest rates often exceeding 5 percent per month was very active. This unofficial market was the primary source for domestic financial funds prior to 1965. However, these funds tended to finance consumer goods production and were beyond government control, thereby not being adequately channeled into government priority investments.

The response to the increased interest rates was greater than government officials anticipated. Total time and savings deposits increased 25 percent during the first month after the reform. These same deposits increased 300 percent the first year and doubled again

72. For a more detailed analysis of financial policy in Korea during the 1960's, see: Gilbert T. Brown, Korean Pricing Policies and Economic Development in the 1960's, (Baltimore: Johns Hopkins University Press, 1973).

73. Kim Seung-hee, op. cit., p. 175.

Table 3.4
Investment and Savings (in percent of GNP)

	<u>Investment</u>	<u>Domestic Sav.</u>	<u>Foreign Sav.</u>	<u>Statistical Discrepancy</u>
1960	10.9	0.8	8.6	1.5
1961	13.2	2.9	8.6	1.7
1962	12.8	3.3	10.7	- 1.2
1963	18.1	8.7	10.4	- 1.0
1964	14.0	8.7	6.9	- 1.6
1965	15.0	7.3	6.4	1.3
1966	21.6	11.8	8.5	1.3
1967	21.9	11.4	8.8	1.7
1968	25.9	15.1	11.2	- 0.4
1969	28.8	18.8	10.6	- 0.6
1970	26.8	17.3	9.3	0.2
1971	25.1	14.6	10.5	0.1
1972	22.2	16.5	5.1	0.6
1973	25.7	22.8	3.7	- 0.8
1974	31.7	19.9	12.1	- 0.4
1975	30.0	19.1	10.1	0.8
1976	25.6	23.6	2.3	- 0.5
1977	27.7	27.5	0.6	- 0.3
1978	31.2	28.5	3.1	- 0.4
1979	35.6	28.1	7.1	0.4
1980	31.3	21.9	9.4	0.0
1981	29.1	21.7	7.7	- 0.2
1982	27.0	22.4	4.5	0.1
1983	27.8	24.8	2.9	0.1
1984	30.0	27.4	2.3	0.2

Source: Economic Planning Board. Bank of Korea.

the following year. By 1967, these private bank deposits equalled 6 percent of GNP. Real time and saving deposits had not increased between 1960 and 1965 but rose 372 percent between 1965 and 1967.⁷⁴

These interest reform measures significantly increased savings in the official money markets, aiding the financing of government development plans. However, this reform was not without its limitations. Interest rates on loans to targeted industries remained lower than interest rates paid on time deposits. This required the government to ration loans to selected investors in targeted sectors, allowing for an increase in the possibility of corruption in the allocation of loans. It also required the government to subsidize the difference between interest paid on deposits and interest paid on the loans. This fueled inflation, and due to the lack of profit incentives, it led to inefficiency in the banking sector. In addition, even with this significant increase in private savings, domestic capital formation remained at inadequate levels to finance the totality of the ambitious government industrialization plans. However, these problems did not negate the significant increase in private domestic capital formation that entered formal financial institutions and became available to finance government economic objectives.

In order to increase government savings, fiscal reforms were implemented. Between 1962 and 1964 government spending was radically cut. In 1962, government spending exceeded 25 percent of GNP. By 1964, it equalled less than 11 percent of GNP. Not including investments and capital loans by the government, by 1966 the Korean government budget was at a surplus as opposed to a 8 percent of GNP

74. David Cole and N. Lyman, op. cit., p. 180.

deficit in 1962. Balancing the national budget also contributed significantly to curbing the inflation rate.

Table 3.5
Government Revenues, Expenditures, and Investment
(in percent of GNP)

	<u>1962</u>	<u>1964</u>	<u>1966</u>	<u>1968</u>	<u>1972</u>	<u>1976</u>	<u>1980</u>	<u>1984</u>
Central gov't taxes	9.3	5.9	9.2	12.7	11.5	15.1	15.6	16.1
Local taxes	1.5	1.2	1.6	1.2	1.1	1.6	2.1	2.3
Total current revenue	10.8	7.1	10.8	13.9	12.6	16.7	17.7	18.4
Central gov't expenditure	12.6	4.8	5.8	4.0	6.3	3.2	3.2	4.5
Defense	5.9	3.5	3.9	3.9	4.4	5.1	6.2	5.3
Sub-total	18.5	7.3	9.7	7.9	10.7	8.3	9.4	9.8
Development investment	6.8	3.3	4.0	8.0	6.2	7.1	8.0	7.3
Total expenditure	25.3	10.6	13.7	15.9	16.9	15.4	17.4	17.1

Source: Economic Planning Board.

The government also implemented measures to increase tax revenues in an effort to increase public savings. The government altered tax structures in a 1962 tax reform law, and over the next three years it reorganized tax collection agencies. In July 1966, the government established the Office of National Taxation headed by a member of the 1961 coup junta. The Office of National Taxation centralized all tax collection functions. In order to increase the efficiency of tax collection, the Office of National Taxation established tax collection quotas and then allocated these quotas to regional, district, and individual tax offices and officers. A system of rewards and punishments was maintained for individual tax collectors as well as offices. These measures rapidly improved tax collection administrative efficiency. Tax evaders were arrested and prosecuted, while high tax payers were given awards of public recognition for their "contribution" to national development plans. The president supported the Office of National Taxation and protected

it from political and economic pressures to assure its functional efficiency.⁷⁵ During the second five year plan (1967-1971), government savings accounted for over 20 percent of total investment. This increase in government financing was directly due to tighter fiscal policy and increased tax collection.

Korea's rapid economic expansion in the 1960's and 1970's was led by significant increases in export production financed principally by domestic savings channeled through government controlled financial institutions. As Cole and Lyman pointed out, "An export drive in a resource poor country such as Korea, which is very dependent on imported intermediate and capital goods, can be easily undercut by domestic inflation or a balance of payments squeeze, unless accompanied by corresponding increases in domestic savings or foreign capital inflows. Without these parallel developments in resource mobilization, the export expansion can easily be choked off by rising prices and wages. The financial reforms of 1965 contributed to (Korea's) domestic stability by raising domestic savings."⁷⁶ Brown concluded that it was the shift in government economic policies and their effective implementation that released the potential for economic growth in Korea.⁷⁷ These alterations in economic policy created opportunities of which the private sector could take advantage. The reorganization of financial institutions and the creation of specialized banks by the state established the institutional means for increasing private savings, and placed financial institutions under close government control so that the

75. Ibid., p. 117.

76. David Cole and N. Lyman, op. cit., p. 268.

77. Ibid., pp. 267-268.

allocation of funds could fit government development planning. The interest reform increased private savings and placed it under government control. A balanced government budget and increased tax collection created a government surplus that could be utilized to finance productive investment. These state-lead policy reforms significantly led to the rapid rise in domestic capital formation and became major contributory factors in Korea's industrialization process at the critical early stages of economic transformation.

3. The Effective Allocation of Resources to Develop Industries Targeted by Central Economic Development Plans

During the Meiji period, the Japanese state provided the framework in which private industry would be induced to create an industrialized economy. The Meiji leaders were primarily concerned with the gap in military power between Japan and the Western nations and the consequences this gap could have on Japanese national sovereignty. The Japanese viewed the military capacity of the West as being the result of the development of strategic industries such as iron and steel production, shipbuilding, railways, engineering, mining, and machinery. To the Meiji leaders, these strategic industries would need to be developed in Japan in order to form the foundation of an industrial economy and to increase national power. However, the initiation of these industries by private initiative was not forthcoming.⁷⁸ In order to initiate development of important industrial sectors, the Japanese state developed institutions and

78. E.H. Norman, in John Dower, op. cit., pp. 224-226.

policies to induce the private sector into industrial production. The Japanese state played a key role in selecting industrial sectors for development. In an orderly sequence based upon careful study of development patterns in Western countries, the Japanese state allocated resources and granted government assistance to assure the inducement of private enterprise into designated "strategic" sectors.

In the early years of the Meiji rule, private entrepreneurs were few in number and were reluctant to invest into industrial development. In the 1870's, the Japanese state directly initiated industries that the state believed to be strategic. Industries were designated as strategic if state leaders perceived an industry to be directly related to national security; if an industry produced exports; or if an industry acted as an import substitution, thereby increasing foreign exchange holdings that could be utilized to purchase necessary productive machinery or technology. The state initiated and operated several textile mills, cement factories, iron and steel mills, the railways, and the shipbuilding industry. In the 1880's and 1890's, the state offered many of these state enterprises at below market value to private, generally family operated, financial house in an attempt to induce private ownership of industrial operations. The state also offered several other economic incentives for private owners to further develop these and other state designated industries.⁷⁹ After the 1880's, Japanese industrial development followed a pattern whereby the state designated a particular industry or project as strategic and, then, offered low interest rate financing, tax incentives and credits, domestic market protection, and often direct subsidies to these family operated zaibatsu to develop

⁷⁹. Kenneth B. Pyle, op. cit., p. 84.

state targeted industries. By 1930, in all major industrial sectors other than iron and steel production, a few privately owned zaibatsu operating under direct state financial incentives became the leading producers.

According to Chalmers Johnson, by 1930, national planning and state economic intervention had extended to most all major industries in Japan.⁸⁰ This allowed the Japanese economy to move through a product life cycle from less sophisticated light industry production to heavy industry, to more technological areas such as electronics and communications in a very short period of time.⁸¹ Early industrial activity was first concentrated on the development of textile export production in order to earn foreign exchange. Then, it rapidly moved into such sectors as chemicals, hydro-electric power production, petroleum refining, transportation and communications infrastructure, automobile production, and electronic goods. By the 1930's, exports were still principally textiles, but import substitution in heavy industry and in electronic technology fields had progressed very rapidly. The Japanese state induced the zaibatsu into designated industries, using the Industrial Bank of Japan or other specialized banks to provide low cost financing. State credit institutions created investment funds that were highly mobile and directed these funds to designated industries. This made the Japanese economic structure very adaptable. Allen argues that with weak capital formation and with limited entrepreneurial activity, it was Japan's ability to centralize bank finance and to allocate it to designated

80. Chalmers Johnson, op. cit., pp. 305-324.

81. Bruce Cumings, "The Origins and Development of the Northeast Asian Political Economy," International Organization, Winter 1984, p. 14.

strategic industries that gave Japan the necessary requisites for rapid industrial growth.⁸²

In addition to low cost loans, the state also offered direct subsidies to induce development of strategic industries. For example, the state enacted the Shipbuilders Encouragement Act of 1896 in order to initiate shipbuilding. Part of this act provided state subsidies to builders of iron and steel ships of over 700 gross tons. The subsidy was twelve yen a ton for ships under 1,000 gross tons and twenty yen a ton for ships over 1,000 gross tons. In addition, five yen per horse power was granted by the state for marine engines built in Japan. Several new shipbuilding yards were founded as a result of the 1896 act. Another section of this act provided for a state subsidy to merchant marine businesses if they used Japanese built ships. By 1909, the gross tonnage of steamships launched in Japan increased five-fold to over 50,000 gross tons.⁸³ Subsidies were also granted to induce production of railway equipment and chemical production and to modernize agricultural techniques. By 1930, these were mature industries.

In 1911, the Japanese state became free of earlier treaties forced upon them by Western nations that imposed import tariff restrictions. At this time, the Japanese state altered tariff structures so that semi-manufactured and finished goods entering Japan were taxed heavily, while raw materials and other goods needed for Japanese production were granted tariff-free status. The newly developing industries at this time such as chemicals, steel, woolen

82. G.C. Allen, Japan's Economic Policy, pp. 42-50, 119-120, as cited in Bruce Cumings, *op. cit.*, p. 15.

83. G.C. Allen, A Short Economic History of Modern Japan, *op. cit.*, p. 83.

spinning, and metals were granted domestic protection in this manner.⁸⁴ Through what may be best labeled as neo-mercantilist policy -- state directed financial institutions, state directed sectoral development, tax incentives, protective tariff structures, and state controlled producers' guilds -- the Japanese state, from the Meiji period onward, was highly active in shaping the pattern of the rapid structural transformation of the economy.

Since the enactment of the first five year plan in 1962, the Korean state has followed an industrial policy that closely resembles the Japanese pattern.⁸⁵ Through the control and allocation of credit, a variety of tax and other incentives, and effective tariff policy that restricts imports and provides protection for domestic producers, the Korean state has induced and nurtured the development of industrial sectors designated by government planners.

During the early stages of Korean industrial development, private businesses were reluctant to enter into ventures in new industrial sectors because of capital requirements, a depressed domestic market, a lack of experience and knowhow, and other inherent risks in developing these industries. The state, desiring the development of these industries, had to act to induce the private sector to enter new fields of production. The principal mechanism to induce the private sector to develop state targeted industries was the state's control over the allocation of finance. Credit was offered to develop targeted strategic sectors at rates between 4 percent and 14 percent. Credit to finance non-state targeted projects was either unavailable or available only at interest rates exceeding 20 to 25

84. Ibid., pp. 129-133.

85. Chang Dal-joong, op. cit., p. 100.

percent. In real terms, interest charges for targeted projects were usually negative. The state, through the Bank of Korea and state-run specialized banks, channeled extensive levels of finance to targeted industries at a variety of interest rates depending on the sector, project, or its level of "strategic importance." The interest rates were also altered regularly in order to shape investment patterns to fit a changing economic environment. For example, in the 1960's, Korean planners perceived a comparative advantage in labor intensive textile production. Preferential loans were granted to textile export producers at that time. In the 1970's, state planners concluded that the capacity of the textile industry in Korea was approaching an optimal level. At this time, financial incentives for textile production were altered to deter future investment in that sector, while financial incentives to invest in heavy and chemical sectors were expanded. In the early 1980's, state planners concluded that an optimal level of production for certain heavy and chemical industries had been reached. Financial incentives to invest in these sectors have been reduced or eliminated, while investments in electronics and higher technological production are now offered finance at low interest rates.

✓ As of June, 1981, the Bank of Korea offered six different loan and rediscount rates ranging from five to twenty-two percent. A high priority was placed on export production, which generally received a ten percent loan rate and more than \$2.2 billion in credit directly from the Bank of Korea.⁸⁶ Investments into the development of high technological industries were granted lower rates.

⁸⁶. Roy Hofheinz, Jr. and Kent E. Calder, The East Asian Edge, (New York: Basic Books, Inc., 1982), p. 140.

These preferential credit allocations removed a high level of risk for the entrepreneur who would develop a state designated industry and provided the state with a high degree of microeconomic control over sectoral development patterns. They also acted to subsidize initial entrance of Korean producers into export markets and created strong political alliances between the state and private enterprise. To encourage the efficient use of these "soft" funds, the state established production quotas for a project that received a preferential loan. In order for a private producer to qualify for a future preferential loan to expand production, that producer would have to have fulfilled his output quota on the earlier project.

The Korean government has also relied heavily on tax structures as a tool for inducing targeted industrial development. Tax privileges for those who invested in targeted industries include accelerated depreciation, special tax offsets and deductions for new investments or for research and development in specific sectors, and tax holidays. The general rule has been that taxes on businesses in targeted sectors should be as low as possible in order to encourage investment and development. Such targeted projects as the naphtha crackers, the Pohang Iron and Steel Complex, oil refining, machine tool production, chemicals, shipbuilding, electronics, and export production were allowed various combinations of the following incentives: (1) Exemption from corporate taxes for the first three years after a project became operational, and a 50 percent holiday for two additional years; (2) Tax credits of 8-10 percent of the investment amount; and (3) Accelerated depreciation of up to 100 percent of normal depreciation allowances.⁸⁷

⁸⁷. Koo Bohn-young, The Role of the Government in Korea's Industrial Development, (Seoul: Korea Development Institute, Working Paper No. 8407, 1984), p. 12.

A further incentive to induce the private sector into state targeted industries has been the use of customs duties. The Pak government revised the tariff structure so that it would provide protection for "infant" industries, rather than merely collect tariff revenue. Import restrictions were placed upon foreign produced goods that would compete on the domestic market with Korean produced goods. The proportion of tariff revenue collected by the state as a proportion of total tax declined from 22 percent in 1957, to 17 percent in 1967, and to 15 percent in 1974. However, the revised tariff structure levied tariffs of 60 to 200 percent on consumer goods that would compete on the Korean market with domestic producers.⁸⁸ In an effort to promote the competitiveness of Korean exports, needed raw materials, intermediate goods, and parts and components used in export production were exempt from tariffs or were granted 100 percent tariff rebates upon re-export. This tariff structure, in effect, created monopoly or obligopoly domestic market structures in Korea that excluded foreign competition. Since the early 1960's, the vast majority of consumer manufactured goods available on the Korean market have been domestically produced and generally cost 10 to 80 percent above international market prices for the same goods. This allows for a high mark-up value on the domestic market, both limiting domestic consumption and increasing the profit rate per item sold for Korean producers. This added mark-up value in the domestic market has allowed Korean producers to sell at lower prices in the international market.

The preferential allocation of financing, tax incentives, and manipulation of customs policy to favor targeted industries have

⁸⁸. Suk Tai-suh, Foreign Aid, Foreign Capital Inflows, and Industrialization in Korea: 1945-75, (Seoul: Korea Development Institute, Working Paper No. 7712, 1977), p. II-75.

played a major role in the development of these industries in Korea. The fact that the designation of these industries and the corresponding privileges offered preceeded structural shifts to these sectors strongly indicates that government policies succeeded in stimulating the development of these sectors. During the 1965-1970 period, immediately after the targeting of manufactured goods for export production, exports increased over seven-fold from \$112 million to \$839 million. When consumer electronic goods were targeted in 1965, no televisions were produced in Korea. By 1970, 3 million units were produced, and in the mid-1970's televisions and other consumer electronics had become major export items. By 1976, exports in manufactured goods increased to \$7.2 billion, and by 1980 this figure increased to over \$16 billion. The first three five year plans (1962-1977) concentrated on developing infrastructure and import substitution of heavy and chemical industries. Between 1965 and 1977, oil refining capacity increased from 35,000 to 435,000 B.P.S.D.; chemical fertilizer production, from 170,000 to 3 million metric tons; steel production capacity, from 322,000 to 4.6 million metric tons; electrical generation, from 769 to 5.8 million m.w.; cement production capacity, from 1.7 million to over 14 million metric tons; and shipbuilding increased from zero to 428,869 gross tons. These import substitution industries matured rapidly and began to export. In 1960, chemical exports were zero, but by 1965 they equalled \$379,000. By 1970 this figure was \$11 million; by 1977, \$221 million; and in 1984, \$845 million. Machinery and transport equipment exports were \$5 million in 1965, \$61 million in 1970, \$1.8 billion in 1977, and over \$10 billion in 1984.⁸⁹ It was direct state initiative that led to the

⁸⁹. Economic Planning Board, Major Statistics of Korean Economy, (Seoul: Economic Planning Board), 1985.

rapid development of these industries.

The wool textile and steel industries offer good empirical examples of the manner in which the Korean state has nurtured and guided effective production in targeted sectors. Textile production was one of the first industries designated by the state in the 1960's to develop export production. Although continuously declining in importance in the overall export structure, textile exports still accounted for 28 percent of total exports in 1983.⁹⁰ In an interview with the general manager of the Korean Wool Secretariat, a wool textile producers' association under government regulation, the role of the Korean state in inducing and regulating textile production and exports was discussed. In the course of the interview, it was revealed that in order to encourage export production, the government has provided financing for the textile industry at low rates, usually at 6 percent to 10 percent since the 1960's. With the granting of low cost finance, an export quota has been placed on each producer. If the quota is met, then the producer can qualify for future financing. This policy has been intended specifically to encourage the expansion of export production by giving the producer a competitive advantage.

In the late 1970's, Korean textile production was a mature industry and highly competitive in international markets. However, the Korean textile industry was losing its competitive advantage due to the increased textile production in "labor cheap" countries, such as China, the Philippines, and Thailand. In addition, quotas had been placed on Korean textile imports entering the American market. The government planners determined that further expansion of the textile industry needed to be limited, and that future policy needed to be

90. Korea Exchange Bank, The Korean Economy, (Seoul: Korea Exchange Bank, 1984), p. 30.

directed to encourage the production of high quality textile items. Higher quality textile items would appeal to a different consumer than the lower priced items coming from the "labor cheap" producers. In addition, high quality items with higher value added would allow Korean textile exports to the United States to remain stable in volume, yet increase the profit generated per item.

To implement these reforms in the textile industry, the government established a new system for the allocation of funds. Under this system, the government levied export quotas on all textile producers based upon dollar amounts. For each \$100 of levied quota, the government would allocate \$60 of finance at 6 percent. This low cost finance could only be utilized to purchase new machinery that would encourage cost efficiency or to introduce a higher level of technology. These funds could not be utilized to expand present production techniques without specific approval from the government. If Korean-made machinery was purchased, finance rates could even be lower than 6 percent. If a textile company did not meet its export quota, the quota would be reduced the next year and so would the level of finance going to that firm. If a textile company exceeded its quota, its quota would be raised the following year as would be the level of finance available to that firm. The government also distributed shares of the American export market to individual textile producers based upon a formula that emphasized profit rates. Those firms that exceeded their value added quotas on the American export market would receive a larger share of the American market the following year. This policy offered direct government assistance to those producers who increased efficiency in production and produced higher quality goods, while punishing those who could not.

The Korean steel industry provides another example of a government induced, nurtured, and highly regulated targeted industry. In the late 1960's, the domestic production of steel held the key to several government planned heavy industrial projects. If Korea intended to expand into heavy industrial production in such areas as shipbuilding, industrial machinery, automobiles, and construction, domestic steel production was a necessary prerequisite. To import the necessary steel for these industries would have rendered these industries uncompetitive in international markets, further increased foreign exchange problems, and left all Korean industries dependent on imported steel. It was clear that heavy industries could not be developed without domestic steel production capacity.

In the late 1960's, Korea approached both the United States and West Germany for assistance in developing a large integrated iron and steel mill. However, American economic advisors argued that heavy industrial production was unsuitable for Korea's factor endowment and small domestic market, and concluded that it was economically irrational to develop a steel industry in Korea.⁹¹ West German economists came to the same conclusion as the Americans.

President Pak and the other government leaders were totally dedicated to the development of the steel mill. Pak declared that "steel equals national power" and approached the Japanese for assistance. In 1969, as part of the Diplomatic Normalization Treaty, Japan agreed to provide Korea with \$73.7 million in government grants, \$50 million in deferred government credits, and technical assistance from Nippon Steel, Mitshubishi, and Nihon Kohan corporations to develop an integrated steel mill in Korea.⁹² With capital and

91. Bruce Cumings, op. cit., p. 33.

92. Chang Dal-joong, op. cit., pp. 61, 114-116.

technical assistance from Japan, the Korean state took over ownership and operation of the Pohang Iron and Steel Company.

Initial construction on the Pohang mill began in April 1970. The government placed the highest priority on the construction of the mill and provided the direct assistance and influence of the E.P.B. and the presidential office in overcoming financial and other obstacles to construction. The mill was completed in July 1973, approximately two years ahead of the average start-up time at comparable mills in Western countries. By November 1973, the mill was in full operation, producing over one million metric tons of steel a year. Within the first two and a half years of operation, the mill produced a \$120 million profit. This profit was granted tax-free status by the government and reinvested into the mill to expand its capacity. By 1976, its production capacity was expanded to 2.6 million metric tons, and over 80 percent of expansion costs were covered by profits from the initial stage. By 1982, the Pohang mill produced 8.5 million metric tons a year,⁹³ and by 1983 Korea became the 10th largest steel producer in the capitalist world with a total national output of 13.7 million metric tons. Also, in 1983, the exports of steel reached \$2.57 billion, comprising approximately 10 percent of total exports.

In terms of economic efficiency, the Pohang mill produced 583 metric tons of steel per employee in 1983, which is 25 percent greater than in Japan's Kobe Steel Mill, the world's second most efficient mill. Production cost per metric ton at Pohang was \$297, while the

93. Micheal Keon, op. cit., p. 81. Economic Planning Board, Major Statistics of Korean Economy, 1985.

average cost per ton at American mills is \$482, and \$387 at Japanese mills.⁹⁴

Automated efficiency in conjunction with low labor costs and government granted privileges has made Korean steel highly competitive in the international market. About 66 percent of earned income in the Korean steel industry has been reinvested to purchase new machinery or to expand production. This low-cost, domestically produced steel has greatly aided the international competitiveness of Korean shipbuilding, automobiles, industrial machinery, and construction projects.

The development of heavy industry in Korea required domestically produced steel. International actors were reluctant to invest in Korean steel production because of a perceived economic irrationality. Domestic industry did neither possess the capital nor technological knowhow to develop a steel industry. The Korean state took it upon its own initiative to obtain financing and to induce technological knowhow into this vital "strategic" industry. The development of the steel industry was strategic in the sense that the further development of heavy industry would have been retarded or not even feasible without the efficient domestic production of steel. Here, the state targeted the steel industry, obtained and allocated credit, induced technological knowhow, and nurtured the industry's development with tax holidays, domestic market protection, and other privileges. These state actions allowed for the targeted steel industry to rapidly develop into an internationally competitive producer.

94. Business Korea, March 1985.

MICHIGAN STATE UNIVERSITY LIBRARIES



3 1293 10774 1393

118

L

LIBRARY
Michigan State
University



RETURNING MATERIALS:
Place in book drop to
remove this checkout from
your record. FINES will
be charged if book is
returned after the date
stamped below.

SEP 11 1989

SEP 2 1989

SEP 3 1989

SEP 3 1989

SEP 3 1989

SEP 3 1989

APR 8 1989

JUN 26 1989

AUG 12 1989

SEP 17 1989

SEP 3 1989

057

[Handwritten signature]

4. State Control Over Private Enterprise and the
Concentration of Industrial Production in a Relatively
Few Corporate Conglomerates

Zaibatsu is a Japanese term that literally means a money-group, and it is used to refer to the large Japanese business groups. A zaibatsu is usually dominated by a family, consists of a multiple of subsidiaries with highly diversified production and financial interests, and is controlled by a central holding company called a honsha. The zaibatsu developed during the Meiji period and utilized traditional Japanese feudal values in structuring corporate relationships. Corporate leadership of the zaibatsu was centered around the founder-chairman's family. Usually, sons and son-in-laws of the founder-chairman served as the presidents of subsidiaries. Labor was organized as "fellow clansmen" who devoted their loyalty to the zaibatsu in return for lifelong employment and paternal assistance in such areas as housing, health care, and employment opportunities for their children.

The zaibatsu that evolved into the industrial producers during the Meiji period found their origin in commercial houses that were engaged in banking and finance during the Tokugawa Shogunate period. Many of these commercial houses, such as the House of Mitsui, had allied with the Meiji leaders and had been the principal financial backers of the revolution.

When the Meiji took control of the government in 1868, industrial development became the highest priority of the state. However, financial resources for investment were limited, and there was no entrepreneurial tradition in Japan. During the 1870's, the

Meiji state initiated several industrial projects, and in the 1880's the state was able to induce the commercial houses to enter into industrial production. As described previously, the government sold many of its industrial projects to the commercial houses at below market value, offered low cost finance, tax holidays, direct subsidies, and market protection as incentives to the commercial houses to initiate production in sectors designated by the state. These commercial houses also became the chief recipients of government contracts.⁹⁵ The Meiji leaders began to rely on these commercial houses to implement the industrial policies of the state. By 1900, these commercial houses had expanded into a wide diversity of production sectors. As the Japanese economy expanded, it was the same few zaibatsus that continually received state incentives to develop new sectors. This inevitably led to a heavy concentration of production and national wealth in a few zaibatsus.

By 1930, the four large zaibatsus -- Mitsui, Mitshubishi, Sumitomo, and Yasuda -- controlled four of the six largest banks in Japan. This financial control by a few, large-scale producers made the zaibatsu highly mobile to sectoral adaptation. Combined with the privileges granted to targeted industries by the state, Japanese capital became unique in the manner that it could rapidly flow into new sectors given "strategic industry" designation. Thereby, the state provided the industrialization goals, and the selected zaibatsu offered the means for directing the product life cycle in Japan.⁹⁶ By the end of the 1930's, 50 percent of copper and coal production, 50 percent of all shipping, 70 percent of flour milling, 90 percent of

95. G.C. Allen, A Short Economic History of Modern Japan, op. cit., p. 133.

96. Bruce Cumings, op. cit. p. 15.

paper production, over 50 percent of aircraft production, and nearly all of the colonial industry and mining were monopolized by Mitsui, Mitshubishi, Sumitomo, and Yasuda.⁹⁷ The major zaibatsus were also dominant in metals, mechanical engineering, electrical appliances, textiles, cement, foreign and domestic trade, food processing, chemicals, glass, shipbuilding, and insurance. By the 1930's, there were no major sectors of the Japanese economy that were not controlled by a few zaibatsus. With control over finance, commerce, and industrial production, the zaibatsu had tremendous advantages over smaller specialized producers to move into a new industrial sector and to take advantage of government incentives.⁹⁸

The zaibatsu system in Japan can be criticized on several grounds, especially on grounds of unequal distribution of national wealth and on unequal access to political influence. However, there is little doubt that in traditional Japanese society where capital formation was very limited, where few experienced entrepreneurs existed, and where management skills were scarce, concentration of production in proven successful enterprises facilitated the rapid development of key industrial sectors. The zaibatsu proved adept at mobilizing resources and skills, obtaining needed technologies, and diversifying into new sectors by drawing on past experience. The Meiji economic development planners progressively targeted and diversified production into more complex technologies and processes, but they continuously relied upon the same proven zaibatsus for sectoral implementation of development plans.

⁹⁷. Ibid., p. 15.

⁹⁸. G.C. Allen, A Short Economic History of Modern Japan, op. cit., p. 134.

After the military came to power in Korea, a relationship began to emerge between the government and the business sector that held many similarities to the relationship between the state and the zaibatsu in Japan. In Korea, the industrial conglomerate is written in Chinese script in the same form as the Japanese zaibatsu, but it is pronounced as "jaebol." A jaebol, in general, resembles the Japanese zaibatsu in its structural organization, in its family orientation, in its paternal employee relationships, and in its ability to rapidly expand into a wide diversity of production sectors.

A jaebol can be defined as a business group comprised of two or more legally independent enterprises which produce goods and/or services within various product sectors of the Korean economy. The jaebol is a highly centralized organization with its principal financial and operational decisions exercised by an identifiable individual or family group that is the major owner.⁹⁹ The jaebol is structured around a small central holding company. Under this holding company are various subsidiaries specializing in particular markets. For example, Hyundai has 35 subsidiaries whose functions vary from dockyard management to automobile production, to engineering and construction, to a major international trading company, to electronics, to iron and steel production, to chemical industries, to name a few. Samsung has 33 subsidiaries; Daewoo has 35 subsidiaries; and Lucky-Gold Star has 48 subsidiaries.¹⁰⁰ In 1977, a sample of fifteen jaebol found that the average jaebol had 16.3 subsidiaries, was 32.6 years of age, employed 30,600 employees, and exported \$274.5

99. Yu Seung-pil, The Development of Large Korean Corporations: Investment Behavior, Capital Structure, and Rate of Return, (New York: Unpublished Ph.D. Dissertation, Columbia University, 1979), p. 18.

100. Business Korea, July 1984, p. 52.

million worth of goods.¹⁰¹ A Harvard study found that in the late 1970's, 61.4 percent of current jaebol chairmen were founders of their firms, 7.9 percent were direct descendants of the founders, and 12 percent were relatives. Only 18.8 percent of all jaebol chairmen were not related to the founders.¹⁰²

At the apex of each jaebol is the chairman. The chairman of the jaebol, most typically, is the founder or his son. Generally, the founder-chairman is an entrepreneur of great talent who founded the company, developed its first product line, then handed over management of that product line to a relative or trusted associate. The chairman's personal involvement then moves on, with government direction and assistance, to a new product line for development, while majority ownership of the business group and subsidiaries remains with the chairman and his family.¹⁰³ The chairmen of leading jaebols have offered dynamic leadership with the capacity to organize vastly different technologies and manpower skills into effective production units.

Jaebol development is similar to the Japanese zaibatsu in many respects. The most significant respect, perhaps, is the high level of entrepreneurial capacity of the founder-chairman and subsequent management to develop a wide diversity of product lines and to market them successfully. However, a major difference exists between jaebol and zaibatsu in the manner of financing and the ramifications in the power relationship between the business group and the state. The zaibatsu grew out of the merchant houses of feudal Japan. After the

101. Yu Seung-pil, op. cit., p. 18.

102. Edward Mason, et al., op. cit., p. 77.

103. Leroy P. Jones and Il Sakong, op. cit., pp. 258-260.

Meiji revolution, the leading merchant houses were the primary holders of capital in Japan. After the revolution, these merchant houses formed their own private banks that functioned along with the newly formed state banks. As the merchant houses began to enter industrial sectors, a large share of investment capital came from their own banks. As the industrialization process advanced, the zaibatsu emerged and became structured around their own corporate banks. The zaibatsu owned banks began to accumulate capital that was independent of the state. The Japanese state could offer subsidies, tax holidays, and other incentives to induce the zaibatsu to invest in a particular pattern, but the state did not directly control financing. In Japan, the zaibatsu themselves have always been at the center of industrial production and capital formation. Private capital sources have allowed the zaibatsu a certain degree of leverage over government policy and have allowed the zaibatsu to be relatively independent of the state if they choose not to follow the state incentives and directives.

On the contrary, the Korean jaebol did not come from traditional private wealth. The combination of the Japanese colonialization, the division of the country, and the Korean War destroyed the traditional aristocracy and left little capital wealth in Korea. When Pak Chung-hee came to power in 1961, the small amount of accumulated wealth that existed was held by a few commercial entrepreneurs who had either taken over small Japanese concerns after independence or who had prospered under Rhee's import substitution and import licensing policies. These entrepreneurs did not possess the level of capital needed for industrial expansion. When the Pak regime arrested most of the nation's leading businessmen for the "illicit accumulation of

wealth," the state confiscated the banking interest of these businessmen and placed them under the control of the Ministry of Finance. This act, in effect, took financial independence away from the private sector and placed it under the control of the state. Accumulated capital, both private and public, had to pass through government controlled financial institutions.¹⁰⁴

In Korea, the expansion of a business firm into an industrial, diversified jaebol came from the firm's ability to obtain long and short term financing directly from the state. It is the state that controls capital and allocates it to industrial enterprises for their expansion. The state has repeatedly resisted attempts by the private sector to obtain significant interests in financial institutions since the industrialization program began.¹⁰⁵ The principal investment institutions in Korea, the Korean Development Bank, the Korean Exchange Bank, the National Investment Fund, and the Import-Export Bank, are all government institutions. This means that the state can control the allocation of credit, thereby effectively controlling the activities of the jaebol.¹⁰⁶

✓ Principally using financial institutions as controlling mechanisms, the Korean state has significantly shaped jaebol expansion. The root of the power and influence of a jaebol has been in its ability to obtain financing from the government, and the ability to obtain funds lies in the jaebol's capacity to implement state designed industrialization plans. Preferential financing, along

¹⁰⁴. Ibid., p. 260. Also see: Yu Seung-pil, op. cit., p. 20, Chang Dal-joong, op. cit., pp. 88-94, 119, and Bruce Cumings, op. cit., p. 31.

¹⁰⁵. David Cole and N. Lyman, op. cit., p. 274.

¹⁰⁶. Bruce Cumings, op. cit., p. 31.

with other privileges, go to the state selected jaebols that develop state targeted industries. The jaebol can only gain and maintain access to financing if they abide by government policy and meet government production quotas and other requirements. Jaebol success is directly dependent upon following government directives in order to gain access to low rate state financing.¹⁰⁷ Throughout industrial development, all significant jaebol decisions have had to be made within the parameters set by state policy makers.

This state-jaebol relationship created two primary effects in Korean political-economics. First, the state's principal goal of rapid industrial expansion based upon export promotion and import substitution of heavy and chemical industries was largely achieved. Government financing and subsidies allowed Korean producers to expand exports rapidly worldwide. As the world market share of Korean products grew, earned funds were channeled by the state to finance a growing diversity of production capabilities. Second, the jaebol owe huge debts to the state financial institutions. The financial structures of the jaebols are very low in assets and very high in debt. All major jaebols are heavily in debt and technically in bankruptcy at all times. In 1966, the debt to asset ratio of the average jaebol was 2:1.¹⁰⁸ Due to the borrowing from the state financial institutions to finance rapid industrial growth, today, very few jaebols have a debt to asset ratio better than 5:1, while many have a ratio of over 7:1.¹⁰⁹ The state financial institutions continuously roll over the debt to keep the jaebol in operation.

¹⁰⁷. Chang Dal-joong, op. cit., p. 92.

¹⁰⁸. Leroy P. Jones and Il Sakong, op. cit., p. 101.

¹⁰⁹. Business Korea, April 1985.

Since credit has been extended by political direction, not by market mechanisms, jaebols have not had to put up collateral for their loans. They could borrow large sums of funds and expand rapidly as long as the state continued to extend credit. As a result, according to the Harvard study, between 1963 and 1974, only 20 percent of jaebol financing came from corporate funds and 14 percent from new equity, while 66 percent of their financing came from borrowed funds from the state.¹¹⁰

The very existence and expansion of any individual jaebol has been largely dependent upon continued government political support. Continued government political support, in turn, has required the jaebol's loyalty to the government's political and economic policies. The jaebol have rapidly expanded with state credit, and their massive debt to the government financial institutions has made them susceptible to the effects of the state calling in their debt. In 1979, the Yolsan jaebol was burdened with debt as were all other jaebols. However, Yolsan began to support Kim Dae-jung, the opposition leader. The government called in Yolsan's debt, which, of course, it could not meet. The government refused to extend further credit to Yolsan, and then it liquidated Yolsan's assets. In 1985, the Kukje-I.C.C. jaebol, the eighth largest jaebol and one of the Korean corporations to make Fortune magazine's list for the 500 largest corporations outside of the United States, was a leading Korean export producer. The Kukje-I.C.C. actively opposed government economic policy and supported the opposition party in the National Assembly election in February 1985. In addition, the Kukje corporation refused to donate to or join the Ilhae Foundation. The

¹¹⁰. Leroy P. Jones and Il Sakong, op. cit., p. 101.

Ilhae Foundation, established in 1982, is a government directed research foundation chaired by President Chun Doo-hwan and financed by donations from jaebols. The membership of the institution is made up of the elites in government and industrial circles. It is widely believed in Korea that the Ilhae Foundation is a power base from which President Chun wishes to exert political and economic influence following the end of his constitutionally mandated single, seven-year term as president. In a highly confidential document shown to this writer by an E.P.B. advisor, financing for the Ilhae Foundation was in excess of \$300 million. All of these funds were solicited by the government from jaebol chairmen. All the major jaebols were listed on this document next to the amount of their "donation." At the bottom of the last page of this document next to an asterisk, it read, "The Kukje Corporation refused to donate to the foundation." In March 1985, Kukje, with a relatively low debt to asset ratio by Korean standards, was told that the government banks would no longer roll over its debt. Kukje collapsed. Its production facilities and other assets were immediately sold by the government to other jaebols.

✓ No jaebol can feel immune from the consequences of veering too far from the state's directed economic strategy. This relationship whereby the state controls financing, allocates it to private industry according to the state's discretion, and then holds the debt of the jaebol is central to understanding the manner by which the Korean state coerces the private sector to implement industrial plans and controls their adherence to state economic policy. In Korea, the government can ensure the failure of any business enterprise should it care to do so.¹¹¹ Unlike Western industrialization experiences, the

¹¹¹. Ibid., p. 68.

Korean state directly planned industrial development and successfully nurtured an immature capitalist class to maturity. The state took the initiative in promoting the sequence of sectoral development by controlling finance and by providing other incentives. The state then placed production in the hands of a few private enterprises and held them responsible for the implementation of government policy.¹¹² In this process, the jaebol were transformed into large industrial enterprises reflecting the state's industrial policy. Those who were loyal and effective at executing state economic policies were rewarded with additional financing for expansion; those who failed to support and execute government policy lost their access to further credit and, in some cases, were liquidated.

This state-industrial sector relationship has inevitably led to the concentration of industrial output in a few producers. This concentration of industrial output is also similar to the Japanese zaibatsu model. In 1974, the ten largest zaibatsus in Japan had \$105.5 billion in combined domestic and export sales, which was slightly over 25 percent of Japan's GNP in that year. These ten zaibatsus exported \$30 billion worth of merchandise or 55 percent of Japan's total exports.¹¹³ In Korea, in 1977, the largest ten jaebols had total sales exceeding 18 percent of GNP, and in 1983 this figure increased to 22 percent of GNP.¹¹⁴ Also, in the same year, the ten jaebols exported over \$13 billion worth of merchandise or over 50 percent of total exports. The largest four jaebols alone exported over 36 percent of total exports. This relatively large concentration

¹¹². Chang Dal-joong, op. cit., pp. 91-91.

¹¹³. Yu Seung-pil, op. cit., p. 18.

¹¹⁴. Business Korea, July 1984, p. 51. Economic Planning Board, Major Statistics of Korean Economy, 1985. Business Korea, June 1984.

of production capacity in a few producers is a striking feature of both the Japanese and the Korean economic development experiences.¹¹⁵

As Jones points out, economic concentration has two dimensions. One is conventionally termed industrial concentration, or the share of a given number of enterprises in a given market. The other is business concentration, or the share of a given number of affiliate enterprises in all markets.¹¹⁶ While industrial concentration grants monopoly or oligopoly privileges to a commodity market, business concentration grants privileges in all product and factor markets.

According to the Economic Planning Board in 1977, of the total 2,186 commodity lines available on the Korean market, 90 percent were considered to be monopoly or oligopoly markets. In this study, a monopoly market was defined as a commodity market where 50 percent or more of a market share was controlled by a single producer. An oligopoly market was defined as a commodity market where 50 percent or more of a market share is split among the three largest producers. In 76.6 percent of all Korean commodity markets, the largest three producers split 70 percent or more of the market share. Only 10 percent of all commodity markets were considered competitive.¹¹⁷

Both industrial and business concentrations are major factors within the Korean economy and reflect a principal feature of the state-jaebol relationship involving the allocation of capital investment. Approximately 30 percent of all bank lending in Korea since 1965 has gone to only ten jaebols. As of September 1983, these ten jaebols owed Korean banks \$10 billion or 32 percent of the total

115. Business Korea, July 1984, p. 51. Economic Planning Board, Major Statistics of Korean Economy, 1985. Business Korea, June 1984.

116. Leroy P. Jones and Il Sakong, op. cit., p. 258.

117. Business Korea, July 1984, p. 52.

outstanding debt of the private sector. It is estimated that Hyundai, Samsung, and Daewoo, the three largest jaebols, owed approximately \$4.2 billion. Since 1965, these three jaebols have received more than 10 percent of all institutional loans.¹¹⁸ They are Korea's three largest exporters, own the three major shipyards, and are the major producers of machine tools. Hyundai and Daewoo are the only producers of passenger automobiles. Samsung is the Korean leader in electronics, and Daewoo is number three. These three jaebols are leaders in construction, oil refining, and chemical production. They are also presently leading the drive in telecommunications and other "high tech" industries. These jaebols entered all of these sectors by receiving substantial government assistance and privileges, and Korean development plans and industrial structural growth have been highly reflected in the growth of these three and a handful of other jaebols.

The concentration of industrialization in a few jaebols certainly has its negative side effects. Political-social problems have been created by the distribution of wealth being skewed by the presence of only a few industrial producers in a rapidly growing economy. However, to the government, economic development has been primarily an issue of growth and production pertaining to an increase in national power.¹¹⁹ Mass welfare and distributional justice have been secondary. The concentration of industrial development in a few jaebols has served the interests of the Korean state as it did the Meiji state. There was a shortage of resources and entrepreneurs. The state intervened to concentrate resources and to allocate them to those who had proven their entrepreneurial capacities. Industrial

¹¹⁸. Ibid.

¹¹⁹. Ibid., p. 90.

concentration has also served economic rationality in industries where economy of scale plays an important role. Rapid industrialization has been the state's goal. What served that purpose most efficiently in the perception of the state was the inducement of a few entrepreneurs who would develop state targeted industries effectively and rapidly.

5. State Repression of Labor

In the first half of the twentieth century, the Japanese government and the zaibatsu were able to repress labor thoroughly.¹²⁰ Martial law ruled in Meiji Japan. Freedom of speech and assembly was banned if it criticized government political or economic policy. Any opposition to the military-bureaucratic-zaibatsu structures and relationships met harsh punishment. All books referring to the French Revolution or the rights of individuals were banned, and their possession resulted in jail sentences. From 1895 to 1910, opposition to the government was principally centered around labor rights. This opposition was severely repressed, and several labor leaders were arrested. The secret police, or kambu-ka, infiltrated universities, labor groups, social organizations, and farmers' organizations, reporting to authorities any opposition to the state. During the 1910's and 1920's, social unrest and militant labor movements were on the increase. In 1918, riots swept Japan over an increase in rice prices. Over 700,000 people participated in these riots. In 1919, there were over 497 labor disputes, which was ten times of the number of five years earlier. The labor movement was growing rapidly and

¹²⁰. Bruce Cumings, op. cit., p. 15.

becoming militant. In the early 1920's, rural tenancy disputes escalated rapidly with the formation of tenant unions. The government was faced with the choice of social reforms to alleviate the growing social unrest or to mobilize a national suppression. The government elites, fearful of social unrest and a slowdown of economic and industrial expansion, chose the latter.¹²¹

In 1925, the Japanese government enacted the Peace Preservation Law which limited political debate to only groups that supported the present system of private ownership.¹²² The government used this law to arrest socialists and labor organizers. With the labor movement suppressed, the government and the zaibatsu were able to keep the price of labor below market value. By the 1940's, Japanese labor had a forced discipline. Almost 60 percent of the industrial labor force was composed of women,¹²³ who received much lower wages than men for similar work.¹²⁴ They worked primarily in the textile industry and were not able to organize. Japan also sent Korean farmers who lost their tenancy in Korea under the Japanese land survey to Japan as laborers. By 1940, over one million Koreans worked in Japanese factories, and they were forced to work at extremely low wages in the most difficult industrial work.¹²⁵ Reducing the cost of production through state repression of labor became a comparative advantage for Japanese goods in the international market.

Along with the direct repression of labor through the banning of unionization and collective bargaining, the Japanese state also

¹²¹. Kenneth B. Pyle, op. cit., p. 124.

¹²². Ibid., p. 127.

¹²³. Ibid., p. 125.

¹²⁴. Bruce Cumings, op. cit., p. 15.

¹²⁵. Ibid., p. 15.

systematically repressed the consumption level of the working class in order to increase savings that would be channeled to industrial production. The state maintained a regressive tax structure whereby workers paid relatively high tax in comparison to industrial producers. Protection from foreign produced goods and monopolistic market structures allowed Japanese producers to make windfall profits on items sold in Japan, while consumers paid higher price for these goods than market value. All these practices reduced consumption levels of the Japanese working class and allowed for rapid industrialization. As a result, a large share of the burden for this industrialization was paid by a repressed labor class.

State suppression of labor in order to decrease production costs and to limit consumption levels has been utilized as a comparative advantage in Korea over the past twenty-five years. The state has prohibited labor from organizing except into strictly controlled government supported unions. All union organization at the national level is strictly prohibited. Collective bargaining is not allowed except through the state sanctioned unions. To strike is illegal and met with harsh police action. Several hundred labor leaders have been jailed, tortured, and at times murdered for non-violent labor organizing activities.

Low wages are seen by the government and jaebol leaders as a comparative advantage for Korean export goods. Suppression of wages has played a key role in Korea's export expansion, which in turn has financed a large share of industrial investment. The government and jaebol leaders view the suppression of wages as an important element of their partnership to drive economic and industrial expansion. In 1984, wages for industrial production workers, who comprise

approximately a quarter of the work force and make up the backbone of the heavy and chemical industries, was less than \$225 per month on an average of 48 hours of labor a week.¹²⁶ Textile workers, who are responsible for approximately 30 percent of export production, earn on an average \$150 per month for 48 hours of work a week. A large portion of the labor force is comprised of females who earn substantially less than their male counterparts. For example, in the Masan Free Export Zone, where Korean and foreign corporations can produce export goods with little or no tax, 80 percent of the work force are females of whom 60 percent are teenagers.¹²⁷ It is estimated that wages in Masan are one-tenth of the U.S. level for comparable work, one-third of the Japanese level, and only half of the Hong Kong wage level.¹²⁸ Over 600,000 Korean workers earned less than \$125 per month in 1984, averaging over 48 hours of labor per week.¹²⁹

✓ The government has maintained extensive domestic intelligence networks which supply it with reports of dissidence to state economic and labor policies.¹³⁰ During the Pak administration, the Korean Central Intelligence Agency was well known for its ability to infiltrate labor movements, farmer cooperatives, and other labor oriented organizations and for its capacity to arrest and torture labor activists. The present regime maintains similar policies. The

¹²⁶. Economic Planning Board, Major Statistics of Korean Economy, 1985, p. 273.

¹²⁷. Bruce Cumings, op. cit., p. 31.

¹²⁸. Ibid., p. 32.

¹²⁹. Business Korea, July 1984, p. 54.

¹³⁰. United States Department of State Report to Congress, "Report on Human Rights Practices in Countries Receiving U.S. Aid," (Washington, D.C.: U.S. Government Printing Office, February 8, 1979), p. 383.

press has been severely censored; freedom of speech has been curbed; and the right to assemble peaceably in opposition to state policy has been restricted. Criticism of the state and its economic or labor policies is met with harsh reaction by the state.¹³¹

✓ To reduce further the consumption levels of the laboring class and to increase savings, a regressive tax structure has been maintained. Wage earners pay their taxes fully before they receive their pay, and they pay a much larger share of tax than do large property owners and upper-level jaebol managers.¹³² Corporate taxes are also very low. Housing for the labor class is inadequate. While the state has allocated billions of dollars to jaebols for productive investment, a relatively small amount has been allocated for housing. In Korean cities, there is less than one housing unit for each two and a half families.¹³³ Families of laborers are forced to pay very high rents and to live with several extended family members in cramped quarters. Financing from state financial institutions for housing is usually offered at very high interest rates if it is available at all.

Consumption of the labor class is further constrained by market protection and monopolistic market structures. There are very few foreign produced consumer goods available on the Korean market, and those that are available face such high tariffs that the price of these goods becomes prohibitive to most Korean consumers. As mentioned previously, approximately 90 percent of the over 2,000 commodity markets are monopolistically or oligopolistically structured. Because of import protection and monopolistic market

¹³¹. Ibid., pp. 374-384.

¹³². Business Korea, July 1984, p. 54.

¹³³. The New York Times, October 6, 1985, p. F9.

structures, Korean-made goods on the domestic market are priced much higher than the same goods in the international market. These policies increase the profit rate of the jaebol, while reducing the consumption of the working class.

In the past few years, the government has seen the necessity of expanding the size of the domestic market as protectionism and other barriers in the international market restrict the level of export sales. Labor wages have increased during this period. However, the government and the jaebol have decided the timing and level of these increases to suit their own purposes. The independent organization of labor and the right to strike are still prohibited. The Korean state still actively pursues policy to restrict the wage levels and the consumption of the working class in order to increase savings and to artificially maintain Korean comparative advantage in international markets.

✓ The Korean government has been able to maintain these repressive labor policies primarily because it draws its political support from the military, the bureaucracy, and from industrial leaders, not from a popular base. Since the government does not have to face public elections, the political leaders have been able to repress wages and consumption levels of the working class and formulate labor policy favoring industrial interests.

Despite these repressive labor policies, the Korean state has been able to maintain relative labor and political stability through economic appeasement. Although wage levels have been maintained at an artificially low level through state actions, successful economic expansion has provided jobs throughout society and allowed all social strata to increase their living standards incrementally, but

Table 3.6
Social Indicators

	<u>Unit</u>	<u>1965</u>	<u>1970</u>	<u>1975</u>	<u>1980</u>	<u>1985</u>
Infant mortality rate	Per 10,000 births	61.8	53.0	41.4	36.8	33.3(1984)
Piped water supply	Household percent	21.1	33.1	43.1	52.0	67.0
Number of people per physician	Persons	2,095	1,773	1,801	1,493	1,841
Hospital beds per person	100,000 persons	40.3	51.3	60.2	99.7	169.9
Enrollment ratio in higher education	Percent	9.5	10.1	12.2	15.9	27.3
Ratio of health insurance to total population	Percent	N.A.	N.A.	N.A.	29.5	51.3
Absolute poverty*	Percent	40.9	23.4	14.8	9.8	N.A.
Rural		35.8	27.9	11.7	9.0	N.A.
Urban		54.9	16.2	18.1	10.4	N.A.
Average protein intake per person per day	Grams	-	64.6	63.6	67.2	69.6(1983)
T.B. prevalence rate	Percent	5.1	4.2	3.3	2.5	2.0(1983)
Parasite infection rate	Percent	-	55.6	38.6	11.9	4.9(1983)

* Absolute poverty line defined as 121,000 won (\$173) in 1981 constant prices per month for a five member household.

Source: Economic Planning Board. Ministry of Health & Social Affairs. Korea Development Institute.

consistently.¹³⁴ The unemployment rate declined rapidly after 1965 and is presently under 4 percent.¹³⁵ The state has also allowed wages to increase steadily in real terms. Labor income as a percentage of national income increased from 30.9 percent in 1965 to 41.7 percent by 1976.¹³⁶ From 1976 to 1984, wage levels continuously increased faster than inflation rates.¹³⁷ The general population and the working class have been relatively tolerant of political exclusion and state suppression of labor principally because economic expansion has eliminated widespread absolute poverty and allowed living standards to increase consistently and noticeably. The Korean population prior to 1961 had known only foreign domination, war, absolute poverty, and massive suffering. The majority of the population was willing to accept political authoritarianism in return for improving living standards.

It is not certain that the emerging generation will be as tolerant as their parents of political exclusion and labor repression. Labor disputes have significantly increased, almost doubling from 1984 to 1985. The state has prosecuted several hundred labor activists and sentenced them to jail in the past two years.¹³⁸ The labor opposition is growing and becoming more militant. It is doubtful that future incremental increases in living standards without real political and

¹³⁴. United States Department of State Report to Congress, op. cit., p. 378.

¹³⁵. Economic Planning Board, Major Statistics of Korean Economy, 1985, p. 28.

¹³⁶. United States Department of State Report to Congress, op. cit., p. 377.

¹³⁷. Economic Planning Board, Major Statistics of Korean Economy, 1985.

¹³⁸. Amnesty International, "Imprisoned Trade Unionists in The Republic of Korea," (London: International Secretariat, 1986)

labor reforms will continue to appease the labor class as it has in the past. However, up to this point, the state has effectively suppressed the interests of the labor class, maintaining relative labor stability and discipline through the combination of increasing employment opportunities, improved living standards, and coercion.

6. Institutional Mechanisms that Survey and Regulate the Inflow and Usage of Foreign Capital and Technology

In the early years of Meiji rule, foreign capital and technology played a crucial role in the industrial development of Japan. However, ownership of the means of production largely remained in Japanese hands. Foreign capital was viewed by the Meiji leaders as the cause of the economic decline in China. Because of this, the Meiji leaders desired to avoid foreign direct investment in key industrial sectors of their economy. In the late nineteenth and early twentieth century, the railways, shipbuilding, mining, and textile industries relied heavily on foreign capital, foreign technology and foreign experts (largely British), but foreign ownership of these industries was rare.¹³⁹

One of the more important functions of the Industrial Bank of Japan was to channel the flow of foreign capital into Japan to fit the perceived needs of state economic development plans. By 1910, a substantial part of the bank's capital was held by foreign concerns with over 350 million yen raised abroad. In total, by 1910, more than 1.2 billion yen had been borrowed from abroad to help finance the

¹³⁹ G.C. Allen, A Short Economic History of Modern Japan, op. cit., pp. 79-81, 90-91.

railways, textile, shipbuilding, and the iron and steel industries development.¹⁴⁰ However, this borrowed foreign capital was channeled to Japanese state enterprises or to the zaibatsu for production apparatus ownership and operation. Foreign technical assistance was primarily purchased, and foreign direct investment was highly restricted and regulated by the state.

Foreign direct investment was restricted to those investments that brought in specific technology targeted by Japanese economic planners and viewed as being necessary for industrial development. These foreign investments were generally required to form joint ventures with Japanese companies in order to increase the likelihood of a successful technological transfer. If domestic producers possessed an adequate technological knowledge in a given sector, or if needed technology could be purchased from abroad, the Japanese state was reluctant to allow direct foreign investment into that sector. This policy was intended to maximize Japanese ownership and control over the means of production. The Meiji leaders feared the development of dependence on foreign direct investment. This approach to the management of foreign capital has been a constant factor in Japan's industrial experience.¹⁴¹ Although foreign technology, foreign technological experts, and foreign capital loans made a major contribution to the industrial development of Japan, the entrepreneurial initiative and ownership of industrial facilities came from the Japanese state and zaibatsu.¹⁴²

¹⁴⁰. Ibid., pp. 48-54.

¹⁴¹. Robert Ozahi, "Japanese Views on Foreign Capital," Asian Survey, November 1971, p. 1071.

¹⁴². G.C. Allen, A Short Economic History of Modern Japan, op. cit., p. 95.

By the 1930's, foreign capital and technological inflows into Japan were subject to the systematic approval of central government planners. Foreign investment was excluded from sectors in which domestic production was technologically able to meet demand. State planning agencies played a central role in surveying capital investment and technological inflows. The import of technology, licensing agreements, and the allocation of foreign exchange to importers needed the approval of government planners.¹⁴³ Approval was granted to those projects that fit the overall needs of government economic policy. Cumings points out that neo-mercantilist policies of restricting entry to Japanese markets and resisting the entry of foreign capital continued throughout this century well into the 1970's: "Total foreign assets in Japan in the mid-1970's were only about 2 to 3 percent of total assets, few non-Japanese multinationals operate there, and the major markets for foreign imports remained food and oil."¹⁴⁴ Because of these policies, foreign interests can exert little influence on Japanese economic and political decisions.

Subsequent to its takeover of the government in 1961, the Pak regime formulated policies similar to Japan in relation to foreign capital and technological inflows. These policies and their effects will be examined in detail in the next chapter of this study. In general, control and regulation of foreign capital and technology have come from state enforcement of the Foreign Capital Inducement Act of 1961 and its many revisions. The original law included inducements such as tax holidays and guaranteed repatriation of profits to foreign

143. Kazaushi Ohkawa and Henry Rosovsky, Japanese Economic Growth: Trend Acceleration in the Twentieth Century, (Stanford: Stanford University Press, 1973), pp. 221-223.

144. Bruce Cumings, op. cit., p. 21.

investors in particular sectors. However, the law also included a "positive list" limiting the sectors where foreign investment was allowed. In 1984, the government altered the law. Today, the Foreign Capital Inducement Act lists "open" sectors, "restricted" sectors, and "prohibited" sectors. This list effectively limits the sectors and projects that foreign capital investments may enter.

In Korea, foreign direct investment activity has been highly restricted by the state. Foreign direct investment has been relatively limited to export production projects and to import substitution sectors where domestic technology is inadequate to meet production needs and where this technology could not be purchased through a technological licensing agreement. Foreign direct investment has neither been allowed to develop production facilities in sectors that would compete in the domestic market with Korean producers nor to purchase existing Korean owned enterprises.

The Foreign Capital Inducement Act has periodically been altered to conform with the changing needs of Korean industrial development. However, it has remained relatively constant in that foreign investment into Korea is only permitted if it will provide export production or a specific technology which is needed to fill a bottleneck in Korean industrial development and which can be induced into Korea only by direct investment. Such foreign investments are approved and often granted tax and other privileges by the Korean government to encourage their arrival into the Korean economy.

For investment capital needs, the Korean government has preferred to obtain foreign loans and then channel this capital through state financial institutions to targeted industries under Korean ownership. By 1986, outstanding foreign debts totaled \$48

billion. Total foreign investment from 1962 to 1986 equalled \$2 billion on an arrival basis.¹⁴⁵ This is more than a 24:1 ratio of foreign loans to foreign investment. Foreign direct investment has not been a major source of Korean capital formation, although foreign capital has been. According to several Ministry of Finance and Economic Planning Board officials interviewed, if Korea possessed a required technology or could purchase it, the government preferred to borrow capital to finance a targeted project. In this manner, Korea could maintain control over ownership and operational decisions to the largest extent possible. All foreign loans entering Korea receive government approval and guarantee of repayment. The state surveys all incoming foreign capital loans, permit those that fit capital investment needs for state targeted areas, and restricts the entry of other capital loan inflows.

Likewise, all technological inflows, technological licensing agreements, and the allocation of foreign exchange for imported technology must be approved by the government. For government approval, the incoming technology must fit government planned needs and not be available in the domestic market. It can be said that although foreign technology, technical experts, and capital have made major contributions to Korean industrial development, entrepreneurial initiative and ownership of industrial facilities have come from the Korean state and the jaebols.

145. Korean Ministry of Finance data.

Summary: The Korean State and the Industrialization Process

Since the military coup in 1961 and the subsequent reorganization of state bureaucratic structures, Korea has experienced substantial economic growth. The economy has been transformed from an agricultural base that was inadequate to feed and house its population to a diversified industrial base that has significantly raised the living standards of all social strata.

This significant economic growth has principally been led by strong state bureaucratic structures that have directly and actively intervened into economic activity to achieve the objective of economic growth and industrial diversification. The state has been the dominant economic actor intervening at several levels of economic activity to plan, finance, initiate, nurture, integrate, and protect sequential sectoral development. The state has been responsible for establishing substantial national economic goals and has established a system of incentives and punishments to induce and compel the private sector to achieve established goals.

In examining the rapid and relatively successful economic transformation in Korea, six principal state interventions into shaping economic structures come to the forefront to highlight what may be referred to as a Korean development model. These same six key state interventions into economic activity are also present and similarly as significant in their impact in Japanese economic transformation.

The first key state intervention into economic activity in both the Korean and Japanese experience was the establishment and the significant utilization of central planning institutions. These

central planning institutions possessed substantial political power to develop and coordinate industrial development strategy. In Japan, the Ministry of International Trade and Industry (MITI) has played a major role in planning economic development and in deciding resource allocation patterns. MITI developed a series of industrial development plans and coordinated policy with the Ministry of Finance to provide public funds to private industrial entrepreneurs.¹⁴⁶ MITI was organized along functional lines similar to the major industries it was attempting to develop. These bureaus developed policies for the development of their area of specialty, aided the producers both economically and politically, and held producers responsible to meet output and profit quotas.

✓ In Korea, the Economic Planning Board (E.P.B.) performed similar functions to that of MITI in Japan. The E.P.B. controlled economic planning, budget allocations, the inflow of foreign capital and technology, and was granted substantial political support from the president's office to coordinate policies among various bureaucratic agencies and the private sector. The E.P.B. planned sectoral development, formed functional bureaus to oversee that development, and became the guiding arm of all major investment decisions.

✓ The second key state intervention into economic activity in Korea and Japan has been the reorganization of state financial institutions and policies to facilitate the coordination of capital accumulation with development planning. In both nations, the reorganization of government financial institutions and the creation of specialized banks by state action established the institutional

¹⁴⁶. T.J. Pempel, "Japanese Foreign Economic Policy: The Domestic Bases for International Behavior," International Organization, Vol. 31, No. 4, Autumn 1977, p. 743.

means for increasing private domestic savings and placed financial institutions under close government control so that allocation of capital funds would fit government development planning. Commercial banks in Korea and Japan have become instruments of national purpose to accumulate capital and to allocate it according to national design.¹⁴⁷ By reorganizing tax collection procedures, by implementing meaningful interest reforms, and by creating fiscal surpluses, domestic public savings levels have also increased significantly.

✓ The third key state intervention that had major impact upon economic development in Korea and Japan has been the development of mechanisms to induce enterprise into industrial sectors targeted by state economic development planning. Central to the overall economic development policy was the effective implementation of major industries in a sequential manner. Industries for development were targeted by the state based upon increasing technological complexity and the necessity of forward and backward linkages. To induce the private sector to respond to planned development strategy, industries targeted for development received state subsidized financing, special tax incentives, and monopoly rights in the domestic market. These policies were necessary in order to induce the private sector into new industries because of the high capital costs and high risks involved in developing these industries in a nation with a depressed market and little industrial experience. Preferential credit allocations removed much of the risk to entrepreneurs and provided the state with a high level of control over sectoral development patterns.

✓ The fourth key state economic intervention has been the state's capacity to control the growth of domestic industrial producers. In

147. Ibid., p. 736.

Korea, a relatively few jaebols have been responsible for the lion's share of production in a wide diversity of industrial sectors. The expansion of private firms largely came from the firm's ability to obtain financing and other privileges from the state. The state concentrated resource allocation within a small group of entrepreneurs who were known to be successful at organizing new industrial production and who were loyal to the government and its economic and political policy orientation. This resulted in heavy business and industrial concentrations in a few producers. However, it most likely led to a more efficient use of capital resources on an aggregate level and allowed for more efficiency in industries that depend on an economy of scale for comparative advantage. This policy also allowed for the rapid development of large corporations in Korea who could then use their resource base to compete effectively with more established competitors in international markets.

✓ The fifth key state intervention that has facilitated rapid economic expansion in Korea and Japan has been the use of state mechanisms to repress the labor class. Particularly present in Japan during the formative years of industrial transformation and still very present in Korea is the use of state coercive instruments to suppress labor movements and to prohibit collective bargaining. The state and industrial producers have worked in close alliance to keep labor wages artificially low. In addition to low wages, regressive tax structures, market protection, and monopolistic domestic market structures have decreased the spending power of the working class and significantly increased the burden that they have carried in financing the costs of industrial development. These policies have worked to reduce consumption levels and have led to increased savings levels.

✓ State suppression of labor has also substantially reduced the cost of production and increased the international competitiveness of export products.

✓ The sixth key state intervention into economic activity has been the establishment of institutional mechanisms that survey and regulate the inflow and usage of foreign capital and technology. In both Korea and Japan, the state has developed elaborate legal and bureaucratic mechanisms to control foreign capital and technological inflows to complement rather than compete with domestic industry.¹⁴⁸ In general, direct foreign investment has not been allowed to enter the domestic economy if it were to compete with or purchase existing domestic producers. Direct foreign investment was only allowed if it produced for export markets or if it were to enter a targeted import substitution sector where domestic technology was inadequate to meet production needs and where this technology could not be purchased by a domestic producer. These policies greatly facilitated the development of domestic industrial firms and significantly increased the control that the state could exercise over both macro and micro economic decision making.

Industrial development in Korea was not a result of a laissez-faire strategy toward the economy, nor was it a reflection of the structural needs of the international economy. In Korea, as in Japan before it, the state has been highly interventionist. This chapter has attempted to explain and analyze the six principal areas of economic activity in which the state has intervened to shape the pattern of resource allocation, private decision making, and economic outcomes. In the case of Korea, state intervention into economic

¹⁴⁸. Ibid., p. 748. For a detailed examination of Korean policy in this regard, see: the next chapter of this study.

affairs has been the dominant characteristic that marks the economic development experience.

Chapter IV: The State and Foreign Capital: Inducement,
Regulation, and Control.

The economic development process in a developing country is significantly affected by that nation's interaction with the international economy. Such international economic factors as aid, commercial loans, direct investment, and technological inflows can directly affect the pattern of sectoral development and the relationship of production to societal structures. Theoretically, the input of foreign capital and technology may be highly beneficial to a developing country's industrialization process. Foreign savings can supply immediate capital inputs that can finance the development of industrial infrastructure and production facilities. Foreign technological knowhow can be introduced to facilitate the development of several sectors where domestic technological expertise is insufficient or non-existent. Foreign investment's knowledge of overseas markets can aid the development of export sectors. Major import substitution sectors can be developed more efficiently and rapidly with foreign technological input. Foreign enterprises, over time, can improve the productivity levels of domestic firms through competition. The presence of efficient foreign firms in a developing economy can facilitate the training of personnel and can channel technological transfers to domestic firms. It can be excessively difficult, and perhaps technologically not possible, for a contemporary developing economy to develop efficient heavy industrial sectors or to gain international competitiveness in several export

manufacturing sectors without large levels of capital and technology from international actors.

However, the impact of foreign capital, foreign direct investment, and foreign technological inflows into a developing economy goes far beyond these seemingly positive effects. For example, foreign direct investment may, in theory, bring in needed capital for investment financing, but often foreign investors actually accumulate a large proportion of their investment capital in host country capital markets.¹ This utilization of domestic resources by foreign firms not only defeats one of the theoretically positive aspects of foreign direct investment (namely additional sources of savings), but also has the effect of decreasing the level of capital available to domestic enterprises. This, in turn, increases the cost of capital to local firms, decreasing the level of local production and its competitiveness. Foreign direct investment also has a tendency of replacing existing domestic enterprises through direct takeover. According to Vernon, one-third of foreign subsidiaries in developing countries are the result of direct acquisition of existing domestic enterprises.² In effect, these activities result not in increased capital formation or domestic production levels, but rather facilitate the "denationalization" of the domestic production apparatus of the host country.

1. Ronald Muller, "Poverty is the Product," Foreign Policy, Winter 1973-74, pp. 240-252. Peter Evans, "National Autonomy and Economic Development: Critical Perspectives on Multinational Corporations in Poor Countries," in Robert Keohane and Joseph Nye, ed., Transnational Relations and World Politics, (Cambridge, Mass.: Harvard University Press, 1972). Richard Barnett and Ronald Muller, Global Reach, (New York: Simon and Schuster, 1974), pp. 152-165.

2. Raymond Vernon, The Storm Over the Multinationals: The Real Issues, (Cambridge, Mass.: Harvard University Press, 1977), p. 72.

Empirical studies have indicated that a primary motive for foreign investment in developing countries is to overcome trade and other barriers in order for the foreign firm to increase its local market share.³ Under the circumstances that the foreign firm is investing to produce goods that were not previously produced domestically, the investment can be beneficial to the host country's balance of payments. However, often the investment is placed in order to capture a larger share of a market from domestic producers and not as an import substitution enterprise, thereby decreasing local production levels in that sector.

Substantial levels of foreign ownership in significant production sectors can subject the developing economy to a pattern of investment and marketing rules determined by the interests of the foreign investor as well as increase dependence on foreign inputs in order to maintain production levels. Often these patterns and inputs will serve the interest of the foreign investor to the detriment of the developing economy. For example, foreign direct invested firms often adopt overly capital intensive production techniques that are familiar to the foreign investor but inappropriate to the labor needs of the host country. Foreign investors, likewise, often import technology from parent firms that is inappropriate for the developing economy at too high a cost. These policies allow the foreign investor to maintain a technological advantage at the expense of the local economy.⁴

3. Richard E. Coves, Multinational Enterprise and Economic Analysis, (Cambridge, England: Cambridge University Press, 1983), pp. 36-56, 195-226. In a survey of foreign investors in Korea conducted for this study, 88 percent of foreign firms surveyed reported the primary motive for their original investment in Korea was to expand their share of the local market.

4. Ronald Muller, op. cit., pp. 255-259.

Foreign investors often set artificially high transfer prices in order to extract excess profits and to avoid paying host country taxes. That is, foreign investors tend to import goods and technology from their parent corporations at higher prices than similar goods or technology available from other sources in order to increase artificially the cost and decrease the subsidiaries' profit level. This limits taxes payable to the host country and exerts unnecessary strain on that country's balance of payments.⁵ Transfer pricing is designed to maximize the profits of the foreign investor and to divert these funds from the developing economy to the global needs of the multinational corporation.

In addition, as foreign direct investment increases, particularly in key industrial sectors, the influence of foreign governments over economic and political decision making in the host nation is increased, thereby reducing the level of autonomy of the developing nation. A representative of the American Chamber of Commerce in Seoul often lamented that the American embassy would exaggerate investment opportunities to potential U.S. investors in Korea in order to increase the absolute level of U.S. investment. This was done because the embassy perceived that increased U.S. investment levels would increase U.S. political influence over the Korean government.

Although foreign capital and technology may be necessary to facilitate industrial development in a developing economy, foreign penetration can also involve several major economic and political contradictions that may be detrimental to the host country's economic

5. International Monetary Fund Research Department, Foreign Private Investment in Developing Countries, (Washington, D.C.: International Monetary Fund, Occasional Paper No. 33, 1985), p. 11.

✓ development. The foreign investor's goal is to generate profit and dividends paid to their global offshore concerns, while the goal of the developing economy is domestic economic growth which requires the generation of savings and its reinvestment back into the domestic economy. Allowed to function free of host country's control, foreign direct investment will tend to maximize the global corporate position, which may significantly increase the cost and reduce the benefits that a developing economy receives from its interaction with foreign investors.

The principal question concerning the relationship between the developing economy and the international economy is not simply whether ✓ foreign capital and technology is beneficial to the host country's economic development (because it provides capital, technology, managerial skills, and marketing expertise), or whether it is detrimental (because it increases dependence levels, utilizes inappropriate technology, expropriates national savings, and facilitates foreign control over key decisions in developing countries). Clearly, evidence of both benefits and detriments of foreign penetration into developing economies is abundant. The ✓ principal question becomes, what strategies can be implemented by the developing country to induce necessary foreign inputs while regulating and controlling foreign penetration into the economy in order to maximize the benefits received and minimize the costs of foreign penetration.

If policies and mechanisms to induce and regulate needed foreign inputs into the developing economy are to emerge, they must come from the state. The state is the sole institution in a developing country with the potential authority and capacity to formulate, implement, and

monitor enforcement of policies designed to control interaction with the international economy. The state, through the implementation of appropriate policy, possesses the capacity to manage foreign penetration into the domestic economy in a manner that allows for the inducement of needed inputs while constraining foreign penetration that is unsuited for domestic economic needs.

Foreign actors who will create desired linkages within the production apparatus of the developing economy need to be induced through various incentives, while foreign actors who desire to penetrate sectors in which national producers possess the capacity to meet capital, technical, and other factor requirements need to be restricted or prohibited. In addition, foreign actors who are induced for capital, technical, or other specific purposes must be regulated in such a manner that the domestic economy will maximize the benefits it receives from this foreign penetration. For example, the state can demand that foreign investors formulate their investment capital offshore rather than from domestic capital markets. Wherever possible, the state can require foreign investors to form joint ventures with domestic firms as partners. Joint ventures will increase the likelihood of technical and managerial skill transfers to local firms. Joint ventures also allow a portion of the profits to be captured by locally held equity, which, in turn, increases domestic savings levels. As conditions of entry, the state can require foreign investors to transfer specific technology or to export specific levels of output. The state can limit practices of transfer pricing by requiring foreign investors to purchase domestically produced inputs, provided that they are available, thereby aiding domestic industry and the balance of payments. These are only a few of a multitude of

policies available to the state of a developing economy to increase the benefits and to decrease the costs of foreign penetration into the domestic economy.

Theoretically, the state in a developing country possesses the potential to regulate the conditions of foreign penetration into its economy; however, in reality, there are several factors that limit that potential. A major constraint to regulating effectively foreign penetration in a large number of developing countries is an honest desire by the state elites to control foreign penetration in the first place. Simply put, benefits received by the local economy from foreign capital and technological penetration will not be maximized if the ruling elites are in a compradore position. That is, where state elites tend to have their personal wealth and vested interests tied to foreign capital, they will not have the will nor the capacity to regulate effectively foreign capital. In this situation, domestic control over production apparatus and the control of foreign interaction within the domestic economy will not be pursued vigorously by the state because the ruling elites have already established a higher priority on their personal interests over the interests of the national economy. If effective regulation and control of foreign penetration in a developing economy is to occur, the ruling elites of that nation must possess a unified goal to maximize domestic control over production as well as a unified desire to establish state mechanisms to facilitate the accomplishment of that goal. This requires the presence of a nationalist-oriented, hard state which possesses the internal strength to impose a consistent strategy of control over foreign penetration of the domestic economy. It also requires an ideological unity within the elite group as to the

necessity of regulating foreign penetration and a state development strategy that views domestic industrial development as a first priority. These are necessary preconditions if the benefits of foreign penetration into a developing economy are to be maximized and the negative effects of foreign penetration are to be minimized. However, such nationalist, hard states are not the norm in the contemporary developing world.

A second primary factor that limits a state's ability to regulate effectively foreign penetration into the domestic economy, paradoxically, is the relative attractiveness of the developing country's domestic market to foreign penetration. In the industrial development process, foreign input into certain sectors becomes necessary for rapid, efficient development. However, foreign investment will only flow to those countries where the foreign investor perceives a market that will allow for a given level of profitability. If the state's demands on foreign capital are viewed as too stifling to a foreign investor to assure a given level of profitability, the input needed will not be induced, and the industrial development effort will be retarded. It is relatively easy for a state to restrict undesired foreign penetration. However, the ✓ inducement of needed foreign inputs under conditions of regulation can be an extremely delicate interaction.

The state's bargaining strength with a foreign investor is relative, and, to a large degree, related to the investment climate of the host economy. The stronger the investment climate, the more the likelihood exists for corporate profitability, and, in turn, the greater the degree that the state can place demands on a desired foreign investor and still induce that investor to enter into an

✓ investment agreement. If a foreign investor is to give up partial control to a joint venture arrangement, agree to transfer specific technology, be required to export given shares of output, or make other concessions not directly in the investor's interest, he needs to be confident of a certain level of profitability, or he will place his investment elsewhere.

The relative attractiveness of an investment climate to a foreign investor depends upon many factors. Such factors as the size and structure of the domestic market, labor skill levels, labor costs, labor discipline, tax structures, profit remittance policy, positive exchange rates, appropriate and cost-efficient transportation, communication and power infrastructure, and political stability affect the attractiveness of a particular domestic economy to a foreign investor. Without a favorable balance of these factors, the bargaining position of the state vis-a-vis foreign investment is highly limited.

In order to attract needed foreign investment under poor investment climate conditions, the state needs to offer a package of incentives such as tax holidays, subsidies, and monopoly rights, which in themselves are not directly in the national economic interest. As the size of the local economy and market grows and as infrastructure and labor skill levels improve, the attractiveness of that national economy to foreign investors increases. This, in turn, strengthens the bargaining position of the state. The factors involved in establishing an attractive investment climate for foreign investors can be positively influenced by appropriate state policies and efficient allocation of resources. As the investment climate attractiveness increases, so does the state's capacity to control and

regulate foreign penetration. The state must not attempt to over-control foreign investors relative to its investment climate attractiveness, or needed foreign actors will go to other locations. However, to undercontrol will decrease the benefits received by the domestic economy. The state in the developing country must be conscious of its relative position vis-a-vis foreign actors and develop the capacity to bargain effectively.

✓ Effective national economic planning can increase the state's bargaining position vis-a-vis foreign investment. This planning must include the delineation between sectors and projects in which local producers possess sufficient resources and skills to produce at required levels and those sectors and projects which are necessary for national economic development goals but require foreign input. Sectors and projects in which domestic production knowledge is sufficient for national development needs should be designated as areas where foreign penetration is not desired. Foreign investment into these "non-desired" sectors and projects should be strictly limited or prohibited by the state. Those sectors and projects targeted as necessary for the achievement of national economic development objectives but where domestic technical or other expertise is insufficient to meet development needs should be designated as "desired" areas for foreign investment. In desired sectors, the state can facilitate domestic economic development through the identification of specific foreign inputs that are necessary to meet development objectives, and then offer economic incentives to induce foreign investment into those areas. In this manner, foreign actors may be induced to provide necessary technology and services to facilitate the achievement of development objectives but are

restricted from decreasing or eliminating domestic production capacities or from gaining control of sectors or markets where their presence and assistance are not necessary.

This approach requires the state to possess both the capacity and will to establish long-range development plans that realistically account for existing economic structures and sectoral needs of the national economy. Development planning on the part of state elites must clearly delineate the role that both domestic and foreign actors need to play in achieving economic goals. Foreign enterprises should be allowed either in sectors that enhance the developing economy's international competitiveness and ability to earn foreign exchange or in sectors where foreign technological capacity will create necessary linkages that complement national investment and production needs. Prior to the approval of any foreign investment proposal, the state needs to evaluate such factors as the sectoral and special location of the project, the size and source of financing, technological transfer potential, the ratio of labor to capital, personnel training, the ratio of foreign to local equity levels, appropriateness of the technology, export potential, the rate of local integration of inputs, divestiture rate of foreign equity, and forward and backward linkages of production processes. The overall net effect of these factors needs to fit the objectives and needs of planned economic development patterns. Otherwise, the investment should not be allowed to penetrate the domestic economy. All of these factors should also be explicitly specified in a formal investment agreement between the foreign investor and the state.

Once foreign investments enter the economy, the state needs to develop bureaucratic mechanisms that effectively monitor the

activities of the foreign investors to assure that they comply with the terms of the original investment agreement. Under a policy where the state controls foreign investment, it is intended that foreign investors can generate an adequate profit for their services, but the state is also restricting the activities of the foreign investors and requiring the investors to provide specific knowledge or services to the domestic economy in return for the right to earn a profit in that domestic economy. Usually, the restrictions placed upon the foreign investors are not directly in the foreign investors' interest. It cannot be assumed that the foreign investors will voluntarily abide by the original terms of the investment agreement. The state needs to develop bureaucratic mechanisms to monitor the terms of all foreign investment in order to ensure that intended benefits to the national economy are, in fact, transferred.

Under the above conditions, state policies and mechanisms to induce, regulate, and monitor foreign penetration effectively become the primary variables to ensure the likelihood of the effective integration of foreign actors into the developing economy. In order to increase the benefits that can be received through its interaction with the international economy, the state in the developing country must allow only those foreign investments that fit the national development scheme. Foreign investments that are deemed "desired" need to be offered incentives in order to assure their inducement, but the cost of those incentives need to be kept in relation to the benefits that are to be received from those investments.

This chapter will examine Korean state strategies and institutions that have been designed to induce and regulate economic interaction with the international economy in order to maximize

national ownership of production apparatus and to maximize the benefits that the national economy receives from this interaction.

Legal and Bureaucratic Control of Foreign Penetration in Korea

Since the military coup in 1961, the Korean state has actively and effectively attempted to manage foreign capital and technological inflows to fit a pattern that complements state development plans.

✓ Korean state policies in relation to foreign capital and technological inflows have been of an economic nationalistic character. Here, economic nationalism can be understood to mean the pursuance of industrialization policies specifically designed to develop and maximize the strategic and economic interest of the nation-state. In conjunction with the principal economic objective of rapid economic expansion, the Korean state has actively pursued a policy that attempts to maximize Korean national ownership over the means of production. While allowing and at times actively inducing foreign direct investment to develop particular sectors of the economy, the Korean state has effectively restricted foreign investment from capturing Korean market shares away from domestic producers and has consciously developed and enforced policies that promote Korean independence from reliance on direct foreign investment.

These policies of the Korean state toward foreign penetration of the domestic economy have been enforced by legal and bureaucratic mechanisms, and have resulted in direct foreign investment patterns that are structured significantly different than in most developing countries. As I will make evident, Korean state policies have allowed

for the inducement of most state "desired" foreign investment, while simultaneously establishing a pattern and structure of foreign investment that has increased domestic technological knowhow and capital accumulation and maximized domestic ownership over the means of production. This, in turn, has effectively increased domestic control over major economic decisions and has increased the benefits that the Korean economy has received from its interaction with the international economy.

Korea's long and unhappy history of colonial domination and manipulation by foreign powers has made sovereignty over the economy a key issue of government policy and national pride.⁶ Korean history has been characterized by foreign intervention and exploitation. Chinese, Mongol, Manchurian, and Japanese armies have conquered and ruled Korea. All have exploited Korea's economic resources. The Japanese colonial period (1910-1945) was particularly harsh and dominates the Korean interpretation of 20th century history. The division of Korea was decided upon and carried out by Soviet and American forces for their own political and global purposes and against the will of the Korean people. The fifteen-year rule of Rhee Syng-man saw the Korean economy and national survival become totally dependent upon foreign economic aid and foreign troops. By the early 1960's, foreign advisors controlled key economic and military decisions. However, foreign aid at this time was being greatly

6. G. Cameron Hurst III, American Problems Doing Business in Korea, (Hanover, New Hampshire: Universities Field Staff International Paper No. 19, 1984), p. 11. Kwan Tae Shin, Deputy Director, Investment Promotion Division of the Korean Ministry of Finance, said in an interview, "Korea has a nationalist desire not to let direct foreign investment control any more than absolutely necessary. Korea can't trust its economic interests to foreigners. . . . This is a result of Korean culture after centuries of foreign domination and the military threat from the North."

reduced, and foreign resolve to fight on Korean soil was no longer guaranteed.⁷ To Koreans, interaction with the international arena has been anything but mutually beneficial. Among Koreans, there is the common belief that national interests need to be closely guarded, and any national advantage needs to be actively pursued if it is to yield benefits.

When the military government of Pak Chung-hee came to power, the enhancement of national sovereignty, both strategic and economic, became the primary objective of the state.⁸ To achieve this objective, a strategy to develop key "strategic" industries was pursued. The Pak regime realized immediately that interaction with the international economy was necessary in order to secure the capital, technology, and market access required to industrialize successfully. However, the regime did not believe that the national interest would be effectively served if foreigners were to control major economic sectors within the Korean economy. The international economy was viewed as a hostile foreign environment that did not treat all national economies in an equally beneficial manner.

Because of the unequal nature of interaction with the international economy, key elements within the Pak government perceived the need to act vigilantly in order to secure the state's interests in its international dealings. These leaders believed that financially strong and technologically advanced foreign firms would undermine the development of domestic firms and the ability of the state to control key economic decisions. Foreign direct investment

7. David Cole, et al., The Korean Economy: Issues of Development, (Berkeley, Cal.: University of California, Institute of East Asian Studies, 1981), pp. 12-21.

8. Chang Dal-joong, Economic Control and Political Authoritarianism, (Seoul: Sogang University Press, 1985), p. 90.

would benefit the Korean national interest only when it produced in a manner that complemented state development planning, principally by developing key industries that were technologically too complex for domestic producers or by producing foreign exchange earning exports. Foreign investment would not be considered beneficial to Korean national objectives when it competed on the Korean market with domestic firms.

In accordance with these nationalistic perceptions, strict rules were established governing the inflow of foreign capital and technology in order to ensure that foreign penetration enhanced and did not hinder or compete with the development of domestic enterprises.⁹ The state then established elaborate bureaucratic mechanisms to control the inflow of foreign capital and technology. All foreign capital and technology would be required to be screened by government agencies and reach formal agreement with the government. These agreements would specify and limit the activities of foreign investors within Korea. The state also established mechanisms to monitor closely the activities of foreign enterprises after their arrival into the Korean economy to assure their compliance with the original entry agreement.

Economic development for the Pak government was largely a political imperative to facilitate economic growth and production that would lead to an enhancement of national power and sovereignty.¹⁰ Strategies needed to be developed that would establish legal and bureaucratic mechanisms to induce necessary foreign capital and

9. Koo Bohn-young, Industrial Structure and Foreign Investment, (Seoul: Korea Development Institute, Working Paper No. 8402, 1984), p. 7

10. Chang Dal-joong, op. cit., pp. 90-91.

technology, but also to regulate those foreign inputs in a manner that would maximize the benefits to local capital accumulation and domestic industrial production. The state needed to develop mechanisms that would direct, regulate, and monitor capital and technological inflows to shape the pattern to be complementary to national industrial interests.

V Korean state control over the inflow of foreign capital and technology was legally established under the Foreign Capital Inducement Act (F.C.I.A) of 1961 and its subsequent revisions. The F.C.I.A. became the principal legislation to control the inflow of foreign capital loans, foreign direct investment, and foreign technology. This act was intended to increase the attractiveness of lending to and investing in Korea, while placing the control of the pattern of inflows in government hands.

Under this act, the government guaranteed the repayment of all foreign capital loans approved by the Economic Planning Board. In effect, foreign financial institutions were assured that their loans to Korea were "sovereign risks." This act significantly increased Korea's ability to secure funds in international financial markets. However, all foreign capital loans were required to receive state approval prior to their arrival to Korea. Through the Economic Planning Board and later the Ministry of Finance, the state established bureaucratic agencies and rigorous screening procedures over all foreign loans.

In order to be approved, all loan applications had to pass rigorous tests involving sophisticated econometric techniques to analyze their probable economic impact on the Korean economy. The funds also had to flow to industries targeted by state development

planners and to producers with necessary technological capacities to utilize effectively the capital. This screening process allowed the state to control the size and sectoral direction of foreign loans entering the Korean economy and attempted to assure that a loan would generate a rate of return in excess of interest payments as well as aid the national balance of payments.¹¹ Over 50 percent of all foreign loan approvals since 1961 have been allocated to economic infrastructure projects designated by state development plans. The remaining funds have principally flowed to targeted export production or industrial import substitution projects. Foreign borrowed funds have not been approved by the state if they were to be used for consumption purposes.

The Korean government also developed bureaucratic mechanisms to monitor the use of borrowed capital and standards by which to measure

11. In an interview with Koo Bohn-young, Special Economic Advisor to the Deputy Prime Minister and Minister of the Economic Planning Board, Koo explained the loan approval procedure. Koo emphasized that in order for a foreign loan to be approved, the state must be convinced that a high level of certainty exists that the borrowed capital will generate a rate of return in excess of interest payments, aid balance of payments, flow to a targeted industry, and flow to a producer with sufficient technical and marketing expertise to meet projected output levels.

Koo's argument was strongly supported by a survey of eighteen major foreign banks in Seoul conducted by myself in 1986 (see Appendix). The survey included American, Japanese, British, and French banks. One hundred percent of the bankers surveyed agreed that the Korean state screening process allows the state to control the size and sectoral flow of all foreign capital inflows. All bankers surveyed further agreed that the screening process assures a high level of certainty that foreign loans will aid the balance of payments. Eighty-eight percent of the bankers surveyed agreed that the screening process assures a high level of certainty that borrowed funds flow to targeted industrial development.

One banker who had served in Brazil for five years in the 1970's and who has been in Korea for four years claimed that in Brazil the government had little idea of where foreign loans would flow or if they would lead to increased production. Often, loans were used for consumption. Loans were also not monitored in Brazil. In Korea, the state closely monitors foreign loan funds after arrival to ensure that they flow only into approved investment and to ensure that production output projections are met after the production facility becomes operational.

its effective usage. Further access to foreign loans by a Korean enterprise is dependent upon the effectiveness by which that enterprise utilized previously borrowed funds. If an enterprise does not meet state established output levels or has trouble meeting its debt obligations, the Korean state stops further foreign borrowing for that enterprise. The Korean state can also take over the management of an enterprise that does not effectively utilize foreign funds or force its sale to another Korean firm.

The F.C.I.A. was also intended to be the principal legal mechanism by which the government could induce and regulate direct foreign investment and foreign technological inflows. The F.C.I.A. empowered the Economic Planning Board to offer incentives to induce desired foreign investment and technology as well as the authority to deny other foreign investment proposals in an attempt to coordinate foreign inputs with overall economic development objectives.¹² As stated in the F.C.I.A., the government's policy is to induce and protect foreign capital that is necessary to the sound development of the national economy and the improvement of the balance of payments and to manage properly such foreign capital.¹³ The F.C.I.A. guarantees the right of foreign firms to repatriate profits and offers generous tax and other financial incentives to foreign investment deemed important and approved by the E.P.B. (Approval decisions on foreign capital and technological inflows were transferred to the Ministry of Finance in 1981.) However, the approval process is

12. Dong Sung Cho, "Incentives and Restraints: Government Regulation of Direct Investment between Korea and the United States," in Karl Moskowitz, ed., From Patron to Partner, (Lexington, Mass.: Lexington Books, 1984), p. 45.

13. Ministry of Finance, Investment Guide to Korea, (Seoul: Ministry of Finance, 1984), p. 19.

tightly controlled under the act, and only those foreign inflows regarded by government planners as complementary to the state industrial development strategy are allowed to enter the Korean economy.¹⁴ Foreign investment is either prohibited or highly restricted from entering the vast majority of consumer goods sectors and from sectors that compete in the domestic market with Korean producers. The F.C.I.A. contained a "positive list" that specifically listed designated sectors and projects open to foreign investors upon E.P.B. approval. All sectors and projects not specified on the positive list were prohibited to foreign investors.

The types of foreign investments listed on the positive list and thereby deemed as desirable by the E.P.B. -- projects that would contribute to an improvement in the balance of payments and projects which would contribute to the development of key targeted industrial sectors -- were encouraged to invest into Korea by financial incentives as generous as anywhere in Asia.¹⁵ In addition to guaranteed profit remittance, the F.C.I.A. mandated that foreign investments receive tax exemptions from all corporate, income, and property taxes for the first five years after arrival and a 50 percent exemption for an additional three years. The F.C.I.A. also allowed double depreciation, the negotiation of reduced utility rates, state guarantees against labor strikes, and the exemption from customs duties paid on imported capital goods.

The F.C.I.A. and the positive list have been revised on a regular basis in order to update policies so that they continuously

14. Koo Bohn-young, op. cit., 1984, pp. 18, 26-28.

15. Larry Westphal, et al., Korean Industrial Competence: Where it Came From, (World Bank Staff, Working Paper No. 469, 1977), p. 18.

For comparison of incentives to foreign investment offered by governments in Asia, see: "Special Survey of Foreign Investment in Asia," The Economist, June 23, 1979, pp. 8-9.

complement the changing needs of the rapidly expanding Korean economy. For example, in 1966 the required infrastructure was in place to encourage a rapid increase of labor intensive export sectors. At this point in time, the government recognized an opportunity to expand export and employment levels, yet domestic production techniques and marketing skills necessary to be successful in international markets were insufficient. To encourage foreign investment and expertise into labor intensive export sectors, the F.C.I.A. was revised to include several potential labor intensive sectors, but for export only. With their inclusion on the positive list, the package of financial incentives was extended to foreign investors in these sectors. The ceiling on the dollar value of investment was reduced as were requirements on domestic ownership levels.¹⁶ In conjunction with these alterations in the F.C.I.A., the Ministry of Finance devalued the currency. This set of state policy reforms induced several hundred small-scale labor intensive export producers to relocate in Korea.

By 1973, the Korean economy had expanded, domestic savings levels had significantly increased, foreign capital loans had become more readily available, and Korean production and marketing expertise of labor intensive export sectors had grown to a point where Korean producers no longer needed foreign technical assistance to compete successfully in international markets. This, in turn, significantly altered Korea's needs from and relationship with the international economy. In 1973, the F.C.I.A. was once again revised to complement more closely the economic objectives of the state. The ceiling on the

¹⁶. Charles R. Frank, Jr., et al., South Korea: Foreign Trade Regimes and Economic Development, (New York: Columbia University Press, 1975), p. 105.

minimum dollar value of foreign investment was raised. The logic was that capital was now available to finance Korean-owned, labor intensive enterprises and that labor-intensive, export production technology and marketing skills had been gained by domestic personnel. As a further control on labor intensive export expansion by foreign concerns, the 1973 F.C.I.A. revisions removed several labor intensive sectors from the positive list, thereby prohibiting foreign investments outright in those sectors. These alterations in the F.C.I.A. effectively eliminated the foreign sector from increasing its control over the labor intensive export sectors. The revised F.C.I.A. allowed only Korean firms financed principally by state financial institutions to expand in these sectors.

Meanwhile, as the Korean state was attempting to increase domestic ownership and control of the relatively mature labor intensive export sectors, the state was simultaneously attempting to nurture the development of infant heavy and chemical sectors. The F.C.I.A. revision closely reflected this by placing specified heavy and chemical production sectors on the positive list and by offering a complete package of financial incentives to these foreign investments.

By the 1980's, most heavy and chemical sectors in Korea had become developed, and domestic production skill and marketing expertise had been learned. Government economic planning now called for the development of higher, technologically sophisticated sectors. The F.C.I.A. and the positive list were again revised as the Korean needs from the international economy shifted. In 1981, most heavy and chemical sectors were removed from the positive list, or if they remained on the positive list, they were granted very limited financial incentives. Several more technologically sophisticated

sectors -- specifically those involving digital electronics, fiber optics, genetic engineering, advanced metallurgy, or related areas -- were added to the positive list and offered highly favorable financial incentive packages. The Korean experience had taught government economic policy makers that domestic control of a viable production sector could be increased once a sector had begun to be developed and the requisite technical and marketing expertise had been gained by domestic sources. However, the rapid development of a new sector was best facilitated by immediate and appropriate foreign input.

In 1984, the F.C.I.A. was again revised. The positive list was abolished and replaced by a negative list. In theory, all sectors and projects not specifically prohibited or restricted by the negative list became open to foreign investment. However, in practice, all investments must still gain state approval on an individual basis, and many investment applications not specified on the negative list have been denied by the government. Under the present version of the F.C.I.A., sectors open to foreign investment are not automatically offered any specific financial incentives. However, the individual investor can negotiate with the government for tax holidays and other privileges. In general, only those investments that offer the introduction of a technology specifically desired by Korean policy makers or investments that will produce only for export tend to negotiate successfully on financial privileges.

The F.C.I.A. has provided an effective legal framework by which the Korean state has been able to manage the sectoral flow of foreign inputs. It has facilitated the inducement of desired foreign inputs to specific sectors and projects, while prohibiting or restricting

foreign activity in sectors where Korean producers had gained sufficient technical and marketing skills to meet production demands.

To implement and enforce the F.C.I.A. and to regulate interaction with the international economy in general, the Korean governmental leaders developed elaborate bureaucratic mechanisms. The principal bureaucratic agency in this regard has been the Foreign Capital Deliberation Committee attached to the E.P.B. until 1981, then transferred to the Ministry of Finance. The membership on this committee was made up of high-ranking officials from the various economic oriented ministries. All foreign loan applications, investment proposals, and technological transfer agreements must be approved by this committee. All proposals for foreign economic inflows are individually passed from the Foreign Capital Deliberation Committee to the ministries that are concerned with the subject matter of those proposals. Proposals are then reviewed in detail on an individual basis at each concerned ministry to assess their economic and technological impact on the Korean economy and to assess their political desirability.¹⁷ Before the Foreign Capital Deliberation Committee approves any individual foreign inflow, all concerned ministries must approve that inflow. If a proposal is deemed unfavorable to the balance of payments by the Ministry of Finance, or if it is deemed to be in competition with a domestic producer by the Ministry of Trade and Industry, or if the Ministry of Science and Technology rules the proposal calls for the importation of technology already available on the domestic market, the proposal is denied.

Merely because a sector or project is listed on the F.C.I.A. as open for foreign investment does not guarantee a proposal in that area

17. Dong Sung Cho, op. cit., pp. 46-47.

will be approved by the government. The F.C.I.A. serves to identify general sectors open for proposed foreign activity, but individual applications are subject to detailed examination for their individual economic and political impact. The F.C.I.A. provides legal prohibitions to those foreign inflows that the government clearly does not desire and guidelines to those that may be desired. However, the highest level of the bureaucracy maintains the authority and capacity to rule on a specific foreign inflow based upon its analysis of the impact of that inflow on the Korean economy. This system of legal and bureaucratic mechanisms has allowed the Korean state to channel foreign economic inflows in a manner that complements the broader economic and political goals of the state (and to reject those foreign inflows that do not).¹⁸

All foreign investment proposals are required to specify the nature of the project, the level and source of investment capital, the specific technology that will be transferred, the ratio of capital to labor, the methods of training and promoting local personnel, the projected levels of output, the ratio of output to exports, and the ratio of foreign to domestic equity holdings. All of these factors are then carefully reviewed by the Foreign Capital Deliberation Committee and the respective ministries prior to any proposal approval. Requiring a well-specified investment proposal allows the government to calculate more accurately the impact of that investment on the Korean economy and increases the state's capacity to monitor and control the foreign investor's activity after arrival. In addition, if there is more than one foreign investor interested in

18. T. Jefferson Coolidge, Jr., "The Realities of Korean Foreign Investment Policy," Asian Affairs, July/August 1981, pp. 370-385. Chang Dal-joong, op. cit., pp. 174-178.

investing in a particular sector or project, the Korean government will use investment proposals as bids and bargain with the competing foreign investors to alter the terms of their proposal to be more advantageous to Korean economic interests. For example, the Dupont Corporation proposed to build a \$150 million production facility to produce TiO_2 . TiO_2 is a whitening agent used in many products produced in Korea. Presently TiO_2 is not produced in Korea, and is an industry designated as open by the F.C.I.A. The Korean domestic chemical industry does not independently possess the capacity to produce TiO_2 . According to the F.C.I.A., a foreign investor can legally hold 100 percent of equity in a TiO_2 project. Dupont originally proposed that they would hold 100 percent of the TiO_2 project. The Foreign Capital Deliberation Committee began to review Dupont's proposal. However, at the same time, Kerr McGee proposed to build a similar facility but as a joint venture project with a Korean firm. The Foreign Capital Deliberation Committee, without officially rejecting Dupont's proposal, notified Dupont of the Kerr McGee proposal and suggested Dupont find a joint venture partner and submit a new proposal. According to the general manager of the Dupont operation in Seoul, the only way Dupont will get approval, regardless of the F.C.I.A., is to outbid Kerr McGee by offering a greater degree of technological transfer and by accepting fewer financial incentives.

These legal and bureaucratic mechanisms are directly intended to manage foreign economic penetration into the Korean economy to assure that it flows to sectors that complement Korean development plans and provides the necessary technology, raw materials, and international marketing expertise at the lowest cost to the Korean economy. The state has been able to shape foreign interaction in a manner that

closely resembles the state's industrial development strategy. In Korea, the ruling elites had a unified objective to develop industrial capacity and to maximize national ownership over the production apparatus. Legal and bureaucratic mechanisms were established to implement these objectives. In conjunction with these legal and bureaucratic mechanisms, specific policies were pursued as a strategy to utilize actively the international economy to serve national development needs and to aid the development of domestic enterprises.

Korean State Strategies and the International Economy

Foreign penetration into a developing economy can be broken down into three principal categories: 1) foreign capital inflows, including foreign aid, concessional loans, and commercial loans, 2) foreign direct investment, and, 3) technological licensing agreements. The principal objective of the Korean state leadership in international economic interaction has been to shape the pattern of foreign penetrations in a manner that would induce inputs necessary to facilitate industrial development patterns, while simultaneously maximizing Korean ownership and control over the means of production. To achieve this objective, the Korean state implemented a variety of policies and strategies.

Korean state leaders have consistently viewed foreign direct investment as the most threatening form of foreign penetration to development objectives. Foreign direct investment, the Korean state perceived, would lead to direct foreign ownership and control over production apparatus; capture domestic market share from local

producers; increase consumption levels, thereby decreasing domestic savings; and expropriate profits that need to be reinvested into the domestic economy. The state perceived that foreign direct investment would only serve Korean development needs if it would provide a technological transfer necessary to facilitate the development of a targeted sector or project, if it would create a forward or backward linkage in a targeted import substitution sector, or if it would produce exclusively for export, thereby earning foreign exchange and providing employment while not capturing local markets from domestic producers. As a source of investment capital in itself, foreign direct investment was viewed by the Korean state as detrimental to overall development goals due to the foreign control it allowed and its expropriation of capital over the long term.¹⁹

Foreign capital sources were necessary to facilitate rapid economic expansion in Korea and played a major role in this regard. However, the Korean state has tended to pursue foreign capital loans to direct investment as a more desirable form of capital penetration.²⁰ Loans, especially long-term concessional loans from international financial institutions and commercial bank loans as well, were considered by Korean economic planners as more desirable

19. Karl Moskowitz, ed., From Patron to Partner, (Lexington, Mass.: Lexington Books, 1984), p. 11.

20. In an interview with Koo Bohn-young, Special Economic Advisor to the Minister of the Economic Planning Board, Koo stated, "Loans have always been preferred over direct investment because more benefits stay in Korea. Direct foreign investment is restricted to those projects where foreign marketing or technical skills are required. If only capital was required, the government would attempt to borrow it. After the 1974 oil shock, when funds became readily available, this strategy could be followed relatively easily."

In a survey of 18 foreign banks in Seoul conducted for this study, 81 percent of respondents claimed that the government has consistently followed a strategy of inducing loans for foreign capital needs.

than direct investment for both political-strategic and economic considerations. Loan funds could be channeled by state financial institutions to domestic producers. This would allow for Korean ownership which would reduce dependence on foreign producers and, theoretically, establish producers more tied to national security and national survival than foreign concerns.²¹ The second reason foreign loans have been preferred by the Korean state over foreign direct investment is based upon economic considerations. Although reliance upon foreign capital borrowing has created the large debt burden that the Korean economy presently bears, the Korean state leaders have concluded that as long as borrowed funds generate productive outcome, loans are less costly to the national economy over the long run than is direct foreign investment. Loans produce a drain on the national economy immediately, but when the loans are paid off, domestic ownership and further profits generated remain in Korea. On the other hand, foreign direct investment, although not draining the economy with loan service requirements, continually drains the economy through

21. This conclusion is based upon a series of interviews and questionnaires conducted for this study. According to Ray Beban, the International Monetary Fund Representative in Seoul, "The Korean foreign capital accumulation strategy has been to borrow capital and license technology wherever possible in order to avoid foreign equity ownership." The general manager of the Chase Manhattan Bank in Seoul claimed, "It has been the conscious and managed policy of the Republic of Korea government to use external borrowing to promote growth of the economy. At the same time, it is the conscious and managed policy of the Republic of Korea government to ensure that domestic industry is not foreign controlled. That means more debt and less foreign equity."

The Dupont general manager in Seoul believes that "if technology is locally available, a direct foreign investment will simply not be allowed." A Westinghouse vice-president claimed, "The Koreans would prefer to operate totally without foreign investment if that were possible."

Of 18 foreign banks surveyed, 92 percent responded that Korean borrowing to finance needed foreign capital requirements has allowed a greater degree of national control over major economic decisions than a similar level of foreign direct investment would have allowed.

the repatriation of profits and transfer pricing. "From a long-term point of view, the burden of foreign exchange outflow is greater on equity investment than on loans."²²

Korean state leaders have preferred loans as a source of foreign capital because it eventually leads to Korean control and increases domestic capital formation, while direct foreign investment increases dependence on foreign producers and continually siphons off capital from the Korean economy. As a result, foreign direct investment has played a minor role in Korean capital formation while loans have played a much more significant role. During the 1962-1971 period, direct foreign investment constituted only 4 percent of net inflow of foreign capital; between 1972-1976, 7.9 percent; and between 1976-1984, it constituted less than 4 percent.²³ In comparason to other developing countries, direct foreign investment between 1967-1971 constituted only 3.7 percent of net foreign capital inflow in Korea, while the comparable figure was 33.8 percent in Brazil, 36.6 percent in Mexico, 32.3 percent in Taiwan, and 26.1 percent in Thailand. Between 1972-1976, a period when several large capital-intensive import substitution foreign investments entered Korea, the ratio of direct foreign investment to net foreign capital inflow was still only 7.9 percent as compared to 22.9 percent in Brazil, 16 percent in

²². Study on the Criteria for Foreign Direct Investment and Joint Venture in Korea, (Seoul: International Management Institute, Korea University, 1972), pp. 54-56. This argument was also made in interviews with Kwan Tae Shin, Deputy Director, Investment Promotion Division of the Korean Ministry of Finance, with Koo Bohn Young, Special Economic Advisor to the Minister of the Economic Planning Board, and with Shin Dong Gyu, Assistant Director of the Foreign Capital Policy Division of the Ministry of Finance. Also see: Sung-Hwan Jo, Direct Foreign Private Investment in South Korea: An Economic Survey, (Seoul: Korea Development Institute, Working Paper No. 7707, 1977), p. 68.

²³. Major Statistics of Korean Economy, 1985, (Seoul: Economic Planning Board).

Mexico, 12.9 percent in Taiwan, and 28 percent in Thailand.²⁴ A major aspect of Korean development strategy in relation to the international economy has been to place strict limits on foreign direct investment if its principal contribution to Korean development is merely a source of capital, and rather to induce actively foreign loans that can be channeled to Korean producers.

In addition to viewing foreign loans as preferable to foreign direct investment as a source of foreign capital formation, the Korean state has preferred to induce necessary foreign technology through licensing agreements or other methods rather than through direct investment. This policy, again, is intended to facilitate domestic production and further limit foreign direct investment penetration into the Korean economy.²⁵ In targeted sectors where domestic technology was inadequate to meet planned production requirements, the Korean state preferred to license technology and pay the necessary licensing fees rather than allow direct foreign investment. In this regard, the Korean state has developed institutions whose staffs spend the majority of their time attempting to locate foreign technological sources willing to lease necessary technology to Korean producers. Foreign loans and technological licensing have been the preferred forms of interaction with the international economy by the Korean state. If the Korean state could induce the right variation of loans and technology through agreement, rapid economic expansion could be achieved with maximum levels of domestic ownership and control over production apparatus.

24. Economic Analysis and Projections Department: International Bank of Reconstruction and Development, Consolidated Balance of Payments, (World Bank, May 19, 1978).

25. Karl Moskowitz, ed., From Patron to Partner, (Lexington, Mass.: Lexington Books, 1984), p. 11.

Foreign direct investment would be preferred and sought after by the state when it would provide a technology that was necessary to develop a targeted import substitution sector and when that technology was not available domestically or through a technological agreement. Foreign direct investment would also be preferred when the foreign investor produced goods for export. The inducement of specific technology and export production was viewed by Korean economic decision makers as in the interest of Korean development objectives. Other types of foreign investments would not serve Korean interests and would be highly restricted by the state.

When a particular technology was deemed crucial to the development of a targeted sector and when that technology was only available through foreign investment, the Korean state, in order to facilitate development of that sector, aggressively pursued foreign investment by offering attractive economic incentives and at times guaranteed specific profit levels to induce a particular investment. Export producers were also offered economic incentives. However, other types of investments were restricted by state policy. If a proposed foreign investment was to compete on the domestic market with a domestic producer, or if the necessary capital or technology could be obtained through other means, that investment would not be allowed to enter the Korean economy. In this manner, the Korean state possessed a high capacity to shape the pattern of its interaction with the international economy.

The Korean state facilitated these policies toward foreign investment by screening all foreign investment proposals. During the early stages of industrial development, the Foreign Investment Deliberation Committee and its respective agencies screened foreign

investment proposals as to their specific technological transfer or foreign exchange earning potential. In the later 1970's, as the economy became more complex, and identifying and evaluating specific technological transfers became correspondingly more difficult, a procedure was devised whereby the Foreign Investment Bureau would screen all foreign investment applications and only refer those that passed certain given criteria to the full deliberation committee. In order for an investment application to be referred to the deliberation committee, the proposed investment needed to be listed on the positive list (and after 1984 not to be listed on the negative list) and needed to pass one of the three following tests:

1) The foreign investment would produce a product in Korea in which 70 percent of the pre-investment market share for that product is composed of imports, and the tariff on that product is less than 10 percent. The rationale is that the investment will be a major import substitution industry. If the tariff is under 10 percent, this indicates that it is a necessary input for a productive purpose and not for consumer consumption;

2) The foreign investment agrees to export over 80 percent of output, thereby earning foreign exchange and providing employment without competing on the domestic market with local producers; or,

3) The investment is in a sector targeted for development and the investment proposed contains specific elements of technological transfer either through a joint venture with a Korean partner or extensive training of Korean personnel. If a foreign investment fits one of these criteria, it was assumed to be potentially beneficial to Korean development objectives, and the proposal would be passed along to the Foreign Capital Deliberation Committee and the specific

ministries of concern for final approval. If the proposed investment did not meet one of the criteria, it was rejected.

Here, Korean general policy toward foreign capital and technological inflows has been explained. The following section will further specify Korean policies and analyze the impact these policies have had on the pattern of Korean economic development and on the structure of Korean interaction with the international economy.

The Inducement, Utilization, and Management of Foreign Capital Loans

The Korean economy has utilized foreign capital to a significant extent to finance development projects. By 1975, the Korean economy had received \$4.5 billion in foreign economic grants and assistance, plus an additional \$6.84 billion in military grants.²⁶ After 1975, foreign aid was virtually discontinued, but Korea significantly increased its foreign borrowing in the later 1970's and 1980's (see ✓ Table 4.1). By 1986, Korea had a total outstanding debt that exceeded \$45 billion, while an additional amount of approximately \$16 billion in principal had already been repaid to foreign sources. In addition, approximately \$1.1 billion had arrived in Korea by 1985 in the form of foreign direct investment.²⁷

26. Bank of Korea, Economic Statistics Yearbook, 1960, 1975. U.S. Government Agency for International Development, "U.S. Overseas Loans and Grants and Assistance from July 1, 1945 - September 30, 1976," as cited in Edward Mason, et al., The Economic and Social Modernization of the Republic of Korea, (Cambridge: Harvard University Press, 1980), p. 182.

27. Ministry of Finance and Economic Planning Board figures.

Table 4.1
Foreign Capital Arrivals
(in million dollars)

<u>Year</u>	<u>Economic Aid</u>	<u>Direct Investment</u>	<u>Loans</u>	
			<u>Public</u>	<u>Commercial</u>
1945-62	3,425.2	0.6	7.3	2.0
1962	232.3	0.6	5.3	2.0
1963	216.4	2.1	9.0	5.4
1964	149.3	3.1	11.0	19.0
1965	131.4	10.7	11.2	27.9
1966	103.2	0.2	62.8	109.7
1967	97.0	12.7	79.7	137.8
1968	105.9	14.7	112.1	252.1
1969	107.3	7.0	148.0	360.9
1970	82.6	25.3	146.7	283.0
1971	51.2	36.7	324.5	319.5
1972	5.1	61.2	437.5	298.6
1973	2.3	158.4	403.6	460.7
1974	1.0	162.6	385.2	603.1
1975	1.1	69.2	476.8	801.5
1976		105.6	713.0	839.0
1977		102.3	638.0	1,241.1
1978		100.5	818.0	1,913.2
1979		127.0	1,089.2	1,578.5
1980		96.6	1,516.5	1,402.4
1981		105.4	1,689.5	1,247.1
1982		100.6	1,868.1	913.7
1983		101.4	1,493.4	973.5
1984		170.7	1,424.4	958.4
1985		250.3	1,023.8	964.1
Total(1962-85)	1,286.1	1,824.9	14,887.3	15,712.2

Sources: Bank of Korea, Economic Statistics Yearbook, various years.
Economic Planning Board, Major Statistics of Korean Economy, various years.
Economic Planning Board, Status of Foreign Capital Inflows, various years.

Note: Loan figures are excluding short-term debt of less than 3 year maturity, which in 1983 totaled \$12.1 billion outstanding. Foreign direct investment figures are on arrival basis. Foreign economic aid figures are from the Bank of Korea. Other sources show discrepancy. The United States Agency for International Development in United States Loans and Grants and Assistance from International Organizations, July 1, 1945 - September 30, 1976 lists economic aid to Korea from 1945-1961 as \$3.2 billion, and from 1962-1976 as \$2.6 billion.

Foreign aid has not directly played a significant role in financing Korean industrial development. The lion's share of foreign aid was received prior to the military coup of 1961 and the subsequent industrial development. Foreign economic aid in the 1950's principally paid for consumer goods imports and government expenditure. Less than 30 percent of the total in economic aid received by Korea arrived after 1961, and only 10 percent arrived after 1966.²⁸ The principal contribution of foreign aid to the Korean economy, aside from its contribution to basic human needs immediately after the war, was that military aid was often used to develop transportation and communication infrastructure that could be utilized by commercial enterprises.²⁹ Perhaps, the most important contribution of foreign aid to Korean industrial development was that the aid received in the 1950's and early 1960's was in the form of grants and did not have to be repaid. This, in conjunction with export promotion policies in the 1960's, gave Korea a very low debt to export ratio. In the later 1960's, while many developing nations were struggling to meet debt service ratios of 20 to 30 percent, Korea's debt service ratio was under 10 percent. This gave Korea a relatively sound credit rating and increased Korea's capacity to gain access to World Bank and commercial loans to finance targeted industrial development projects.³⁰

Public and commercial loans from international sources have by far been the most significant source of foreign resources utilized in Korean industrial development (see Table 4.1). Foreign loans as a

28. Bank of Korea, Economic Statistics Yearbook, 1960, 1975.

29. Edward Mason, et al., op cit., p. 198.

30. Anne O. Krueger, The Developmental Role of the Foreign Sector and Aid, (Cambridge: Harvard University Press, 1979), p. 146.

source of investment capital should, in theory, provide needed investment funds while allowing a greater degree of domestic ownership of production apparatus and control over the domestic economy than similar levels of direct foreign investment. Loans will provide capital to finance domestically owned production, while direct investment is owned and controlled by foreign actors. Where domestic technological expertise and marketing knowledge is sufficient to meet production demands, but due to limited domestic capital formation a particular project can not be initiated, foreign loans are preferable to direct investment as this will allow for greater domestic participation and control. However, many developing countries that have attempted to follow a strategy of inducing foreign loans to finance domestic production have had major problems servicing their debts and have had to gain assistance from the International Monetary Fund in order to reschedule debt service payments. In the course of rescheduling their debts, these countries have had to relinquish a large level of autonomy over economic policy to the I.M.F. and other foreign financial institutions. In general, countries who reschedule debts must follow I.M.F. devised austerity government budgets and more openly allow direct foreign investment to flow into their economies. The rescheduling results in an increased control over the domestic economy by international actors. Thus, in effect, many nations that have adopted a strategy of loans in preference to foreign direct investment in order to increase domestic production have, in reality, significantly decreased their control over their domestic economic decisions and their ability to control foreign investment.

Following a strategy of inducing foreign loans in preference over foreign direct investment as a source of finance capital for

✓ economic development will allow a developing country to increase domestic control over the direction of its development only if those borrowed funds are utilized in an effective manner that leads to productive increases. If borrowed funds are utilized to build steel mills that do not function or monuments to ruling elites, or flow into private accounts in the Cayman Islands or in New York, debt service payments will not be met, and the developing economy will become vulnerable to the foreign penetration and control that accompany debt rescheduling. If foreign borrowing is to be used as a capital source that will lead to increases in domestic output and national control over key economic decisions, the state of the developing country must establish mechanisms that ensure that borrowed funds flow to domestic producers who possess, or can obtain, sufficient technological expertise and marketing knowledge to meet production demands, and then monitor and place responsibility on the recipients of the funds to assure that the funds result in productive output.

Since the enactment of the Foreign Capital Inducement Act, the Korean state has actively pursued foreign capital to aid in the financing of development plans. It is estimated that foreign capital borrowings have contributed an additional four percent a year to GNP growth.³¹ However, all inflows of foreign capital have had to meet the approval of the Economic Planning Board and the Ministry of Finance prior to their arrival in Korea. These agencies have attempted to regulate the size and pattern of foreign capital inflows to assure that these funds will be utilized to enhance development objectives, lead to productive use, and generate sufficient return to assure debt servicing requirements. Before any foreign loan is

31. Charles R. Frank, Jr., et al., South Korea, (New York: Columbia University Press, 1975), p. 107.

approved, the loan is subjected to a series of econometric tests and must meet the following three criteria: (1) The foreign capital must flow to a sector targeted by state planners for development, or create backward or forward linkages for the development of a targeted sector; (2) The foreign capital must lead to an increase in productive capacity that will directly or indirectly aid the balance of payments; (3) The foreign capital must flow to a domestic producer who possesses necessary technological expertise to meet production demands, or who can realistically obtain the necessary technological expertise through a licensing or other technological agreement. Through effective bureaucratic regulation and control, the Korean economy has been able to utilize foreign capital sources to finance domestic industrial development plans and has not had serious problems servicing its debt.

The state has effectively shaped the pattern of foreign capital

inflows so that these funds complement development objectives and lead to productive ends. These state mechanisms, effectively designed to induce, direct, and control the pattern of foreign capital penetration into the Korean domestic economy, have facilitated national development objectives and increased the capacity of domestic actors to control major economic decision making within Korea.

Foreign capital loans have played a key role in Korean capital formation. Foreign savings, primarily in the form of loans, accounted for 55 percent of total investment during the first five year plan (1962-1966). During the second five year plan (1967-1971), foreign capital accounted for 41.9 percent of total investment. In the third five year plan (1972-1976), Korean foreign borrowing increased in absolute terms by over 240 percent. At this time Korea's credit rating had improved due to its record of economic and export growth

and capital on international financial markets became readily available as a result of the first oil crisis. However, in the 1970's domestic capital formation significantly increased. Although foreign borrowing sharply increased during the third plan, the share of foreign savings to total capital investment decreased to 24 percent.³²

During the fifteen years between 1962 and 1976, the Korean economy borrowed approximately \$7.6 billion in long term loans from foreign sources. During this same time span, foreign direct investment into Korea equalled only \$670 million. This period was the formative years of industrialization in Korea. Manufacturing accounted for less than 13 percent of GDP in 1962 and over 24 percent in 1976. The financing for industrial expansion during this period was largely provided by foreign sources, but in the form of loans, and then channeled through the state to domestic producers to develop targeted sectors. Between 1962 and 1976, 36 percent of foreign borrowing was channeled by the state to economic infrastructure development which was immediately needed to facilitate the development of manufacturing sectors. The allocation of these funds was highly concentrated in the development of electrical generation plants, communication facilities, and transportation construction projects directly related to major import substitution sectors and export production. Transportation and construction received 53 percent of foreign infrastructure development loans, while 31 percent was allocated to electric utility development, and 5 percent to communication.³³

32. Economic Planning Board, Major Statistics of Korean Economy, 1985.

33. Economic Planning Board, Status of Foreign Loans Authorized by Industry, 1977.

From 1962 to 1976 approximately 45 percent of foreign borrowed funds were allocated to domestic producers to develop targeted manufacturing industries directly related to the balance of payments. Textile and electronic goods development, principally intended for export production, received 20 percent of these funds. Chemical sector import substitution projects received 17 percent of these foreign loan funds allocated to manufacturing, steel and metal production received 16 percent, machinery production received 7 percent, and petroleum refining development received 6 percent. In total, 81 percent of foreign borrowed funds between 1962-1976 were channeled directly to state targeted infrastructure and manufacturing development. In addition, 12 percent of foreign borrowed funds were allocated to export finance and 6 percent to agriculture and mining. Only 1 percent of borrowed funds were allocated to consumption in the form of residential housing.³⁴ The strategy of inducing foreign loans rather than direct investment to finance industrial expansion allowed Korea to increase industrial output rapidly while maximizing domestic ownership and control over production apparatus.

During the fourth and fifth five year plans (1977-1986), foreign capital borrowing increased significantly in absolute terms, but continued to decrease as a proportion of total investment. Total outstanding debt at the end of 1976 equalled approximately \$9.7 billion. That figure rapidly increased to \$24 billion by 1979. After the second oil shock in 1979, Korean borrowing increased even more rapidly. By 1985, total Korean outstanding debt exceeded \$48 billion. Although foreign capital inflows into Korea have substantially increased in absolute terms over the past decade, the relative

34. Ibid.

✓ Importance of foreign loans to total investment remained relatively stable until the 1980's and has significantly declined since that time. During the fourth five year plan, foreign savings equalled 25 percent of total investment as compared to 24 percent during the third plan. However, during the fifth plan (1981-1986) foreign savings accounted for only 11 percent of total investment. Korean domestic capital formation increased approximately 300 percent between 1976 and 1981, and another 180 percent between 1981 and 1984.³⁵

During the fourth and fifth five year plans, foreign loan funds were utilized almost exclusively for infrastructure development and for the development of industries related to the balance of payments. In 1986, Korea had its first significant balance of payments surplus and utilized much of the \$4 billion surplus to credit their foreign debt service payments. In contrast to the large level of Korean foreign borrowing over the past decade, only \$1.5 billion in foreign direct investment has been approved by the government and entered into the Korean economy. Between 1965 and 1986, foreign direct investment accounted for less than 5 percent of foreign capital formation. These figures support the claim that the Korean state has effectively utilized a strategy of foreign loan inducement over foreign direct investment as a source of foreign capital, and that this strategy has allowed for a relatively high degree of Korean national ownership and control of production apparatus.

In addition, the increase in domestic capital formation allowed the Korean economy to borrow heavily from international financial markets, while simultaneously decreasing its overall dependence on foreign capital. The channeling of foreign and domestic savings into

35. Ibid.

✓ productive purposes where the lion's share of investment would directly lead to increases in export production or the development of targeted import substitution projects has allowed the debt service ratio to remain in the serviceable 17-20 percent range. The ✓ combination of these policies -- (1) using foreign loans as opposed to foreign direct investment as the principal source of foreign capital, (2) significant increases in domestic savings, and, (3) the channeling of investment funds into productive investment directly or indirectly related to the balance of payments -- has allowed the Korean economy to utilize international capital sources actively while maintaining a highly nationalistic approach to ownership and control over of production apparatus.

In addition to maintaining control over the flow and pattern of foreign capital entering the Korean economy, the government has acted to increase its bargaining strength with the international financial community. Commercial borrowing to total foreign borrowing increased significantly in the early 1970's. Often, Korea had paid interest rates on commercial loans that exceeded the London prime rate by 3 percent or more. In 1972, the government created a bureau in the Ministry of Finance and coordinated bureaus in the Bank of Korea (the central bank) and the prime banks responsible for channeling borrowed capital to Korean corporations. These bureaus were entirely dedicated to developing strategies to increase national bargaining strength over the terms of international loan agreements. The bureaus in the banks were responsible for gathering and coordinating information that would lead to a better understanding on the projection of capital requirements and the coordination of policy between industrial firms and the Ministry of Finance. The bureau in the Ministry of Finance

was responsible for increasing the government's understanding of international financial systems and the development of bargaining strategies. Guided by this governmental structure designed to increase awareness of capital requirements and to coordinate a national borrowing strategy, the Korean government was in a position to improve the terms and conditions by which it borrowed funds from international financial institutions. The costs of the state strategy of utilizing foreign loans in favor of foreign direct investment as a means of financing capital investment requirements could be greatly reduced if the state acted effectively to improve the terms by which it borrowed foreign capital.

Before 1973, most foreign capital borrowing by Korea was from international development banks or bilateral agreements with the United States government. These loans were long-term loans with concessional terms. However, these loans were not adequate in size to provide the foreign capital requirements called for during the 1970's as the Korean government pursued its ambitious development of heavy and chemical industries. During the 1960's and early 1970's, commercial loans were difficult for the Koreans to induce due to the risk commercial banks placed on Korea's economic ability to repay the loans. However, by 1973 Korean economic performance and export promotion had increased its creditworthiness, and after the 1973 oil crisis funds became oversupplied in the international financial market. These changing events increased Korea's access to commercial bank lending.

The Korean ability to borrow from international commercial banks increased significantly after 1973. However, at this time the Korean state was inexperienced at bargaining with the international banking

community. The Ministry of Finance would select either the Bank of Korea, the Korea Exchange Bank, or the Korea Development Bank as the borrower. The selected bank, in conjunction with the Ministry of Finance, would then approach a major international bank to see what funds were available and on which terms. The international bank would put together a syndicated loan package often charging relatively high service charges and interest rates as high as three percent above the London prime rate. The Korean government would have to accept these terms in order to have access to the international funds they required.

Through the mid-1970's, Korean state officials became much more knowledgeable on matters of the international financial system. Also, during this period, Korean exports expanded rapidly and Korea's reputation as a model borrower increased. These combined factors increased the capacity of the Korean state to bargain for better terms on foreign commercial loans. The Korean government was able to use its attractiveness to foreign lenders as a bargaining chip to improve the terms by which it borrowed. By the late 1970's, the normal procedure of Korean borrowing still saw the Ministry of Finance select a particular Korean bank as a recipient. However, before making contact with an international bank, the Ministry of Finance would develop a proposal specifying the capital amount required, the service charge the government was willing to pay, and the interest rate (usually .25 percent above the London prime rate) that it is willing to pay. The Ministry of Finance would then approach a specific international bank with the proposal and give that bank a specified period of time to accept or reject the terms. If that bank declined to accept the terms, the government would withdraw the offer and

approach another bank. If a bank refused a proposal, it was highly unlikely that that bank would be approached again by the Ministry of Finance to be a lead bank on a future syndicated loan to Korea. To increase the attractiveness of the offer to the bank, even though the percentages were low, the Ministry of Finance would attempt to borrow in packages usually exceeding \$500 million. The Ministry of Finance has made serious attempts to diversify its borrowings by the nationality of the bank and by the specific bank in order to reduce the level of dependence on any one supplier or nationality and to increase competition among the various banks. Due to the increased bargaining capacity of the government, commercial financial institutions make much less profit on their loans to Korea in the 1980's than they did in the 1970's.³⁶

Once commercial funds are lent to a Korean bank, the foreign banks and the I.M.F. are not aware of how these funds are allocated by the Korean state. According to foreign bankers interviewed and the I.M.F. representative in Seoul, they are not overly concerned with how these funds are allocated by the Korean banks as long as they are repaid on schedule. As long as debt service payments are met and export levels remain high, the Korean banks will continue to receive foreign loans and can allocate them throughout their economy however they desire. A manager of a major American bank stated that "the Koreans are good managers, desire control, and are good economic planners who have never missed a debt payment. How they allocate the funds they borrow is primarily their concern." Foreign capital has been available and heavily employed in Korean industrial development,

36. This information was obtained in interviews with Seoul branch managers of Bank of America, Hanover Manufacturers Bank, Lloyds of London, and Mitsui Bank.

✓ and it has been managed by the Korean state in a relatively autonomous manner that has significantly increased output levels and has allowed for a relatively high level of national ownership and control.

The Korean economy has relied heavily upon foreign loans to finance industrial development. By the end of 1986, total outstanding foreign debt exceeded \$45 billion, making Korea the fourth largest international borrower. Many students of international political-economy would state that these figures alone support the arguments of dependent development theorists. Drawing a quick conclusion such as this tends to underestimate the increase in autonomy that international loans can facilitate if they are managed correctly.

The principal factor in relation to foreign capital loans and dependence revolves around the ability to utilize the borrowed capital in a manner that will allow for its repayment. If debt service payments cannot be met and rescheduling becomes necessary, national economic autonomy is threatened due to the increased role of the I.M.F. in directing domestic economic decision making. This has been the case in several Latin American and Asian debtor nations. However, due to more effective financial management of foreign capital (and probably due to much less corruption involving foreign borrowed funds), Korea has not missed a single debt payment and the international financial community has had relatively minimal ability to influence the economic decisions made by the Korean state.

✓ The capacity of the state and the domestic private sector to save, to earn foreign exchange, and to utilize borrowed foreign funds effectively is a factor that has a direct impact on the degree of autonomy that a state has in relation to the international financial

community. These factors will largely determine the degree to which the state in a developing economy can maintain interaction with the international economy, yet pursue domestic economic objectives in a relatively autonomous manner.

State Management of Foreign Direct Investment

Central to Korean industrial development has been the issue of domestic control over production apparatus. The Korean government has believed since the early 1960's that an open foreign investment policy would have very adverse effects on the Korean economy and the Korean industrialization process.³⁷ The adverse effects of foreign direct investment -- introduction of inappropriate technology and production, the weakening of domestic entrepreneurial activity, the capture of domestic market shares by foreign producers, the foreign use of domestic capital markets, foreign control over key industrial decisions, and the expropriation of national surplus through transfer pricing, repatriation of profits, and royalty payments -- would restrict the effective implementation of Korean industrial development plans.

However, the Korean government realized that domestic technological capacities were insufficient to meet production demands in critical sectors. The Korean government recognized that foreign direct investment would be beneficial to Korean industrial development plans if that investment provided specific technology without which

³⁷. Koo Bohn-young, The Role of Foreign Direct Investment in Korea's Recent Economic Growth, (Seoul: Korea Development Institute, January 1983) p. 6.

the development of a targeted sector would not be possible or if a foreign investor produced exports. The state policy in relation to foreign investment was to induce actively those foreign investments perceived to be beneficial to industrial development and to exclude all others. Just as sectoral development is targeted and led by the state, foreign direct investment has been directed into state established pattern that varied over time to meet state targets. The state has attempted to minimize the level of foreign investment by limiting its entrance into the Korean economy to only those cases that the state considers to be necessary for and compatible with state development objectives.³⁸ An examination of foreign direct investment reveals that the empirical record of the pattern of foreign direct investment closely resembles state industrial planning and policy.

The size of foreign direct investment equity holdings in Korea is minimal compared to total stock or to total foreign capital usage. Between 1962 and 1985, approximately \$2.65 billion of foreign investment has been approved by the government (see Table 4.3), and approximately \$1.82 billion has arrived (see Table 4.1). Foreign investment has effectively been excluded by the government in most consumer goods production sectors, and contrary to the pattern of foreign direct investment in most developing countries, foreign direct investment has been effectively excluded from primary production sectors. This, to a large degree, can be explained by strict state restrictions on foreign firms owning land or investing into agriculture, mining, or consumer goods production.

As of December 1985, of 1,186 foreign investment projects approved by the government since 1962, only 66 projects or 5.6 percent

38. Koo Bohn-young, Industrial Structure and Foreign Investment: A Case Study of Their Interrelationship in Korea, (Seoul: Korea Development Institute, Working Paper No. 8402, 1984), pp. 26-28.

of total projects were placed in mining or agriculture (see Table 4.2). These investments totaled only \$23.7 million or less than one percent of total foreign investment by value (see Table 4.3). However, in such key import substitution sectors as petroleum refining, petrochemicals, chemicals, metal products, electronics, and machinery, foreign direct investment takes on a significance far in excess of what aggregate levels of foreign direct investment may indicate. Foreign direct investment patterns in Korea, being largely a result of government policy, have tended to be concentrated in sectors of export manufacturing and in sectors of targeted import substitution where Korean producers had insufficient technical expertise to meet production demands.

Of the total value of foreign investment approved since 1962, 59.1 percent have been placed in manufacturing sectors and 40 percent has been placed in service related sectors (see Table 4.3). Manufacturing investments have been heavily concentrated in three sectors and significant in only five other sectors. Chemicals, electronics, and machinery sectors have accounted for 39.3 percent of total foreign direct investment or 66.3 percent of total manufacturing oriented foreign investment. These three sectors, combined with the sectors of textiles, transportation equipment, metal products, medical products, and food processing, have accounted for 53 percent of total foreign investment or 89 percent of all manufacturing foreign investment. These sectors have all been designated as target sectors by Korean state planners. Foreign investment in these sectors has played a significant role in the Korean industrialization drive by providing foreign exchange earning exports or as providers of crucial import substitution technologies that have provided necessary linkages for domestic industrial producers.

Table 4.2
Foreign Investment by Economic Sector/Number of Projects

	<u>1962-66</u>	<u>1967-71</u>	<u>1972-76</u>	<u>1977-81</u>	<u>1982-85</u>	<u>Total</u>	<u>%</u>
Mining & Agriculture	1	8	26	15	16	66	5.6
Manufacturing	15	138	391	149	283	976	82.3
Foodstuffs	1	4	3	10	28	46	3.9
Textiles	3	15	44	5	6	73	6.2
Wood products	-	-	2	1	-	3	0.3
Chemicals	-	20	56	24	36	136	11.5
Medical products	3	4	3	4	28	42	3.5
Fertilizer	2	-	2	-	-	4	0.3
Petroleum	1	2	1	-	1	5	0.4
Ceramics	-	7	12	3	7	29	2.4
Metals	-	13	33	17	20	83	7.0
Machinery	1	19	62	37	51	170	14.3
Electronics	3	27	121	21	66	238	20.1
Transportation	-	1	4	2	2	9	0.8
Others	1	26	48	25	38	138	11.6
Social Overhead Capital	-	17	33	33	61	144	12.1
Finance	-	2	3	5	7	17	1.4
Construction	-	7	9	11	35	62	5.2
Electricity	-	-	-	2	-	2	0.2
Transportation	-	5	4	4	2	15	1.3
Hotel & Tourism	-	3	17	11	17	48	4.0
Total	16	163	450	197	360	1,186	

Source: Ministry of Finance (on approval basis).

Table 4.3
Foreign Investment by Economic Sector/Value
(in \$1,000)

	<u>1962-66</u>	<u>1967-71</u>	<u>1972-76</u>	<u>1977-81</u>	<u>1982-85</u>	<u>Total</u>	<u>%</u>
Mining & Agriculture	102	943	6,672	7,162	8,809	23,688	0.9
Manufacturing	22,897	59,925	425,937	392,468	669,204	1,570,431	59.2
Foodstuffs	100	1,056	1,729	29,276	38,628	70,789	2.7
Textiles	759	4,048	57,505	2,562	7,675	72,549	2.7
Wood products	-	-	263	850	-	1,113	0.1
Chemicals	-	11,626	146,143	120,258	100,391	378,418	14.3
Medical products	313	2,654	2,082	9,377	62,613	77,039	2.9
Fertilizer	20,500	-	21,325	150	-	41,975	1.6
Petroleum	-	7,845	15,407	8,283	5,000	36,535	1.4
Ceramics	-	5,649	4,379	4,231	14,232	28,491	1.1
Metals	-	8,975	30,003	21,318	12,352	72,648	2.7
Machinery	20	5,287	30,330	44,139	197,757	277,533	10.5
Electronics	901	10,614	82,995	107,765	183,894	386,169	14.5
Transportation	-	40	25,542	19,485	21,499	66,566	2.5
Others	304	2,131	8,234	24,774	25,163	60,606	2.3
Social Overhead Capital-	11,805	132,630	188,113	728,300	1,060,848	40.0	
Finance	-	1,621	11,340	52,472	55,830	121,263	4.6
Construction	-	3,307	15,856	37,344	54,661	111,168	4.2
Electricity	-	-	-	3,395	-	3,395	0.1
Transportation	-	783	3,412	24,437	3,355	31,987	1.2
Hotel & Tourism	-	6,094	102,022	70,465	614,454	793,035	29.9
Total	22,999	72,673	565,239	587,743	1,406,313	2,654,967	

Source: Ministry of Finance (on approval basis).

In service sectors of the economy, foreign direct investment has been concentrated in three principal areas. Hotel and tourism has led all other sectors of the economy in attracting foreign investment. Over \$793 million in foreign direct investment or 29.9 percent of the total has been placed in hotels and tourism. The Korean government has viewed tourism as a relatively costless way of earning foreign exchange. In the fifth five year plan, the development of the tourism industry was targeted for development, but Korea had little experience in operating world standard hotels and tourist attractions.

— Principally led by Japanese firms owned by families with Korean ancestry, the Korean tourist industry has been the sector of the economy most open to foreign investment. Over 43 percent of foreign investment approved by the government during the fifth five year plan was in this sector.

✓ Finance and construction have been two service sector areas that have also received large shares of foreign investment during the past ten years. Fearful of foreign dominance of financial markets, foreign investment into the financial sector was highly restricted by the Korean government until the late 1970's. However, as the economy became more technologically advanced and diversified, it became apparent that financial services in Korea were antiquated. Modern financial technology was needed to increase the efficiency of capital accumulation and resource allocation. During the fourth five year plan, the government began to induce actively leading international banking corporations to invest in Korea in order to gain access to advanced financial technologies. Joint ventures with Korean banks were encouraged through financial incentives. By 1985, the financial sector accounted for 4.6 percent of total foreign investment

approvals. Approximately 90 percent of all financial sector, foreign investment arrived following major alterations in government policy during the fourth five year plan. At this time, the government felt confident in its ability to control the financial sector and no longer feared foreign investment in that sector as a major threat to national control.

In the construction sector, the government also restricted foreign investment prior to the late 1970's. Domestic construction was protected for domestic firms such as Hyundai, Ssangyong, and Dong A. However, after the oil crisis, several Middle-Eastern nations began major construction projects and offered construction contracts to international bidding. The Korean government actively assisted Korean construction firms to obtain these lucrative Middle-Eastern contracts. To the Korean government, these construction projects would earn foreign exchange and offset the balance of payments deficit with the oil producing nations. Korean construction firms, with the reputation as efficient producers who met completion deadlines at relatively low costs, were in an attractive position to underbid European, American, and Japanese construction firms on several projects. However, there were also several projects where Korean construction expertise lacked the requisite technological knowledge. To gain these required construction technologies, very attractive financial incentives were offered by the Korean government to foreign construction firms to enter into joint ventures with Korean firms. By 1985, foreign investment in the construction sector constituted 4.2 percent of all foreign investment approvals. Over 82 percent of foreign investments arrived after 1977, and the majority of these were involved in providing complex construction technology related to overseas construction projects.

By examining the inflow of foreign direct investment into Korea, it becomes clear that the Korean state has effectively shaped the pattern. Foreign direct investment has been shaped to flow into Korea in a manner that complemented the industrial strategy being pursued by the government at given stages of industrial development. Foreign direct investment has been channeled by the state to those sectors designated for development and into projects where Korean producers lack independent technical capacity to produce.³⁹ In the early stages of industrial development, foreign investment was channeled into the development of synthetic fibers for textile production and major import substitution projects in petroleum refining and chemical fertilizers. By 1968, these investments constituted 75 percent of foreign investment. With these investments in place, the government targeted the development of the textiles and electronic consumer goods for export in order to finance the further development of chemical and heavy industries. Although domestic producers would produce the lion's share of output in these sectors, specific technologies were needed from the foreign sector. By 1973, electronics, automobile assembly, machinery, and chemical sector, foreign investments significantly increased and accounted for 40 percent of total foreign investment. Throughout the 1970's, foreign investments were principally channeled into targeted heavy and chemical sectors. By 1980, foreign investments were concentrated in chemicals (25 percent),

39. Charles A. Barone, "Dependency, Marxist Theory, and Salvaging the Idea of Capitalism in South Korea," Review of Radical Political Economics, Spring 1983, p. 48.

In a survey of foreign investors conducted for this study (see Appendix), 100 percent of respondents claimed that the Korean state exercised much more control over the pattern of direct foreign investment than other capitalist developing states that they had experience in or knowledge of. They also responded that the Korean government effectively excluded foreign investment into areas where domestic producers could meet production demands.

machinery (16.7 percent), electronics (12.2 percent), metal products (4.8 percent), and construction (4.5 percent). Strict control over the inflow of foreign direct investment has allowed the Korean economy to induce and utilize desired technical expertise while shaping the pattern of those foreign investments in a manner that would protect and nurture the development of domestic enterprise.

In addition to controlling sectoral flows of foreign investment, the Korean government has effectively pursued several other strategies directly designed to limit the activity of foreign investment. All foreign investments entering Korea must negotiate elaborate investment agreements with the government. In the process of these negotiations, the government attempts to negotiate specific conditions under which the foreign investor may operate within Korea. The government attempts to negotiate into all investment agreements conditions that include: (1) a joint venture be formed with a Korean partner, where the Korean partner will have or will obtain, in a specific period of time, financial and operational control over the enterprise; (2) an explicit agreement as to the level of capital investment, the level of output, the level of export, the level of technological transfer, the provision of raw materials, and access to foreign markets that the foreign investor will provide; and, (3) an explicit agreement on the divestiture of foreign held equity to the domestic partner at a specific future date.

In addition to these negotiated agreements, the government restricts expansion of foreign investments already in place in Korea. This allows a Korean producer who may later gain the necessary technological expertise in a given sector the first opportunity to expand, thereby reducing the market share that is foreign controlled.

The Korean government also effectively restricts capital formation by foreign investors in the domestic capital market, and bureaucratically monitors their activities to assure that they abide by the terms of the investment agreements.

The effectiveness of these strategies varies on a case by case basis relative to how greatly the government perceives the need of a particular foreign investor to the achievement of development objectives and to how attractive the Korean market is to the particular foreign investor. If the government's conditions are too restrictive to the foreign investor and the investment can be placed elsewhere, Korea will fail to induce that investment. If the investment involves a critical technology, Korean development objectives may be jeopardized by requiring excessive conditions. In these cases, the government will have to decrease the conditions placed upon the foreign investor in order to induce a critical investment. However, in a sector where the Korean market is perceived by the foreign investor to be lucrative, the Korean government attempts to increase the conditions placed on the foreign investor in the investment agreement. If more than one foreign investor is interested in placing a particular investment, the position of the government in the bargaining relationship is enhanced. In these cases, the government can require the foreign investor to make competitive bids and accept the bid that maximizes the government's position.

A primary strategy to increase benefits deriving to the Korean economy from foreign investment has been the government's requirement, whenever possible, that foreign investments form joint ventures with Korean firms as a condition of entry into Korea. Even in those

✓ sectors listed as open to foreign direct investment in the Foreign Capital Inducement Act, bureaucratic control mechanisms maintain the principle that a minimum of 50 percent of equity be held by a local partner. Only those foreign investments that will produce exclusively for the export market or those that will transfer a technology designated as necessary for achievement of development objectives but can not be induced otherwise are approved with foreign ownership levels exceeding 50 percent.

The rationale for this policy is that joint ventures with foreign firms will increase technological and managerial skill transfers to domestic firms and facilitate domestic capital accumulation to a greater degree than would the inducement of fully owned foreign investments. Over time, the Korean partner could learn the technological process and master the production process. This would allow the Korean partner to lead any expansion of that sector that may be required in the future as well as adapt that technical knowledge to other related production operations. Further, the Korean policy that foreigners can not make up a larger proportion of the board of directors than their share of stock ownership allows for a larger share of Korean control over a joint venture's decision making process than would occur in the decision making within a wholly owned foreign venture. Central to the issue of benefits deriving to the domestic economy from foreign direct investment is the share of surplus expropriated by the foreign investor from the domestic economy. Profit remittance, transfer pricing, royalty payments, and the division of local and export markets are issues directly related to how surplus is divided between a foreign investor and the domestic economy. A joint venture involving a local firm whose survival is

tied to local capital accumulation will tend to influence corporate decision making in a manner that is more favorable to the domestic economy than a wholly owned foreign firm.

By 1968, 113 foreign investment proposals had been approved by the Korean government. Of these, 18.6 percent were wholly owned by foreign investors. After 1968, the Korean government actively pursued the inducement of Japanese producers in export sectors and routinely approved 100 percent foreign ownership in these sectors. By 1972, 21.6 percent of all foreign investments in Korea were wholly foreign owned. However, by 1972, Korean expertise in production and marketing of labor intensive export sectors had significantly increased; accordingly, the terms of entry for foreign investors in these sectors were increased. As a result, few wholly owned foreign investment projects were approved by the government after 1972. By 1985, only 13.3 percent of all foreign investments were wholly foreign owned (see Table 4.4). By international standards, this is an extremely low figure. In a study of 66 countries conducted in 1977, Korea ranked the lowest of all countries in the proportion of foreign firms that were wholly foreign owned. At this time, approximately 17 percent of foreign invested firms in Korea were wholly foreign owned. The second lowest on the list was Israel with 30 percent, and third was Japan with 33 percent.⁴⁰ By 1985, only 13.3 percent of all foreign invested firms in Korea were wholly foreign owned, and in only 26.6 percent of foreign invested firms did a foreign investor hold more than 50 percent of the equity.

The pattern of foreign ownership levels in Korea has been directly affected by the government's policy of favoring approval of

⁴⁰ J.P. Curhan, W.H. Davidson, and R. Suri, Tracing the Multinationals, (Cambridge University Press, 1977), p. 314, as cited in Koo Bohn-young, op. cit., 1983, p. 26.

foreign investments that include Korean partners in joint ventures and a ceiling of 50 percent equity ownership held by foreign partners. However, the inducement of foreign investment is constrained by this policy. Multinational corporations generally do not desire to form joint ventures and give up control over their operations. In order to induce a foreign investor into a joint venture, the foreign firm needs to be assured that at least a minimum level of profitability will be reached. Guaranteed access to the domestic market and the sole right to produce in a given sector for a specific period of time are incentives that can be used to induce certain foreign investors into joint ventures. In Korea's case, this has been particularly true in labor intensive sectors and in sectors that require less sophisticated technology that is available to several different foreign producers. However, to induce more sophisticated technology that may be available to only a few foreign producers, the Korean government has had to allow larger shares of foreign ownership. Also, in order to induce exclusively export producers, the Korean government has allowed larger shares of foreign ownership. This is reflected empirically in the pattern of foreign ownership levels when examined over time and by sector.

In 1968, 18.6 percent of foreign invested firms were wholly foreign owned, while 24.8 percent were majority owned.⁴¹ These foreign invested firms were principally small value investments in export production of textiles and electronic consumer goods. The two largest foreign investments at this time were an oil refinery and a fertilizer production facility. Both of these projects were major import substitution projects which the government highly desired and

41. Economic Planning Board data.

✓ wanted to have Korean involvement. In order to induce a foreign partner into a joint venture, the government guaranteed a minimum profit rate of 15 percent, a five year tax holiday, exclusive rights to the domestic market, and exclusive rights to supply raw materials. However, a Korean partner was granted 50 percent ownership. The majority of foreign investments prior to 1968 were labor-intensive, low capital investments. If these investments produced exclusively for export markets, they were granted majority or whole ownership. If the investment produced for the domestic market, they were required to form joint ventures and to hold less than majority ownership.

In 1968, the government altered its policy and began to encourage foreign investors, particularly Japanese investors, to establish production facilities in chemical, machinery, textile, and electronic sectors. At this time, the Korean government eased its restrictions on the level of foreign ownership in these sectors. By 1972, 21.6 percent of all foreign invested firms in Korea were wholly foreign owned, while the proportion of majority owned decreased to 17.6 percent. However, by this time, the Korean government was becoming fearful of Japanese ownership of production facilities in Korea and began to realize that little technological transfer to Korean producers was occurring where 100 percent foreign ownership was present. In 1973, the Foreign Capital Inducement Act was again altered to limit majority ownership in foreign investments to those that brought specific technology needed for targeted import substitution investments or to projects which exported over 80 percent of output.⁴² By 1980, the proportion of wholly owned foreign invested firms declined to 14 percent, and majority foreign owned firms declined to 12.2 percent.

42. Koo Bohn-young, op. cit., 1984, p. 21.

After 1980, the proportion of foreign investments that were wholly owned further decreased. Between 1981 and 1985, only 10.7 percent of the total 401 foreign investment proposals approved by the government were wholly foreign owned. However, during this same period, majority foreign ownership was granted in 28.1 percent of the cases.⁴³ In total between 1962 and 1985, only 13.3 percent of approved foreign investment projects were wholly foreign owned and 26.6 percent were majority foreign owned. Here, we see a pattern of foreign investment where the Korean state has been highly restrictive toward foreign ownership share. In 1975, when Korea had the lowest proportion of 100 percent foreign owned firms, 17 percent were wholly foreign owned. By 1985, this figure decreased to 13.3 percent although total foreign investment approvals increased 180 percent during that period.

However, when the value of foreign investment rather than the number of investments is examined in relation to foreign ownership level, a different pattern emerges (see Table 4.5). In 1967, less than 3 percent of foreign investments by value were wholly foreign owned, and only 4.3 percent were majority foreign owned. Foreign ownership levels by value increased significantly by 1971 when 9.4 percent were wholly foreign owned and 27.5 percent were majority foreign owned. These increases correspond to the increases in number of foreign investments and ownership shares during this period due to open encouragement of foreign investment by the government. However, between 1972 and 1980, a period where wholly and majority foreign owned firms decreased significantly in proportion by number, the proportion of foreign wholly and majority owned firms by value

43. Ministry of Finance data.

increased significantly. During this period, wholly owned foreign investments by value equalled 32.9 percent of total foreign investments and 44.1 percent were majority owned. By 1980, the proportion of wholly owned foreign invested firms equalled 30.1 percent by value, while majority foreign owned firms by value equalled 41.8 percent.

✓ In the 1980's, the proportion of wholly foreign owned and majority owned foreign firms by value further increased. Between 1981 and 1985, 42.7 percent of foreign investments by value were granted 100 percent foreign ownership, and 16.2 percent were granted majority foreign ownership. During this period, the government was seeking to induce high technical investments in the electronic sector and the development of international tourism. In order to induce the highly technical electronic investments, the government often needed to allow 100 percent ownership shares. In the tourism sector, the government has traditionally allowed 100 percent foreign ownership of large, world class hotels in order to attract foreign exchange through the tourism industry.

The comparison between wholly and majority owned foreign invested projects by number and value reflects both the Korean state policy and its bargaining position relative to the types of investments it desired to induce. Lower value investments in textile and electronic assembly dominated foreign investments in Korea in the early stages of industrial development. By 1976, over 84 percent of all textile and 64 percent of all electronic foreign investments in Korea were in place. Investors in those sectors were seeking low cost labor for labor intensive production. These investors could be more easily forced to form joint ventures with Korean firms as terms of entry. Here, the Korean state was in a strong bargaining position due

Table 4.4
Foreign Investment by Investment Ratio/Number of Projects

	<u>Under 25%</u>	<u>25-49%</u>	<u>50%</u>	<u>51-99%</u>	<u>100%</u>	<u>Total</u>
Agriculture & Fisheries	4	28	7	4	1	44
Agriculture	3	12	5	4	-	24
Fisheries	1	16	2	-	1	20
Mining & Manufacturing	40	295	254	108	122	819
Mining	1	6	1	-	5	13
Manufacturing	39	289	253	108	117	806
Foodstuffs	1	13	9	4	2	29
Textiles & Garments	5	36	13	8	5	67
Wood products	-	2	1	-	-	3
Chemicals	7	40	50	14	3	114
Medical products	1	6	15	11	1	34
Fertilizer	-	1	3	-	-	4
Petroleum	-	1	3	-	-	4
Ceramics	1	12	-	7	5	25
Metals	4	28	23	7	10	72
Machinery	2	60	35	12	21	130
Electric & Electronics	10	49	65	23	49	196
Transportation	2	1	2	1	3	9
Others	6	40	34	21	18	119
Social Overhead Capital	7	38	42	17	7	111
Financing	3	4	4	1	-	12
Construction	3	16	15	4	5	43
Electricity	-	2	-	-	-	2
Transportation & Storage	-	5	8	2	-	15
Hotel & Tourism	1	11	15	10	2	39
Total	51	361	303	129	130	974
Percentage	5.2	37.1	31.1	13.2	13.3	100

Source: Ministry of Finance data.

Note: 1962 - 1984 on approval basis.

Table 4.5
Foreign Investment by Investment Ratio/Value
(in 1,000 U.S. Dollars)

	<u>Under 25%</u>	<u>25-49%</u>	<u>50%</u>	<u>51-99%</u>	<u>100%</u>	<u>Total</u>
Agri. & Fisheries	160	8,363	3,002	1,354	2,486	15,365
Agriculture	111	3,826	1,627	1,354	-	6,918
Fisheries	49	4,537	1,375	-	2,486	8,447
Min. & Manufacturing	71,697	171,533	406,848	168,469	332,797	1,151,344
Mining	219	1,472	425	-	971	3,087
Manufacturing	71,478	170,061	406,423	168,469	331,826	1,148,257
Foodstuffs	2,500	6,144	17,357	21,684	1,910	49,595
Textiles & Garments	399	8,135	23,111	36,034	2,122	69,801
Wood products	-	210	53	-	850	1,113
Chemicals	5,958	32,196	175,422	10,843	105,438	329,857
Medical products	2,242	3,313	20,819	33,293	3,175	62,842
Fertilizer	-	17,650	24,325	-	-	41,975
Petroleum	-	789	30,746	-	-	31,535
Ceramics	188	7,060	-	4,284	3,509	15,041
Metals	5,130	12,398	12,437	21,155	13,943	65,063
Machinery	12,440	19,589	29,685	6,204	27,407	95,325
Electric & Electro.	27,480	41,025	20,374	22,007	166,726	277,612
Transportation	13,845	287	45,854	5,780	800	66,566
Others	1,296	21,265	6,240	7,185	5,946	41,932
Social Overhead Cap.	34,760	149,474	113,630	42,148	246,170	586,182
Financing	30,058	36,764	27,719	989	-	95,530
Construction	2,802	9,530	14,666	1,993	44,499	73,490
Electricity	-	3,395	-	-	-	3,395
Transportation & Storage	-	12,900	11,918	6,598	-	31,416
Hotel & Tourism	1,900	86,885	59,327	32,568	201,671	382,351
Total	106,617	329,370	523,480	211,971	581,453	1,752,891
Percentage	6.1	18.8	29.9	12.1	33.2	100.0

Source: Ministry of Finance data.

Note: 1961 - 1984 on approval basis.

to the availability of inexpensive Korean labor and the need for inexpensive labor by these investors. During the 1967-1971 period, the average manufacturing investments only equalled \$431,000. These investments were principally assembly type investments. The majority of these, 71 percent by number and 56 percent by value were Japanese investments. In the textile sector, 80 percent of investments were less than 50 percent foreign owned. However, after 1972 the Korean state began to pursue actively heavy and chemical sectoral development.

During the 1970's, foreign investments in labor intensive sectors still applied to the Korean state for entry, but the Korean state was principally seeking the technology of capital intensive import substitution oriented foreign investment. Foreign investors in these capital intensive industries demanded higher equity levels. The state had to allow greater foreign equity levels in these capital intensive sectors, or it would fail to induce the investments. The average foreign investment between 1972 and 1980 equalled \$1.4 million. In the chemical sector, investment during this period averaged \$2.75 million per investment. As the size of the investment increased, the level of technical complexity also tended to increase. This gave the investor more bargaining power over the state in gaining equity levels and control.

After 1980, foreign investments into labor intensive sectors in Korea became almost non-existent. By 1980, Korean producers had gained technical and marketing expertise in these sectors, and the Korean government would no longer approve investments in these sectors. Most foreign investments by number since 1980 have been production investments in heavy and chemical sectors and investments

oriented toward production for the domestic consumer market. These investments have principally been allowed only in those cases where domestic partners hold majority ownership. However, since 1980 the Korean government has made a major effort to develop high technology industries. This has required the inducement of foreign investment that would introduce to Korea new sophisticated technologies. As the level of technical sophistication increased, the value of investment also tended to increase. Of the total number of foreign investment projects approved by the government since 1962, 30 percent were approved between 1982-1985. However, in this same period, 53 percent of foreign investments by value were approved. The increased level of technical sophistication has weakened the government's bargaining position, and this has required the government to grant higher foreign equity holdings in order to induce these investments.

Although the Korean government has had to grant greater than majority ownership to foreign investors to induce more technological investments, it has managed to channel the vast majority of foreign investments into joint ventures. The Korean government has consciously utilized its bargaining strength to gain domestic participation. This governmental strategy has been designed to facilitate technical transfer to Korean firms, to increase the level of funds generated by foreign firms being reinvested back into Korea, and to assist Korean producers gain control over sectors that were originally developed by foreign investments.

Once a foreign firm enters into a joint venture with a Korean firm, technical and managerial expertise begins to be transferred. As agreed upon in the terms of the joint venture, the foreign partner is required to train personnel of the Korean partner in necessary

managerial, technical, engineering, accounting, and other related production techniques and skills. As explained in interviews with several foreign managers in Korea, a joint venture with a Korean firm involves a high level of personnel rotation. That is, Korean firms have a tendency to assign personnel to joint venture projects, but after they acquire the necessary knowledge to perform their tasks, they are often transferred to other subsidiaries of the Korean firms. New personnel are then transferred into the joint ventures to be trained by the foreign partners. The Korean joint venture partners' personnel learn the technologies and expertise of the foreign partner and can then apply this knowledge in other related production processes of the Korean firms. Over time, Korean personnel are also able to learn the technology necessary to operate the joint venture enterprises. After that point, further expansion in those sectors is carried out by the Korean firms, and those sectors are closed to further foreign investments. Eventually, production in those sectors becomes dominated by Korean producers.

In addition to technological transfer and the training of personnel, joint ventures also increase the likelihood that the profits generated by foreign invested firms will be reinvested into the Korean economy. If a government in a developing country directly restricts the repatriation of profits, that country will have great difficulty in attracting desired foreign investment. Specifically to facilitate the inducement of desired foreign investments, the Korean government, in the Foreign Capital Inducement Act, has explicitly guaranteed the right of foreign investors to repatriate profits. This, of course, expropriates a certain level of surplus that the Korean government would prefer to utilize in the form of investment

capital. Few foreign investors in Korea cite any direct action by the government that constrains profit repatriation. However, by requiring foreign investors to form joint ventures with Korean firms, not only are profits to be shared, thereby directly providing for a portion of the profits to be reinvested into the Korean economy, but also the overall level of dividends paid out can be reduced by the government offering incentives to the domestic partner to reinvest a large share of earnings back into the joint venture's operation. This facilitates lower levels of dividends paid and greater corporate expansion within Korea.

During several interviews with foreign investors and with officials from both the American and the Japanese Chamber of Commerce in Korea, a common complaint emerged in relation to the conflict between foreign and domestic joint venture partners over the generation of profits and the issuance of dividends. As previously explained (see Chapter 3), under the Korean government industrialization plan, the state provides low cost financing to Korean firms in targeted sectors, largely based upon a firm's level of output and/or export expansion. If a firm does not increase output or export levels according to state quotas, that firm risks losing access to future subsidized finance and other privileges. Korean firms, accordingly, are not as concerned with profits and dividends as they are concerned with expansion. Korean firms reinvest the lion's share of their earnings back into their firms to facilitate rapid expansion and show very low profit levels. In a joint venture between Korean and foreign partners, there is a continual struggle over the proportion of reinvestment to dividends paid, with the domestic partner attempting to maximize the former and the foreign partner the

latter. As a Westinghouse official in Seoul stated, if the local partner refuses to issue a dividend, remittance of profit is not possible. This conflicting goal orientation between domestic and foreign partners has worked to limit dividends paid and the repatriation of capital, thereby increasing the level of gross domestic investment over those that would have occurred if the foreign investment project had been wholly foreign owned.

The Korean government strategy of requiring foreign investors to form joint ventures as terms of entry into the Korean economy wherever possible has allowed Korean producers to learn necessary technological expertise and eventually retake national dominance in several sectors. This has been particularly true in the key industrial sectors of petroleum refining and chemicals.

In 1962, Korean state planners designated oil refining as one of the first strategic import substitution projects. At this time Korea was required to import all of its petroleum requirements in refined form. This was a substantial foreign exchange expenditure and seriously constrained future development efforts. Therefore, the government designated the development of an oil refinery as a top economic development priority. However, no Korean producer possessed the technological capacity to develop an oil refining industry. Gulf Oil Corporation was approached to develop a refining operation in Korea, but it was reluctant due to the government's insistence on a joint venture relationship. To induce Gulf into a joint venture with the Korean Oil Company, the government had to offer Gulf highly favorable terms including tax holidays, free land, total financial and operational control, monopoly rights on the supply of crude oil to the operation, and a guaranteed minimum profit level. Gulf Oil originally

invested \$4.8 million in 1963. By 1973, Gulf had remitted over \$10.5 million, and this figure does not include charges for the transportation and sale of crude oil to its Korean operation.⁴⁴ However, the joint venture agreement with Gulf not only served as an import substitution project that would aid balance of payments and guarantee supply of a needed raw material, but, perhaps more importantly to long range development objectives, it also offered the opportunity for Korean engineers, technicians, and managers to learn the oil refining process.

As the Korean market grew during the 1960's, so did the need for refined oil. Gulf offered to expand its capacity. However, the Korean government wanted to reduce its dependence on only one crude supplier by diversifying sources. Economic growth in Korea had made the Korean economy more attractive to foreign investors and allowed the government to open up bidding on the second refinery. In 1965, a joint venture was formed between Caltex and the government selected Lucky-Gold Star Corporation to establish Korea's second oil refinery. Caltex, a joint venture between Standard Oil of California and Texaco, was offered generous incentives including price supports, tax concessions, and financial and operational control to enter Korea on a joint venture basis. The inducement of Caltex offered an opportunity for a second Korean company to enter the oil refining sector as well as to diversify crude oil suppliers.

As the Korean economy continued to expand, so did the demand for refined oil. In 1968, Union Oil Corporation was induced to form a joint venture with Korean Explosives Corporation. In 1976, after the first oil shock, in an attempt to diversify suppliers directly to the

44. Chang Dal-joong, op. cit., p. 137.

✓ Middle-East oil sources, the Korean government induced the National Iran Oil Company to form a fourth refining joint venture with Ssangyong Corporation of Korea. In the first two ventures, Gulf and Caltex were granted operational and financial control under the terms of the investment agreements and needed to supply all technological knowhow. In 1968, when the Union-Korean Explosives venture was approved, the Korean state granted operational control to Union Oil but only 50 percent decision making power in financial matters. Union was not granted guaranteed profits. By 1976, Korea had gained the necessary technical expertise to operate a refining operation. Under the terms of the National Iran Oil Corporation-Ssangyong venture, the Korean partner held operational control and 50 percent of financial control.

In the late 1970's, the Korean state began to nationalize foreign held equity in oil refining joint ventures. First, in 1979, after the fall of the Shah of Iran, the new Iranian government agreed to sell its equity to Ssangyong. The Korean government agreed and provided financing to Ssangyong to purchase the Iranian share. After the second oil shock in 1979, several oil companies found themselves in short supply of crude oil and in need of restructuring their worldwide portfolios. Gulf desired to sell its Korean operation not only because of crude oil shortages, but also due to internal legal problems in the United States that linked the chairman of Gulf Oil, Robert R. Dorsey, to a bribe scheme with Korean President Pak Chung-hee's Democratic-Republican Party.⁴⁵ Union Oil needed to restructure its worldwide portfolio and desired to sell its interest in Korea partly because of problems of repatriating dividends due to Korean

45. Ibid., pp. 134-136.

Explosives' actions to reinvest profits into corporate expansion.⁴⁶ Gulf and Union were now prepared to sell their equity shares in Korea at relatively low prices. The Korean partners now possessed the necessary technological skills to operate the refining operations. Foreign participation was no longer needed in the oil refining sector. The Korean government encouraged the Korean partners to purchase the foreign interest by extending subsidized financing. By 1983, the only foreign invested firm in the Korean oil refining sector was Caltex, and Caltex was required to renegotiate its original investment agreement so as to grant operational and financial control to Lucky-Gold Star.

Today, Korea refines 100 percent of its domestic requirements, purchases its crude oil supply on a contractual basis or in the international spot market, hauls the majority of its crude oil in its own ships, and controls the financing and operation of its oil refining sector.

In an interview with the managing director of the Caltex operation in Korea, the "nationalization" of the Korean refining industry was discussed. According to this interview, the Korean state has always regarded oil refining as a most vital national interest. During the early stages of development, Korean producers required foreign technological knowhow and were forced by the conditions of the market to induce foreign firms with such incentives as guaranteed profits, price controls, and generous tax benefits. However, over a period of fifteen years, Korean producers acquired all important

46. Information on the Korean repurchase of foreign held equity in the oil refinery sector has principally been obtained in interviews with Caltex officials, Korean government officials, and with professors at Seoul National University School of Business and Management.

technological knowledge in petroleum refining. When this occurred, the Korean state desired domestic ownership and control. As soon as the situation was opportune so that they could purchase foreign held equity without exerting undue force on the foreign concern thereby damaging other national interests, the state encouraged the Korean firms to purchase their foreign partners' equity.

According to this interview with the Caltex managing director, Caltex is still in operation in Korea due to a different corporate approach and different corporate needs than Gulf and Union. Caltex is not a worldwide operation but primarily an Asian operation, and prefers to remain in Korea. Profits have been at a steady 10 percent annual rate, and Caltex has not had a problem with Lucky-Gold Star over dividend payments because it offers several other benefits to the Korean economy and to Lucky-Gold Star. First, being a joint venture itself between two major oil corporations, Caltex has agreed to utilize its corporate sources to guarantee access to oil supplies for all Korean refineries whenever necessary and wherever possible. In addition, Caltex has been willing to renegotiate its investment agreement over financial and operational control. Caltex also allows Lucky-Gold Star personnel access to Caltex research and development, management training, and computerized management and analysis techniques. This allows Lucky-Gold Star to gain substantial benefits from Caltex which it can utilize in its other subsidiaries and operations. Caltex has trained all levels of Lucky-Gold Star managers and technicians at Caltex training centers and has granted top management positions to Korean nationals. In return for these benefits to Lucky-Gold Star and the Korean economy, Lucky-Gold Star and the Korean government have allowed Caltex to remain in business in Korea

and to repatriate dividends. However, Caltex can not operate retail outlets or petroleum transportation services within Korea. "Koreans have an overriding concern not to be dominated by foreigners. Where they don't absolutely need foreign input, foreigners are not allowed," claimed the Caltex managing director in Korea.

✓ The chemical sector has been another major sector of the Korean economy where the government has induced a substantial level of foreign investment, channeled it into joint ventures with Korean firms, and eventually financed the domestic partners' purchase of the foreign investors' share. In the 1960's, the Korean economy did not possess the technical capacity to develop a chemical industry. The chemical sector had induced some small scale investments in the 1960's, but began to grow rapidly during the third five year plan (1972-1976) when the chemical sector was designated as a target industry.

In 1973, the first major petrochemical plant came on line. By 1980, over \$223 million in foreign investments in the chemical sector had been approved by the government. This equalled 20 percent of total foreign investments by value at that time.⁴⁷ Approximately 41 percent of chemical sector foreign investments by number were minority foreign owned. These were principally small scale operations with relatively non-complex technological requirements. Approximately 44 percent of chemical sector, foreign investments were on a 50-50 joint venture basis. Approximately 15 percent of chemical sector foreign investments were majority or wholly owned by the foreign investors. Only three chemical sector foreign investments were wholly owned out of a total of 114 that were approved prior to 1983. However, these

47. Economic Planning Board data.

were large-scale, technologically complex operations, and by value they equalled 33 percent of total chemical sector foreign investments.⁴⁸ Dow Chemical Corporation owned and operated one of these operations.

Dow Chemical Corporation entered the Korean economy in 1968 when it invested \$7 million in a 50-50 joint venture with Korean Pacific Chemical Company to produce vinyl chloride monomer (V.C.M.). In 1976, Dow placed a second investment in Korea. This second investment was to develop a major petrochemical complex. Dow successfully negotiated to maintain sole ownership of this complex and invested \$140 million.⁴⁹ This petrochemical complex was a major import substitution project and made Dow the largest individual foreign investor in Korea. Dow's wholly owned petrochemical complex was to produce chlorine caustic soda and ethylene dichloride. Dow's production was to be sold downstream to Dow's venture with Korean Pacific Chemical Company as well as to other Korean producers.

✓ When Dow's wholly owned complex went into operation, Dow began to have problems in its relationship with Korean Pacific Chemical and, ultimately, with government officials. Dow's wholly owned upstream plant began to sell chlorine caustic soda at artificially high prices. The high price of chlorine caustic soda charged to the downstream joint venture operation increased the share of profit to the upstream plant. Dow was, in effect, transferring prices to favor its wholly owned enterprise at the expense of its joint venture.⁵⁰ The local partner of the downstream operation began to resist by purchasing

48. Ibid.

49. Brian Levy, "The Perils of Partnership: Dow in Korea," in Karl Moskowitz, ed., op. cit., pp. 61-73.

50. Ibid., p. 68.

chlorine caustic soda from cheaper foreign sources thereby leaving Dow's upstream operation without a ready market. Dow protested to the Korean government and wanted import protection, which, in Korea, is a common practice for goods that are manufactured in Korea. However, the government felt that Dow was attempting to exploit its monopoly position at the expense of the Korean economy. The government refused to grant Dow import protection. When the downstream partner and the government refused to give in to Dow's pressure, Dow proposed to merge the two operations. Such a merger would reduce the downstream partner to that of a minority without any operational voice and would reduce its profit or burden of loss to a proportion equal to its equity holding, approximately five percent.⁵¹ This would allow Dow to control both the upstream and downstream operations. At this point, Dow approached the Korean government to approve the merger.

By 1979, the Korean chemical sector was becoming developed. Several Korean companies had joint venture operations with foreign partners. In petrochemicals, there were 14 large foreign invested projects. Of these 14 petrochemical projects, all except two had either entered Korea with less than majority foreign ownership or had recently renegotiated majority of shares to their Korean partners and had transferred operational control. The only two petrochemical operations not majority owned by Korean partners were Dow's joint venture and Dow's wholly owned operation. Although Dow possessed international leverage and appealed to the United States government for assistance, the Korean government saw the opportunity to extend national control over the chemical sector. At this point, knowledge of petrochemical operations had been gained in several joint venture

51. Ibid., p. 62.

operations. Dow's technical knowledge was no longer indispensable to Korean development objectives. There was little reason for the Korean government to side with Dow. The petrochemical complex was in place and operational. Dow was proposing to take over a 50 percent domestically owned operation, thereby creating a foreign controlled monopoly over chlorine caustic soda and V.C.M. production. Dow no longer possessed any special technical knowledge that Koreans had not already gained. The Economic Planning Board not only refused Dow's proposal, but began to actively seek the buy out of Dow's interests in Korea. In October 1982, an agreement was finalized where a consortium of Korean chemical companies, financially supported by the government, bought out all of Dow's interests in Korea for \$60 million. Dow took a loss of approximately \$100 million.⁵²

Another major strategy employed by the Korean government in its attempt to control and increase the benefits that the domestic economy receives from foreign investments is to demand that the investment agreements explicitly include the factors of production and other services that foreign investor will provide to the Korean economy. Depending upon the nature of the investment and the specific contribution that the government desires from an investor, such factors as the specific level of raw materials that the foreign investor will provide to the Korean economy, the level of output, the level of export, the specific technology and the means of its transference to Korea, and international marketing mechanisms to be utilized are required to be explicitly declared in the investment agreement between the government and the foreign investor. In Korea where state sectoral development plans are coordinated with the

⁵². Ibid., p. 62.

Foreign Capital Inducement Act, state economic planners attempt to channel specific inputs from foreign investors into the economy. By explicitly agreeing upon the foreign investor's legal activity at the time of the investment agreement, the state's capacity to control the activity of the foreign investor and to require the foreign investor to perform and not exceed a specific role is further facilitated.⁵³

In targeted import substitution sectors, technological transfer and raw material supply were viewed by the Korean government as the primary contributions that foreign investors were to make to Korean industrial development.⁵⁴ Investors in these sectors were offered generous incentives to induce their entry, but specific technological transfers and the level of raw material supply were explicitly stated in investment agreements. For example, when Amoco entered into a joint venture with Samsung Corporation of Korea in 1974 to produce P.T.A., the primary ingredient for producing polyester fiber, plastic containers, and cassette tape, Amoco was offered generous tax concessions and a guaranteed profit level for five years by the Korean government. This was a major import substitution project for the Korean textile, electronic, and other industries. Within the terms of the investment agreement, Amoco specified the level of all raw materials it would supply and the method of technical transfer to Samsung. In 1980, American Telephone and Telegraph (A.T. & T.) desired to enter the Korean market in a wide range of electronic communication sectors. The Korean state offered A.T. & T tax concessions and guaranteed market shares in specific electronic sectors, but only if A.T. & T. would form a joint venture with Lucky-

⁵³. Koo Bohn-young, op. cit., 1983, p. 82.

⁵⁴. This information was collected in interviews with Amoco, A.T. & T., Samsung, and Lucky-Gold Star officials in Seoul.

Gold Star of Korea, one of Korea's two giant electronic firms, transfer specific technology, and export 30 percent of output. A.T. & T. first balked at this agreement because it only wanted to sell on the domestic market. The joint venture and export requirement, in effect, would allow Lucky-Gold Star to not only learn A.T. & T. technology but also to export it, thereby cutting A.T. & T.'s overall world market share. However, the Korean electronic communication market was rapidly expanding, and other multinational electronic firms were interested if A.T. & T. was not. A.T. & T. eventually entered into Korea under these terms. By 1986, the A.T. & T. - Lucky-Gold Star joint venture has expanded, allowing Lucky-Gold Star to increase its level of knowledge of electronic technology and its export markets. Lucky-Gold Star has also been able to apply this technology to other products.

✓ In labor intensive sectors where the technological gap between foreign and domestic firms was relatively small, the Korean government would allow only export production by foreign investment.⁵⁵ This policy was motivated by the rationale that foreign firms with greater capital resources and marketing experience would capture domestic market shares away from Korean producers. Labor intensive foreign investment would only aid the domestic economy through the foreign investors' knowledge of and access to foreign markets. So, labor intensive foreign investments were required to agree explicitly to export a specific level of their output and were restricted in their domestic sales by their investment agreements. After 1973, most labor intensive foreign investments were only allowed if they exported 100

⁵⁵. Eul Young Park, "An Analysis of the Trade Behavior of American and Japanese Manufacturing Firms in Korea," in Karl Moskowitz, ed., op. cit., p. 24.

percent of their output.⁵⁶ By 1978, 39 percent of all foreign invested firms were required to export 100 percent of their output. Of the firms permitted to sell in the domestic market, over 25 percent had to sell at least 50 percent of their output abroad. Some of these firms had output level ceilings to further minimize the level of the domestic market share they could control. Fewer than 40 percent of foreign investments in Korea by 1978 had no condition regarding export levels. These investors were highly concentrated in targeted import substitution sectors.⁵⁷

Terms of entrance requirements being specifically stated in investment agreements are the normal practice in gaining entrance into the Korean economy. According to a survey conducted for this study (see Appendix), by 1986, 38 percent of foreign investors had specific export level requirements stated in their investment agreements, 80 percent had specific technological transfer requirements, 36 percent had specific raw material supply requirements, and 28 percent specifically agreed to help their Korean partners gain export market access. Over 92 percent of all foreign firms surveyed had at least one of the above requirements specified in their investment agreements, over 68 percent had at least two or more specific requirements. All of the respondents stated that they were regularly monitored by state agencies to verify that they were in compliance with their investment agreements.

As previously stated, in order to protect and facilitate domestic ownership and production, the Korean state would not approve a foreign investment if it were to produce in a sector where a

⁵⁶. Ibid., p. 31.

⁵⁷. Larry Westphal, et al., Korean Industrial Competence: Where It Came From, (World Bank Staff, Working Paper No. 469), p. 53.

domestic producer was capable of production. Paralleling this policy, no foreign firm would be allowed to purchase an existing Korean firm. According to the Foreign Capital Inducement Act, no foreign investment could take over or purchase a Korean company.⁵⁸ Under these circumstances, foreign capital was considered non-desirable. If a domestic producer was technically capable of production in a particular area and that sector needed to expand production capacity, the state would attempt to formulate capital from domestic or international sources and allocate it to a domestic producer to expand its operation. If a domestic concern was intending to sell its operation, the state required the purchaser to be a Korean national. In the course of research for this study, only one case of a Korean firm purchased by a foreign investor could be documented. This was in the 1960's when A-Dong electric, an export oriented electronic consumer assembly operation, was purchased by a foreign firm. After this, the Economic Planning Board refused to allow any more purchases of domestic firms by foreign investment. This is in sharp contrast to Vernon's estimate that one-third of all foreign subsidiaries in developing countries were formed through the purchase of domestic firms and discussions such as Evans' on the "denationalization" of domestic firms in Brazil.⁵⁹

58. Business Korea, July 1985, p. 76.

59. Raymond Vernon, The Storm Over the Multinationals: The Real Issues, (Cambridge, Mass.: Harvard University Press, 1977), p. 72. Peter Evans, Dependent Development: The Triple Alliance of Multinational, State, and Local Capital in Brazil, (Princeton, N.J.: Princeton University Press, 1979), pp. 103, 112, 116, 125. Evans defines denationalization as the displacement of local enterprises by foreign ones. In his study, he traces the denationalization of several industries in Brazil and highlights a Brazilian industrial ownership structure where local enterprise tends only to survive in small-scale, less capital intensive enterprises due to the superior capital and technological levels of multinational corporations.

In contrast to the "denationalization" of domestic firms through foreign purchase, which is common in many developing countries, the Korean state has pursued a policy of actively encouraging the Korean repurchase of equity held by foreign firms. Between 1962 and March 1983, \$1.3 billion foreign direct investment had arrived in Korea. Of that value, \$263.5 million had been repurchased by Korean firms.⁶⁰ Over 20 percent of foreign direct investments had subsequently been reacquired by Korean nationals after technical knowledge of the production process had been gained. The Korean government had led the way to these foreign stock purchases through its requirements of joint ventures as terms of entry, by including specific divestiture requirements in investment agreements, and through the allocation of subsidized loans for the purchase of foreign held equity.

Particularly in the labor intensive sectors where Korea's bargaining position was strongest vis-a-vis foreign investment, not only did the Korean government require a foreign investor to enter into a joint venture with a Korean partner but also, under the terms of the investment agreement, it required the foreign investor to agree to a divestiture of equity provision. Under this provision, the Korean partner had the option to purchase a certain equity level (usually 15 percent, or enough to give the Korean partner a majority share) from the foreign partner in a certain period of time (usually 10 years) or when the foreign partner had repatriated a specific percentage (usually 150 percent) of the original investment.⁶¹ At this time, operational and financial control would be transferred to

60. Economic Planning Board data.

61. The information on the divestiture of foreign held equity was obtained through an interview with the Seoul branch manager of a major Japanese bank who was personally involved in the negotiations to buy out several Japanese firms in Korea.

the Korean partner.

In the late 1960's and early 1970's, several Japanese electronic consumer goods producers and textile producers were establishing production facilities in Korea to take advantage of low labor costs. Sony, Toshiba, Mashushita (National, Panasonic, Pioneer brands), Sharp, Mitsui, and others established production facilities in Korea. As terms of entry, the Korean government granted tax privileges, low utility costs, and other incentives in conjunction with financial and operational control. However, joint ventures with Korean partners were required along with divestiture agreements. For the Korean economy, these foreign investments increased export levels, increased employment levels, and would allow the opportunity to expand domestic control at a future date subsequent to when technological and other necessary skills were gained by domestic producers.

By the mid-1970's, many of the triggering mechanisms of the divestiture agreements were reached. In most cases, the government supported the Korean partners in exercising the equity purchase options and provided low cost financing. In many cases, the foreign companies were opposed to giving up a majority position, but the Korean state continued to pressure the foreign investors to abide by the original agreement. At this time, the Japanese companies were also worried about potential business interests in China in relation to the Chou En-lai principles. In 1970, Chinese Prime Minister Chou En-lai declared that Japanese companies that had business interests in South Korea or Taiwan would be barred from doing business in China. Many Japanese companies felt that if they stayed in Korea, the China market would be lost,⁶² and they were also not interested in staying

⁶². Chang Dal-joong, op. cit., p. 181.

in Korea as minority owners without financial and operational control. Several Japanese companies in this situation agreed to sell all of their equity to their Korean partners. Sony, Mashushita, Toshiba, and others sold off their ventures in Korea and relocated in Singapore, the Philippines, or elsewhere. In the textile sector, several Japanese firms sold their entire equity holdings to their Korean partners. Others did not leave Korea but submitted to Korean pressure to reduce equity levels. Teijin, who held a 50 percent interest with the Korean firm Sunkyoung to produce polyester fiber, was forced in 1976 to reduce its share of equity to 33.5 percent and to give up financial and operational control. Toray Corporation had to reduce its share of a joint venture with Korean Polyester from 40 to 19.8 percent, while Mitsui's share in Korean Polyester declined from 10 to 8.2 percent, giving the Korean partner majority ownership and control.⁶³

Korean corporations gained ownership and control of several electronic consumer goods and textile companies under this strategy. The local market was then protected for these producers, allowing them exclusive rights at home, and they began to compete successfully in international markets with many of the same companies which had been their joint venture partners.

✓ The Korean state has established several means to monitor foreign invested enterprises to ensure their compliance with appropriate laws and with the terms of their investment agreements. The Ministry of Finance, the Ministry of Trade and Industry, the Ministry of Science and Technology, the Ministry of Agriculture, the Ministry of Health, the Customs Bureau, and the National Tax Service

⁶³. Ibid., p. 192.

all have agencies that regularly monitor various aspects of the activities of foreign investors.

✓ The Ministry of Finance is responsible for monitoring foreign exchange matters. A primary concern of the Ministry of Finance is to assure that investment capital is brought in from overseas sources. A common argument in favor of foreign direct investment in developing countries is that it provides a source for needed capital. However, several studies have indicated that a large share of investment capital of foreign owned subsidiaries is actually formulated on domestic capital markets,⁶⁴ thereby defeating one of the primary theoretical contributions of foreign investment to the developing economy. In Korea, the Ministry of Finance's control over financial institutions and the allocation of investment capital has strictly guarded against foreign investors using domestic funds for investment. Foreign investors have little or no access to domestic capital markets. In a survey of foreign investors conducted for this study, 86 percent of all respondents formulated 100 percent of their investment capital abroad. Of the 14 percent of respondents who formulated investment capital domestically, all funds were borrowings from foreign bank branches in Seoul, using the parent corporations to

64. See: Peter Evans, "National Autonomy and Economic Development: Critical Perspectives on Multinational Corporations in Poor Countries," in Robert Keohane and Joseph Nye, Jr. ed., Transnational Relations and World Politics, (Cambridge, Mass.: Harvard University Press, 1972), pp. 328-330. Richard Barnett and Ronald Muller, Global Reach, (New York: Simon and Schuster, 1974), pp. 152-165. Fernando Fajnzylber, Estrategia Industrial y Empresas Internacionales, (Rio de Janeiro: United Nations, CEPAL, 1970), p. 65, as cited in Global Reach, op. cit., pp. 152-154. Gert Rosenthal, The Role of Private Foreign Investment in the Development of the Central American Common Market, (Chicago: Adlai Stevenson Institution of International Affairs, 1973), p. 235. Economic Commission for Latin America, External Financing in Latin America, (New York: United Nations, 1965). David T. Devlin and George R. Kruer, "The International Investment Position of the United States," Survey of Current Business, Vol. 50, No. 1, October 1970.

guarantee the loan. These were not funds originating from domestic Korean sources. The source of investment capital and of repatriated profits is monitored by the Ministry of Finance, and use of domestic capital sources by foreign actors is highly restricted to ensure domestic savings are utilized for the development of domestic enterprises.

✓ The Ministry of Trade and Industry's Foreign Investment Control Bureau's sole responsibility is the monitoring of the activities of foreign invested firms. Detailed reports must be submitted to the bureau on a monthly basis by foreign investors. These reports monitor output levels, personnel matters, import and export levels, profit rates, domestic content, taxes paid, and other matters. The Bureau of Customs also monitors imports and exports, and, among other responsibilities, ensures that only those capital goods directly related to approved production processes and not produced in Korea are imported by foreign firms. This policy is designed to limit the extent of transfer pricing by foreign firms and to increase the use of Korean produced capital goods in foreign invested production processes.

✓ Of the foreign investors surveyed for this study, 100 percent of respondents claimed that they are monitored by various state agencies on a regular basis to ensure their compliance with Korean law and with the terms of their investment agreements. Several foreign investors noted examples where the state has determined that a foreign investor was not in compliance with local law or with its investment agreement. In these cases, either fines were levied or privileges offered by the government in the investment agreement such as tax reductions or low rates on utilities were revoked by the state until the investor

complied with the state's requirements. Ninety-four percent of foreign investors who responded to a question comparing the capacity of the Korean state to monitor compliance with the terms of investments responded that the Korean state has more control over foreign investors' activities through its approval and monitoring process than other developing countries in which they have previous experience in or knowledge of. All respondents agreed that the Korean state restricted direct foreign investment to only those sectors that either required foreign technology or where exports were to be produced.

State Policy and the Inducement of Foreign Technology

The inducement and utilization of technology are central to the industrialization process. Like most industrializing economies, the ultimate source of technology for Korea has been from the advanced industrial countries.⁶⁵ The most common form of technical transfer from advanced industrial countries to developing countries is through various forms of formal contractual agreements. Foreign direct investment may transfer technology to a developing economy directly. Foreign licensing transfers technology through a domestic firm's purchase of the right to use a technology of a foreign owner. A firm may also purchase technical assistance in gaining the knowledge of a technical process. Technology can also be transferred through more informal arrangements such as turnkey contracts, machinery purchases, or through a buyer providing production specifications to a

⁶⁵. Kee Young Kim, "America's Technology and Korea's Technical Development," in Karl Moskowitz, ed., op. cit., p. 75.

producer.⁶⁶ Technology can also be transferred more indirectly through education in engineering, science, and technical fields.

The Korean government has preferred, whenever possible, to obtain technology necessary to facilitate industrial development plans through means other than foreign direct investment. Technology is the principal factor of production that the Korean government desires and needs from multinational corporations. Multinational corporations are, in general, willing to transfer technology to developing economies in the form of direct investment if it does not jeopardize their ability to collect monopoly rents from this knowledge.

Traditionally, foreign direct investment has been described as a mechanism for transferring capital, technology, and management skills to developing economies in a packaged form. However, it also establishes foreign control over industrial production and will resist the voluntary transfer of knowledge to domestic firms in the developing economy. On the contrary, the Korean state has desired localization of technical knowledge as the necessary first step to domestic control over industrial production processes. Ultimately, the Korean state would like to order the environment so that the domestic economy could reap the benefits of increased capital accumulation from these technologies while principal economic decisions are made by domestic actors. For these reasons, foreign direct investment has been the least desired form of technical transfer from the Korean state's perspective. Foreign direct investment has only been a principal source of technological transfer in a few sectors of the Korean economy -- chemicals, electronics, and petroleum refining. In these sectors where foreign direct investment

66. Ibid., p. 76.

✓ has played a leading role in technological transfers, other forms of technological inducement have either been too complex to be feasible or not available to the Korean economy through a technical licensing or technical assistance agreement.⁶⁷

✓ The Korean state has actively pursued a strategy of "unbundling" the package of resources that is theoretically offered by foreign direct investment. This is a strategy designed to increase domestic knowledge and control over technology. The Korean government has attempted, through licensing, machinery import, turnkey operations, education, and more recently domestic research and development, to obtain necessary technology in a manner that would maximize domestic control. Principally through technological licensing, the Korean economy has been able to obtain modern technology to develop the steel, automobile, shipbuilding, synthetic fiber, metal, machinery, construction, and other industries. A large level of machinery imports has allowed Korean producers to master several production techniques in many industrial sectors without having first to learn the underlying engineering principles of the machinery. Turnkey operation, especially in coal and nuclear generated power plants and in the textile sector in the 1960's, has played a major role in increasing Korean technical competence. In industries such as synthetic resins and fibers, the first plants were often built on a turnkey basis and intentionally built much smaller in design than market size or economy of scale required. Construction of second and subsequent plants followed quickly with Korean engineers and technicians assuming increasingly larger roles in project design and utilizing technical knowledge gained from the turnkey operation.⁶⁸

⁶⁷. Larry Westphal, et al., op. cit., p. 67.

⁶⁸. Ibid., p. 48.

There has also been a major effort on the part of Korean industry to master technology that is induced through foreign investment or technical agreement and to apply this mastery in other related undertakings. This has allowed the Korean economy to limit its reliance on foreign direct investment and to foster locally based innovative activity.⁶⁹ In industries for which process technology is not product specific, mastery of one product often leads to the adapting of that technology to other related production.⁷⁰ The mechanical engineering industry, among others, is a primary example. Such processes as machinery, casting, hydraulics, vacuum compressors, and mechanical assembly, once learned through foreign investment joint ventures or technical agreements in the production of one item, can be applied relatively easily to the production of others.

In 1978, Daewoo Corporation of Korea entered into a contractual agreement to produce forklift trucks for Caterpillar Tractor Company. According to this agreement, Daewoo would establish a fork truck production plant in accordance with Caterpillar specifications and technology. The Daewoo Incheon Plant now produces forklift trucks according to Caterpillar specifications and under the directorship of Caterpillar quality control engineers. Daewoo financed 100 percent of the plant and holds 100 percent of equity. Daewoo produces the forklift truck, complete with everything including the Caterpillar brand name, then sells the products under contract to Caterpillar. Caterpillar then exports 100 percent of the trucks to its worldwide market. Caterpillar has closed its forklift truck facility in the United States because it can now purchase the finished product cheaper under contract from Daewoo.

69. Ibid., p. 70.

70. Ibid., p. 47.

Daewoo has gained valuable technical knowledge that has been directly transferred to other enterprises. Daewoo has sent dozens of engineers, management personnel, technicians, accountants, and production employees to Caterpillar's training centers. Caterpillar has sent production specialists, accountants, engineers, technicians, and computer analysts to train Korean personnel and to maintain Caterpillar production quality. When the plant first became operational, there were over thirty Caterpillar engineers and production specialists in full time residence at the Inchon plant. By 1985, there was one. The rest had been replaced by Korean personnel who Caterpillar had trained. Daewoo can now produce a world marketable forklift truck, and is negotiating with Caterpillar to license the technology outright when the present ten-year-contract expires. At that time, Daewoo will use its own brandname, probably will have exclusive rights to the Korean market, and will export its product in direct competition with Caterpillar, that is, if Caterpillar still has a forklift truck in the market.

More importantly to Daewoo and Korean industrilization efforts in the 1980's has been the technical knowledge gained from Caterpillar that can be immediately applied to other related sectors. Knowledge learned in relation to hydraulics, machinery electrification, drive train mechanics, gearing, and production and assembly techniques have been direclty applied to other Daewoo heavy equipment and machinery production processes. In addition, Caterpillar accounting techniques and engineering process have been adapted into other Daewoo operations.⁷¹

71. Information on the Daewoo - Caterpillar agreement to produce forklift trucks was received in interviews with the Caterpillar project manager and with Daewoo officials in Seoul.

The state of a newly industrializing economy can greatly assist industrial development by taking both direct and indirect actions to develop necessary technical capacity.⁷² The state can aid the identification of appropriate technology, assist in facilitating its transference to domestic producers, and offer economic incentives to encourage domestic producers to utilize properly appropriate technology. In Korea, the state has played a major role in assisting domestic industry to gain access to foreign technology and has channeled that technology into the domestic economy in a manner that is highly consistent with national development objectives.

Primarily to assist the development of necessary technological knowledge, the Ministry of Science and Technology (M.O.S.T.) was established in 1967. The Economic Planning Board and the M.O.S.T. immediately developed bureaus to coordinate the inducement of technology with the development of targeted industrial sectors. The E.P.B. and the M.O.S.T. attempted to induce appropriate technology that would contribute to the achievement of development plans, but also they actively screened all incoming technology to eliminate the inflow of inappropriate technology. In accordance with the Foreign Capital Inducement Act, all inflows of foreign technology had to first meet the approval of the E.P.B. To gain approval, a foreign technological agreement had to meet three principal criteria. All incoming foreign technology had to: (1) be determined to be necessary and suitable for the development of a targeted industry; (2) be at the best terms available, and (3) aid the balance of payments. If a technology met these three criteria, the technology was ruled to be

72. Carl J. Dahlman, et al., Lessons from Newly Industrializing Countries, (Washington, D.C.: World Bank Staff, Working Paper No. 717, 1984), p. 49.

appropriate, that is, it would aid the achievement of state development objectives. If it could not meet these criteria, it was ruled to be inappropriate and denied approval.

Selecting appropriate technology that suits the developmental needs of a developing economy requires a requisite level of information to be gathered and disseminated effectively. In most developing economies, information gathering sources are limited. The effective use of resources calls for the state to centralize information gathering and dissemination. The state can assist technological development by establishing agencies that both systematically screen world technological markets in search of desired technology and facilitate the linkage of appropriate technology with domestic industrial concerns. In Korea, the M.O.S.T.'s primary task has been to locate and arrange for the transfer and adaptation of technology needed for the development of targeted industries. In the 1960's and 1970's, the M.O.S.T. with its affiliated think tank, the Korean Institute of Science and Technology, devoted most of its attention to identifying necessary technology, arranging for its transference to Korea, and integrating that technology into the production process of Korean producers. As the Korean economy has grown and Korean producers have increased their technical knowledge and ability to identify necessary technology, and as the Korean economy has come to require more complex technical processes, the M.O.S.T. has expanded its role and now oversees and supervises the development of government affiliated research institutes and the research and development activities of private industry. In this role, the M.O.S.T. is primarily concerned with developing technological capacity in targeted industries from domestic research and development activities.

Another function of the M.O.S.T., in conjunction with the customs agency, is to screen all foreign technological agreement proposals and incoming technological imports to ensure that no technology is imported if a similar technology is already available in the Korean market. This screening process serves two purposes. First, since foreign exchange will be necessary to pay for imported technology, the denial of imported technology that is already available in the Korean market is a mechanism to aid the balance of payments. Second, by denying the import of foreign technology, the domestic market is protected for the domestic producer.

The state can also alter the relationship of power in the negotiating process between foreign technological suppliers and domestic users by actively taking part in the negotiating process and by instituting measures to control the price and terms of technological agreements.⁷³ The E.P.B. and the M.O.S.T. actively take part in all major technological agreement negotiations. On a case by case basis, largely dependent on the nature of the technology concerned and its availability in the world market, the Korean government attempts to use its authority to reduce royalty payments, to eliminate provisions that restrict the use of purchased technology in export production, and to eliminate stipulations that inputs into the purchased technological processes must be imported from a parent firm when comparable inputs are available from a domestic source. These measures supported by the state, in conjunction with the encouragement of competitive bidding between foreign suppliers, can often both offset the asymmetry in bargaining strength between foreign

73. Ibid., p. 50.

suppliers of technology and domestic recipients and serve to protect and promote local producers.⁷⁴

By 1985, the Korean government had approved 3,073 technical licensing agreements with foreign enterprises and had paid slightly over \$1 billion in royalty payments. These licensing agreements, like foreign direct investment, are highly concentrated in state targeted industries (see Table 4.6). The machinery sector accounts for 27.6 percent of technological licenses, electronics and electronic equipment account for 18.7 percent, petroleum and chemicals account for 16.3 percent, metallurgy accounts for 8 percent, textiles account for 5.4 percent, and shipbuilding 3.5 percent. Together, these six sectors account for 80 percent of all technical license agreements in Korea.⁷⁵

The first technical license agreement was approved by the state in September 1962. Joong-ang Medical Company formed a technical assistance agreement with Pfizer of the United States to provide technical pharmaceutical data, employee training, and to allow Joong-ang to use certain Pfizer patents. During the period of the first two five year plans (1962-1971), Korea needed two principal types of technology. Targeted industries such as petroleum, machinery, fertilizer, cement, and construction needed technology from abroad in order to develop industrial infrastructure. In order to pay for this technology and other imports, Korea also needed to develop labor intensive export industries, often requiring foreign technological input.⁷⁶ The state sought out these technologies and often designated

⁷⁴. Ibid., p. 51.

⁷⁵. Economic Planning Board and Ministry of Science and Technology data.

⁷⁶. Chang Dal-joong, op. cit., p. 166.

Table 4.6
Foreign Technological Licenses by Industrial Sector

	<u>1962-66</u>	<u>1967-71</u>	<u>1972-76</u>	<u>1977-81</u>	<u>1982-84</u>	<u>Total</u>
Agriculture & Mining	0	6	0	5	13	24
Manufacturing						
Food processing	2	6	7	30	65	110
Paper products	0	4	3	7	3	17
Textiles	5	2	10	13	9	39
Chemical textiles	2	5	14	28	79	128
Ceramics & Cement	1	11	9	34	25	80
Oil refining & Chemicals	5	59	85	193	160	502
Pharmaceuticals	2	17	8	27	37	91
Metal products	1	28	45	105	67	246
Electronics	5	65	84	205	218	577
Machinery	6	58	116	402	267	849
Shipbuilding	0	1	10	45	52	108
Communications	3	13	10	21	19	66
Electricity	0	2	7	37	16	62
Construction	1	3	4	21	22	51
Others	0	5	22	46	50	123
Total	33	285	434	1,219	1,102	3,073

Source: Prior to 1981, Economic Planning Board.
1981-1984, Ministry of Science and Technology.

the Korean recipient company. Technology from abroad was principally imported from Japan and the United States and adapted to the Korean environment by miniaturizing several products and by reducing capital intensive inputs whenever possible.

During this period, the government also moved to strengthen technical education. Technical high schools were established throughout the country to develop basic technical knowledge and skill. University funding was increased to develop engineering schools and knowledge in applied sciences. The government also supported the overseas study for advanced students in engineering and science curricula.

During the third and fourth five year plans (1971-1981), Korean economic development concentrated on heavy and chemical sectoral development. Foreign technical agreements played a major role in the development of these sectors, particularly in development of the machinery, shipbuilding, automobile, and steel industries.⁷⁷ The automobile, steel, and shipbuilding industries in Korea were developed almost exclusively by foreign technological agreements as foreign direct investment was highly restricted by the state from entering these sectors. Government-funded, specialized research institutes were established in the fields of machinery, shipbuilding, steel production, and electronics. The Technological Development Promotion Law and the Engineering Service Law were enacted to give administrative and financial support to technical development and the integration of foreign technology into these sectors. These policies were intended to facilitate the development of heavy and chemical industries under the ownership and control of domestic producers. The

77. Larry Westphal, et al., op. cit., p. 65.

development of the Korean automobile industry serves as an effective example of the success of these policies.

Before 1969, the Korean automobile industry consisted of the assembly of imported automobile parts. This assembly of foreign automobile parts supplied the limited demand for automobiles in Korea. In the 1970's, the automobile industry, as well as the shipbuilding and machinery industries, was targeted for development. The targeting of these industries was largely to create a domestic market for the new, state-owned steel complex that was under construction at Pohang. However, unlike countries such as Brazil or Taiwan whose automobile production is largely carried out by foreign subsidiaries, the Korean government selected domestic producers to develop the automobile sector. Korea's approach was calculated to account for slower growth and higher costs in the short run. However, in the long run, domestic ownership and control of the automobile sector were intended to lead to a major payoff in terms of national capital accumulation, as it had in Japan.⁷⁸

Between 1970 and 1974, the Korean government, working with Hyundai, Daewoo, and KIA, the three Korean corporations selected by the government to produce motor vehicles, negotiated over twenty technical agreements with foreign sources to produce automobile components so that the automobile assembled in Korea would have a high domestic content ratio. In 1974, after the Pohang steel plant became fully operational, the government enacted the Long Range Automobile Industry Promotion Plan. Under this plan, the government would extend financing at low terms, administrative assistance, tax concession, and other needed assistance to upgrade automobile technology to a level

78. Larry Westphal, et al., op. cit., p. 68.

that would allow for the domestic design and production of automobiles. Hyundai Motor Company was selected by the government to develop the production facilities to implement this plan.

Hyundai Motor Company was founded in 1967 as a wholly owned subsidiary of Hyundai Corporation. Its first operation was based upon a technical agreement with Ford Motor Company and consisted of the assembly of a Ford Cortina in Korea. Immediately following the enactment of the Automobile Promotion Plan, Hyundai commenced with the design and construction of a automobile production complex financed largely by the state. Between 1974 and 1976, as the production complex was being built, Hyundai entered into technical agreements with a Japanese firm to gain engine block design, transmission, and drive train technology; with an English firm to gain technology related to factory layout and construction; with a second English firm to gain technology on the production of internal combustion engines; and with an Italian firm to gain technology related to body design and die stamping. The experience and knowledge that allowed Hyundai to absorb and adapt these various technologies had been gained previously through its technical agreement with Ford,⁷⁹ and carried out by Hyundai engineers and technicians. In 1976, Hyundai began to produce its own automobile. Approximately ninety percent of its components were produced in Korea. This domestic content ratio was largely the result of eighteen different major technological agreements that Hyundai had entered into as well as several smaller technical agreements made by other Korean producers who were under contract with Hyundai. By the late 1970's, Hyundai dominated automobile production in Korea and controlled over 80 percent of the domestic market.

79. Kee Young Kim, "American Technology and Korea's Technological Development," in Karl Moskowitz, ed., op. cit., p. 90.

In 1979, Hyundai was strongly encouraged by the Ministry of Trade and Industry and by the economic incentives of the government's machinery export promotion policy to enter into export production of its automobiles.⁸⁰ To compete successfully in the export market, Hyundai was required to improve its quality of product as well as reduce its costs per unit. Hyundai and government agencies began to search world markets for needed technical inputs. Hyundai entered into over thirty technical agreements at this time with firms from England, the United States, and Japan. To gain technology to meet American safety and pollution control standards, Hyundai was forced to sell ten percent of its equity to Mitshubishi Motor Company of Japan, but Hyundai maintained financial and operational control of its operation. In order to reduce technical dependence, Hyundai consciously sought to diversify its technical sources. Hyundai has often gone to two separate sources for similar technology, often gaining fundamental concepts from an American or a European firm, then utilizing Japanese technology to adapt and assimilate the technology into a final product.⁸¹ In the early 1980's, Hyundai began to export automobiles to Asia and Canada. In 1986, Hyundai Motor entered the American market and is presently exceeding its original sales target by over 100 percent. Hyundai, through direct state support, was able to implement effectively the Korean government's objective of establishing an automobile industry owned and operated by domestic producers.

Under the fifth five year plan (1982-1986), the Korean government began to target the development of high technology

80. Ibid., p. 91.

81. Ibid., p. 91.

industries. Given the structural problems revealed as a result of the 1979 oil shock, the changing world competitive environment, and declining cost advantages in labor intensive export sectors, the Korean government decided to undertake a major policy re-evaluation and to reorient economic development toward the higher value added higher technical production industries. Because of the difficulties in inducing advanced technologies from foreign sources, the government began to develop a comprehensive technological development program that would emphasize the development of domestic research and development capacity in conjunction with the inducement of advanced technologies from abroad. The effect was to elevate technological development to a national objective and to reorient bureaucratic mechanisms to the development of high technical industries. Tax holidays, low cost financing, and direct subsidies began to be offered by the Korean government to domestic firms that would conduct research and development activities into targeted industrial sectors as well as for those who utilized sources of technology that have been developed in Korea.

In 1982, in conjunction with the fifth five year plan, the Science and Technological Promotion Program was launched. This program contained several elements to increase technological capacity. One major element was centered around manpower development. In conjunction with past programs, the government expanded its funding for technical and engineering schools, for training students at government funded research institutes, and for sending students, engineers, and technicians abroad for advanced training. In addition to significant increases in technical education funding, the government began a campaign to encourage the repatriation of Korean

scientific and technical specialists who were living abroad. Tax incentives, direct subsidies, high wages, and other benefits have been offered to former emigrants who return to Korea with knowledge of technology and its application to industrial production. The 1982 Science and Technological Promotion Program targets the development of 80,000 highly trained technical specialists, 5,000 of whom it hopes to recruit from abroad.⁸²

The principal element of the Science and Technological Promotion Program is the identification of target technologies to be developed and the application of government planning and implementation mechanisms to achieve a coordinated technological development strategy. The Ministry of Science and Technology, in conjunction with the Economic Planning Board and the Ministry of Trade and Industry, identified five priority technological areas to be developed. The first area includes those technologies immediately applicable to Korean industrial production: specialized chemicals and metals, electronic semiconductors, digital industrial machinery, fiber optics, and telecommunications. The second area is national defense technology. The third area is health and environment oriented technology. The fourth area is concerned with technological development in engineering, particularly industrial engineering for automobiles, shipbuilding, aeronautic, and construction industries. The fifth area is the development of basic research applicable to small scale industries.

These five targeted areas of technological development are to be developed through the expansion of government owned and operated research institutions, the expansion of Korean private industry

82. Kee Young Kim, op. cit., p. 79.

research and development, and through the inducement of foreign technology. As with other designated target areas for development in the past, the government offered attractive economic incentives for private corporations to enter into these sectors. The government established funding for the development of research in the targeted areas and provided low cost terms to those corporations who would develop targeted research. The Korean Technological Development Corporation was established by the government in 1981 to finance research activities by providing long-term, low-interest loans. With initial assets valued at \$100 million, half provided by the World Bank, the early research initiatives of the fifth five year plan were undertaken. Total assets of the corporation have grown to nearly \$1 billion by 1986. The Korean Development Bank has also played a major role in financing research efforts.

The government has also offered very generous economic benefits to private corporations who invest their own funds into research and development. Investment into research and development can receive up to double the normal tax deduction. Further, depreciation allowances on research equipment have been doubled; imported research equipment is free of tariffs; and goods developed through domestic research and development are given protection in the domestic market.

Spending on research and development has increased significantly as a result of the government effort. In 1979, 0.7 percent of GNP was invested into research and development. By 1983, this figure had increased to 1.2 percent, and by 1986 it was 2.0 percent.⁸³ In the targeted technological areas for development, the share of research and development spending for private industries increased from 1.4

83. Ministry of Science and Technology data.

percent of sales in 1980, to 2.44 percent in 1982, to over 6 percent in 1986. The larger firms such as Samsung and Lucky-Gold Star are spending up to 10 percent of sales on research and development in the targeted areas.

To oversee and to assure coordination and cooperation in implementing planned technological development, the National Technological Promotion Congress was established in 1981. The congress is presided over by President Chun Doo Hwan himself and includes the entire cabinet, top leaders of industry, directors of research institutions, and other leading scientists and engineers. The meetings are comparable in stature to the export promotion meetings chaired by Pak Chung-hee in the 1960's and 1970's. The congress establishes technological development strategies and coordinates policies among the government, industry, and the scientific community.

Since the beginning of the technological development program in 1981, research and development efforts have increased significantly. Under the direction of the Ministry of Science and Technology, the Korean government has expanded the activity of several government operated research institutes. All state owned enterprises have been directed to develop research and development facilities and have been encouraged to spend up to 3 percent of turnover on research and development activity. Between 1981 and 1983, the government's incentives offered to private corporations to increase R & D efforts led to the doubling of the number of private research centers. In 1981, there were 1,933 in-company research institutes in Korea; by 1983 there were over 4,217 in-company research institutes. The average company expenditure on R & D increased from under .5 percent

of turnover to .71 percent.⁸⁴ These efforts have led to a significant increase in industrial products that have been developed through Korean research and development activities.

Summary: The Korean State and the Control of Foreign Capital
and Technological Inflows

Domestic political structures and state industrialization policies can have a significant impact on the pattern of foreign capital and technological inflows into a newly industrializing economy. In Korea, the state has placed a high priority on industrial development, but an equally high priority has been placed upon the maximization of domestic ownership of production apparatus and upon domestic control over key economic decisions. In pursuance of these priorities, the Korean state has organized legal and bureaucratic mechanisms in a manner that would facilitate the inducement of necessary foreign inputs while simultaneously shaping the pattern of those inputs so as to complement domestic industrial development.

After the military coup in 1961, the elites within the Korean state structures held a general consensus that controlling foreign capital and technical inflows into the Korean economy would be necessary in order to realize domestic industrial development. In conjunction with this elite consensus, a relatively consistent strategy of control has been pursued. Korean state development plans were designed to achieve rapid industrial development that was primarily owned and operated by Korean firms. Foreign capital loans

84. Business Korea, August 1983.

and technological inflows were consciously channeled by the state to domestic producers. The state developed a strategy toward foreign direct investment that was highlighted by the delineation of "preferred" sectors (those where foreign expertise was necessary for a targeted sector's development) and "non-preferred" sectors (those where domestic producers were technologically capable of meeting production requirements or where domestic producers could obtain necessary technical expertise through contractual agreements). Foreign direct investment has been offered generous economic incentives to invest in "preferred" sectors but has been largely excluded from "non-preferred" sectors.

The Foreign Capital Inducement Act (F.C.I.A.) became the principal legal means utilized by the Korean state to control foreign capital and technical inflows. It was within the F.C.I.A. that the "preferred" and "non-preferred" sectors were legally delineated. The F.C.I.A. was closely tied to overall Korean development planning and periodically altered to meet the changing needs of a growing economy and to aid in facilitating new directions in industrial expansion. In this manner, foreign capital and technological inflows became coordinated with state economic development objectives.

In conjunction with these legal controls, the Korean state restructured governmental bureaucratic institutions into functional bureaus that effectively screened and monitored foreign capital and technical inflows. These bureaucratic reforms further increased the control the state could exercise over foreign inflows and assured that such inflows conformed with the F.C.I.A. and with other state economic and political objectives. Explicitly specified investment agreements between the state and foreign investors preceded the arrival of

foreign direct investment. These agreements specified the nature of a foreign investment, the size and source of capital, the special location, the technology to be utilized and its means of transference to Korea, the raw materials to be supplied, the level of output, the level of export, the ratio of capital to labor, and the ratio of domestic to foreign equity holdings. Well specified investment agreements allowed the state to calculate and control more accurately the impact of foreign direct investments on the domestic economy and increased the state's capacity to monitor foreign investors' compliance with the original terms of entry.

The Korean state granted generous financial incentives to induce "preferred" foreign direct investment, but also pursued specific concessions from foreign investors as terms of entrance into the domestic economy. The state actively utilized its authority to promote joint ventures with domestic firms, to restrict capital formulation by foreign investors in the domestic capital market, and sought the divestiture of foreign held equity once domestic technical expertise was gained. These policies allowed the Korean economy to induce and utilize needed foreign direct investments, but strictly limited the activities of the foreign investors and granted the state the authority to control the allocation of domestic market shares and further expansion by the foreign investors.

The Korean state also played an active role in coordinating foreign technological transfers to domestic producers. The state identified necessary and appropriate technologies needed to achieve development plans, located foreign owners of these technologies, and used its authority to reduce the cost of this technology to domestic producers. The state then offered economic incentives to encourage

domestic producers to utilize appropriate technology once it was transferred to Korea. The state has also played an active role in developing technical education and has recently taken the initiative in developing domestic research and development institutions.

In Korea, state policies have, to a large extent, determined the conditions under which access to the domestic economy has been granted. Strict state control over the inflow of foreign capital and technology has allowed the Korean economy to induce and utilize desired foreign capital and technology while shaping the pattern of these inflows in a manner that would protect and nurture the development of domestic industry. The relatively effective implementation of these policies has led to an industrialization process that is predominantly owned and controlled by Koreans.

Chapter V: Concluding Observations: The Korean Development
Model and Its Implications for Other Developing Countries

The consistent and effective intervention of the state into the economic developing process has been the dominant factor leading to the industrial transformation in Korea during the past quarter century. Korea's success in economic development has been due to effective government management of economic affairs. The Korean state has actively intervened to establish economic policy and to shape political economic structures that facilitate rapid industrial expansion and domestic ownership over the means of production. In Korea, the state has played the dominant role in planning economic development, in resource formulation and allocation, in shaping and monitoring the behavior of the industrial capitalist and labor classes, and in establishing the pattern of foreign access to the domestic economy.

In this study, I have attempted to present an explanation of the primary state economic interventions and to analyze the effect these interventions have had on the economic performance and the structure of production in Korea. This final chapter will first present a summary of the Korean industrial experience, and then conclude with a discussion of the implications of Korean development strategies and policies for other developing countries.

The State and Economic Development in Korea

After the military coup in 1961, the new ruling elites in Korea held a united consensus that national survival and regime legitimacy were both dependent upon successful industrial development. State bureaucratic institutions were significantly reorganized. Government policies related to economic development were given the highest priority, and government initiatives were given high levels of political support.

The Korean economy has been developed largely in accordance with economic development plans designed by the state. Economic development planning has been centered around the Economic Planning Board (E.P.B.). Not only was the E.P.B. granted the political authority to carry out planning initiatives, but it was also granted substantial mechanisms to facilitate the implementation of development plans. The E.P.B. controlled the national budgetary process, indirectly controlled the allocation of credit, and was granted the authority to regulate all foreign capital and technological inflows. By controlling the allocation of resources, the E.P.B. held the necessary power to influence and shape significantly the behavior of the state bureaucracy and the growth of the private industrial sector. Resource allocations by the E.P.B. corresponded with planning initiatives, and government bureaus and private industry who received E.P.B. resource allocations were held accountable for implementing state development plans. The E.P.B.'s authority to control foreign capital and technological inflows allowed the Korean state to coordinate foreign inputs with state planning and domestic industrial development.

Korean economic development planning was designed to build systematically an industrial infrastructure and to develop domestic industrial production that sequentially became more complex and diversified. The state targeted sectors for development, identified necessary forward and backward linkages, and allocated resources to those sectors. Early development targets were focused on basic import substitution projects of oil refining and chemicals, on labor intensive export manufacturing, and on power generation and transportation infrastructures. Early import substitution projects not only aided balance of payments, but, perhaps more importantly, began to develop the technical expertise of domestic firms. The export of labor intensive manufactures not only provided employment but also generated needed foreign exchange so that the imported machinery and technology of the import substitution industrial sectors could be financed.

As industrial development proceeded, development planning targeted more technologically complex sectors and projects and continued to develop industrial infrastructure and to promote export production. Through the 1960's and 1970's, targeted sectoral development in steel, shipbuilding, machinery, motor vehicles, chemicals, electronics, and construction led to successful development of relatively mature domestic heavy and chemical sectors. In the 1980's, Korean state development planning and resource allocation have been targeting the development of high technological fields.

A significant aspect of central economic planning in Korea has been the delineation of "preferred" and "non-preferred" sectors for foreign investment. The delineation of these "preferred" and "non-preferred" sectors is closely tied to the development of targeted

sectors and the technological capacity of domestic producers. Foreign direct investment has been prohibited or greatly restricted in sectors labeled by state planners as "non-preferred." "Non-preferred" sectors were sectors either not targeted for development (largely domestic consumer goods industries) or targeted sectors in which domestic producers possessed or could obtain necessary technical expertise to meet production demands. In "non-preferred" sectors, the state actively intervened to aid domestic producers by providing low cost financing, by assisting in obtaining necessary technical transfers from abroad, and by granting protection and monopoly (or oligopoly) rights to the domestic market. This state assistance became directly responsible for initiating domestic production in several key sectors and in nurturing the development of these sectors. As a result, domestic production grew and began to compete effectively in the international market in such key sectors as steel, automobiles, industrial machinery, shipbuilding, construction, metals, and electronics.

In targeted sectors in which domestic producers did not possess the necessary technical expertise to meet production demands and in which necessary technical expertise could not be obtained through a transfer agreement, foreign direct investment was "preferred." In "preferred" sectors, foreign direct investment was actively encouraged by state incentives to provide necessary forward or backward linkages that otherwise would have retarded development plan implementation.

The delineation of "preferred" and "non-preferred" sectors by the state at the development planning stage and the general adherence to those classifications at the implementation stage became crucial factors in shaping the pattern of foreign penetration into the

domestic economy. Through these means, several key sectors of the Korean economy developed free of foreign competition and, very likely, foreign domination. With comprehensive state assistance, domestic producers were induced into new industrial sectors, nurtured, matured, and came to control industrial production in Korea.

In order to implement development plans effectively, capital resources must be formulated and then allocated in a manner that corresponds with plan objectives. In Korea, the state has consistently intervened to provide financing for the sectors and projects that were targeted in development plans. Investment funds have been allocated by state directive, not by market mechanisms. This has granted the state the authority to direct limited capital resources to domestic producers who develop targeted sectors and to restrict resource flows to other uses. Through its control over financial institutions, the state has manipulated investment patterns to match plan objectives. The single most important factor in explaining the Korean success in reaching planned development targets has been its capacity to direct capital investment patterns through state controlled financial institutions.

To increase the level of investment, the Korean state has actively intervened to formulate both domestic and foreign capital. Through fiscal, tax, and interest reforms, domestic capital formation increased from under 10 percent of GNP in 1961 to 24 percent in 1976.¹ Domestic capital formation remained near 25 percent of GNP through the 1980's. The Korean state has also actively utilized foreign capital markets to obtain additional financing for development objectives. Both foreign and domestic capital resources were required to pass

1. Economic Planning Board, Major Statistics of Korean Economy, various years.

through state controlled financial institutions. Although foreign capital borrowing increased significantly after 1977, greater increases in domestic capital formation led to a continued decline in the share of foreign savings to total savings, thereby decreasing the overall level of capital dependence.

It is usually easier for a state in a developing economy to restrict foreign investment from a particular sector than to induce a domestic firm to initiate production in a sector targeted for development. The high level of capital required to initiate production in most industrial sectors coupled with the high level of risk involved in initiating technologically complex production processes discourage domestic producers from entering new industrial sectors. To encourage domestic producers to enter into industrial sectors targeted for development, the Korean state has offered substantial economic incentives, including low cost financing, tax holidays, market protection, and direct assistance in obtaining necessary technical expertise. Further, to initiate domestic production in key sectors, the state has offered financing at negative interest rates in real terms. This financing was usually extended without collateral. State financial institutions would hold the debt and accept the risks involved.

Through a package of incentives, the state effectively induced domestic producers into targeted sectors. However, the state also developed mechanisms to hold domestic producers accountable for their actions. Along with the privileges granted to domestic producers, output quotas and other obligations were placed upon them. If domestic producers failed to meet these obligations, they would be denied future financing. In some cases, the state would direct the

financial institution which extended the credit to call in the debt, thereby causing the financial collapse of those firms. The state would then sell off their assets to other domestic firms.

Principally through the state's control over the allocation of financial funds and the granting of privileges, corporate expansion in Korea followed state planned economic expansion. The expansion of any individual corporation in Korea came from its ability to obtain financing directly from the state and to develop targeted industries. As a result, all major corporate decisions have been made within parameters established by the state.

The Korean state has repressed the labor class systematically. This is principally a result of the state policy to reduce labor costs in order to increase the international competitiveness of Korean export products and to reduce consumption levels of the working class in order to increase national savings. Wage levels have been set artificially low through agreement between the production firms and the government. The state has prohibited the formation of independent labor unions and all attempts to form collective bargaining units. State coercive mechanisms have infiltrated labor movements. Labor organizers have been imprisoned and tortured. In addition to low wages, the Korean workers are subject to a regressive tax structure imposed by the state and must pay artificially high prices for consumer goods due to monopoly market structures. Repression of labor has given Korean goods a comparative advantage in international markets and has decreased domestic consumption levels. However, it has also required state coercion in order to exclude the labor class from the political process and has forced the labor class to accept the lion's share of the burden of economic development.

The Korean state has also played a very active role in shaping the pattern and conditions under which foreign capital and technology penetrate the domestic economy. The consistent strategy of the Korean state in relation to foreign capital and technology has been to channel foreign inflows in a manner that facilitates the implementation of development plans while simultaneously maximizing domestic ownership and control over the means of production. Foreign capital loans have been induced by the state and utilized extensively to finance development projects. Where foreign technology was necessary to develop a given sector, the state assisted domestic producers to obtain that technology through various technological transfer agreements. Foreign direct investment has been strictly limited to "preferred" sectors where foreign technical or marketing expertise was required in order to meet development objectives. When foreign direct investment was allowed to enter the domestic economy, the state attempted to increase the benefits received by using its authority to require, wherever possible, joint ventures with Korean partners, specific agreements as to technological transfer, the training and promotion of Korean personnel, and specific output and export levels. Direct foreign investment was not allowed to compete with domestic firms, formulate capital in domestic capital market, or purchase an existing firm. These policies were consistently implemented by the state and effectively shaped the pattern of foreign penetration to reflect development planning and to support the growth of domestic industry.

The examination of the Korean industrialization process clearly demonstrates that the state in a contemporary developing country is capable of shaping its economic development process. In Korea, the

state was responsible for establishing comprehensive development plans. The state then utilized its authority to formulate and allocate resources. Through the allocation of resources, the state shaped the structure of the production process. The Korean state also utilized its authority to bargain effectively with the international economic community in order to shape foreign penetration to meet the needs of domestic production. These significant state interventions in Korea have been responsible for leading to an industrial transformation that was internally articulated and predominantly controlled by domestic actors.

The Implications of Korean Industrialization Policy for
Other Developing Countries

The examination of the Korean economic development experience has demonstrated that industrial transformation that is domestically led, controlled, and owned can occur in a contemporary developing country. A developing country, if properly managed, can maintain a relative autonomy from international forces over its development pattern if its state consciously acts in a manner that represents its own national interest. The state possesses a certain level of autonomy that allows it to shape economic development processes and the pattern of interaction with foreign economic forces.

In the literature on the political economy of developing nations, a great deal of attention has been focused upon the vulnerability and weakness of the nation-state to deal with and effectively alter the forces of the international economy. Where

industrialization does occur in the developing world, it is often argued that this industrialization is of a dependent nature and is characterized by the foreign ownership and control of the production apparatus.² Valid as such claims may be in several developing nations, it is incorrect to assume that industrialization in developing nations systematically leads to foreign economic domination. Despite common international stimuli, the pattern of foreign ownership varies greatly from one developing nation to another. This suggests that variation in domestic political structures and in alternative state policies may have an important impact on the pattern of foreign ownership and the control that foreign capital may exert in a developing economy.³

Though the capacity and will to do so vary from one state to another, national governments can and do exercise important controls over their own territories and determine, to a large extent, the conditions under which access to those territories will be granted.⁴ The international economic order is a system of highly unequal relationships between national actors. However, each nation-state

2. See: Peter Evans, Dependent Development: The Triple Alliance of Multinational, State, and Local Capital in Brazil, (Princeton: Princeton University Press, 1979). Fernando Cardoso, "Associated Dependent Development," in Alfred Stepan, Authoritarian Brazil, (New Haven: Yale University Press, 1978). Guillermo O'Donnell, Modernization and Bureaucratic Authoritarianism: Studies in Latin American Politics, (Institute of International Studies, University of California, Berkeley, Politics of Modernization Series, No. 9, 1973). Thetonio Dos Santos, "The Structure of Dependence," American Economic Review, May 1970.

3. For similar arguments dealing with developing economies, see: T.J. Pempel, "Japanese Foreign Economic Policy: The Domestic Bases for International Behavior," International Organization, Autumn 1977, Vol. 31, No. 4.

4. Samuel P. Huntington, "Transnational Organizations in World Politics," World Politics, April 1973, Vol. 25, pp. 333-368. Also see: T.J. Pempel, op. cit., p. 724.

potentially holds the capacity to take internally generated action to facilitate and shape, to a degree, its pattern of industrial development and its interaction with foreign economic forces. The international division of labor is not pre-given and is in part determined by state industrialization and development strategies.⁵

The pattern of industrial transformation in the Republic of Korea exemplifies one empirical example of the effect that state industrialization and development strategies can exert on the development process. At first glance, there are many features of the Korean industrialization process that resemble those of the bureaucratic-authoritarian models of development in Latin America as described by O'Donnell and others.⁶ Such features as the authoritarian suppression of labor and an elite coalition of military and civilian technocrats dominating political power and orienting state structures toward the objective of industrial development are similar in the bureaucratic-authoritarian states in Latin America and Korea. However, upon deeper examination, significant differences appear in the Korean experience which have led to state industrialization strategies that are markedly different than in Latin American bureaucratic-authoritarianism. These differences have, in turn, led to alternative state strategies in relation to industrial development.

O'Donnell's analysis of Latin American bureaucratic-authoritarianism and its relationship to industrialization has

5. Stephan Haggard and Chung In-moon, "The South Korean State in the International Economy: Liberal, Dependent, or Mercantile," in John Ruggie, ed. The Antinomies of Interdependence, (New York: Columbia University Press, 1983), p. 140.

6. Guillermo O'Donnell, op. cit. Also see: David Collier, ed., The New Authoritarianism in Latin America, (Princeton: Princeton University Press, 1979).

received much attention. O'Donnell identifies certain recurring patterns in Latin America in which different regimes, power coalitions, and policies have appeared.⁷ Based upon his analysis of these recurring patterns, O'Donnell describes three types of political systems that represent an historical sequence of political economic movement.⁸ The first type of political system in O'Donnell's historical sequence is what he labels as the "oligarchic." In the oligarchic system, the principal economic activity is centered around the production of primary products for export. During this phase, the elites who control primary product production capture and control political institutions. Public policy is oriented around the needs of this elite group. The majority of the population is engaged in various forms of agricultural pursuits and are not politically active. The oligarchic system is replaced when the production of light labor intensive industry is introduced into the economy and begins to gain dominance over the economy.

The oligarchic system is sequentially replaced by what O'Donnell labels the "populist" system. The populist political system is based upon the incorporation of various urban industrial classes into a coalition party generally led by a charismatic leader. The state in the populist system promotes economic and other forms of nationalism to unite the diverse social interests of the coalition. Public policy is oriented to support the development of import substitution consumer goods industries. The state supports domestic industrial capitalists by such policies as protective tariffs, import prohibitions, and supportive tax structures. The state also supports domestic market

7. Guillermo O'Donnell, op. cit., p. 68.

8. Ibid., Chapter 2. David Collier, op. cit., p. 23.

expansion and the interests of urban labor by encouraging the increase of wages.

The bureaucratic-authoritarian system, the third stage of O'Donnell's historical sequence, emerges as the consumer goods import substitution stage of the populist period becomes mature. With the maturing of the consumer goods industries, opportunities for economic expansion become limited. To expand the economy further requires the deepening of the economy through the development of heavy and chemical industries. However, to develop these industries requires high levels of capital, technical, and managerial input that do not exist in the populist domestic economy. According to O'Donnell, to overcome these economic constraints, the industrial bourgeoisie must become affiliated with international actors, particularly multinational corporations who can supply these requisite inputs. These requirements force a major alteration in the domestic political structures and the orientation of public policy.

O'Donnell argues that the need to attract multinational corporation inputs into the domestic economy in order to develop heavy and chemical industries requires that state structures move to create an investment climate that is highly favorable to international interests. This, in turn, requires the suppression of labor and the exclusion of the popular sectors of society from the political process. To enforce this exclusion requires authoritarian measures on the part of the state. The elite coalition now becomes reduced to military and civilian technocrats working in close association with foreign capital. Public policy becomes oriented toward the promotion of advanced industrialization and the authoritarian exclusion of the labor class.

The bureaucratic-authoritarian system promotes a pattern of capital accumulation which becomes highly skewed toward the benefit of domestic and foreign oligopolistic units of private capital. This sharply increases inequality in the distribution of national resources.⁹ The movement to the bureaucratic-authoritarian phase of political-economic development corresponds to, and promotes, an increasing transnationalization of the productive structures in the domestic economy. This results in the denationalization of the ownership of the production apparatus and a lessening of the authority and control that the state can exercise over domestic economic activity.

Although O'Donnell's assessment of the movement to bureaucratic-authoritarianism may be correct in several Latin American states,¹⁰ it is certainly incorrect to infer that O'Donnell's historical sequence is universally applicable to all developing countries that have experienced effective industrialization, or to infer that the authority of the state to shape the pattern of foreign inflows is necessarily sacrificed as the developing nation enters into heavy industrial development. The movement to the deepening of economic structure can result from political imperatives as well as economic, and the degree of national control over production apparatus can be largely controlled by effective state strategies.

In Korea, political economic structures that resemble O'Donnell's bureaucratic-authoritarian description in many ways came

9. Guillermo O'Donnell, "Tensions in the Bureaucratic-Authoritarian State and the Question of Democracy," in David Collier, ed., op. cit., p. 293.

10. For arguments questioning and criticising O'Donnell's argument, see: Albert O. Hirschman, "The Turn to Authoritarianism in Latin America and the Search for Its Economic Determinants," in David Collier, op. cit., chapter 3.

into being after the military coup in 1961. The power structure of the Korean government became centered around an elite coalition of military and civilian technocrats who promoted industrial development as a top priority. Authoritarian mechanisms to suppress labor and exclude the popular sector of society from the political process became dominant. However, the rise of the bureaucratic-authoritarian state in Korea was not the result of an economically driven historical sequence. Rather, it was centered around the political objective of national security as perceived by the military leaders of the coup. As was also true in Japan in the late 19th century, the move to a bureaucratic-authoritarian regime in Korea was a reaction to an external threat to national survival. In Korea's case, the military perceived that internal political instability and a weak industrial base could incite a north Korean invasion. Industrial development in Korea, particularly development of heavy and chemical industries, was a primary concern of the new regime. However, the principal objective of the regime was the enhancement of national security. Industrial development was viewed as the means to the achievement of the political objective. In the Latin American experience, as described by O'Donnell, the move to bureaucratic-authoritarianism came as the economic structural needs of the industrial bourgeoisie came to require a political move to authoritarianism in order to exclude the popular sectors of society and to create a stable investment climate for foreign capital. The move to bureaucratic-authoritarianism in Latin America was not in response to an external military threat. However, in Korea, as was true in Meiji Japan, no substantial industrial bourgeoisie existed at the time of the political transition to authoritarian-bureaucratic government. On the contrary, a primary

concern of the Korean military leaders in 1961, as was also the case of the Meiji leaders in Japan, was to establish an industrial bourgeoisie that could develop "strategic" industries under the leadership and dominance of the state bureaucracy. In Korea, the state was largely responsible for creating the industrial bourgeoisie rather than vice versa. Primarily through control over financial institutions, the state in Korea was able to control the expansion of the bourgeoisie and hold them responsible for implementing state designed industrial development strategies.

Principally because the move to bureaucratic-authoritarian political structures was a political imperative to enhance national security in the face of a real external threat to national survival, the Korean political leaders viewed the role that foreign investment should play in its industrialization process significantly different than did those in the Latin American states. In Korea, the goal was industrial development to enhance national security. This necessitated the development of policy that would facilitate industrial development that was not transnational in nature but rather domestically owned and controlled. In Korea, foreign capital and technological knowhow were seen as being necessary to rapid industrial expansion. However, foreign ownership and control of industrial production apparatus was viewed as highly threatening to national security and state sovereignty. Accordingly, the Korean state began to devote considerable energy to developing policies and bureaucratic mechanisms that would allow for the inducement of necessary foreign inputs, but in a pattern that would maximize domestic ownership and control over the development of key industries. Over a period of time, the Korean state has become highly effective at inducing foreign

capital and technological inputs that have allowed for the successful deepening of the Korean economy while simultaneously maximizing domestic ownership and control over the production apparatus.

In a similar manner as in Korea and contrary to the bureaucratic-authoritarian model as described by O'Donnell, the state in Taiwan has also played a very active role in developing industrial development strategies and in shaping the pattern of industrial transformation to facilitate domestic ownership and control over the means of production. When the Kuomintang took control of Taiwan in 1950 and established the Taiwanese state, the principal concern of the new rulers was national security. Industrial development was viewed as a principal factor in enhancing Taiwan's strategic interests. However, as in Korea and Meiji Japan, Taiwan possessed very little industrial capacity, financial institutions were unorganized, and no industrial bourgeoisie existed.

To overcome these significant constraints to industrial development, the state took direct action by intervening in all aspects of economic affairs. The Taiwanese state established the pattern of industrial development through the effective initiation and implementation of comprehensive development plans.¹¹ Investment capital utilized to finance targeted sectoral development was principally formulated and allocated by state controlled financial institutions. The Taiwanese state has also been highly active in establishing policies and mechanisms to manage the inflow of foreign capital and technology. Foreign capital and technological inflow

11. See: Alice H. Amsden, "The State and Taiwan's Economic Development," in Peter Evans, et al., Bringing the State Back In, (Cambridge: Cambridge University Press, 1985). Stephan Haggard and Tun-jen Cheng, "State and Foreign Capital in the East Asian NIC's," in Fred Deyo, ed., The Political Economy of the New Asian Industrializing Countries, (Ithaca, N.Y.: Cornell University Press, 1987).

patterns into the Taiwanese economy have been closely controlled by state agencies and effectively integrated with central development objectives to enhance domestic industrial capacity. These state interventions into key economic processes are largely responsible for the success Taiwan has experienced in economic growth and in the growth of domestically owned and operated production in key industrial sectors. As in the case of Korea, the Taiwanese state actively utilized its autonomy to shape both domestic production structures and economic interaction with the international economy. As a result, domestic owned and controlled industrial development did occur.

A principal difference in the pattern of industrial development in countries such as Korea and Taiwan as compared to the bureaucratic-authoritarian regimes in Latin America can be found in the pattern of domestic ownership of production apparatus and in the level of domestic control over key economic decisions. In Latin America, the movement to bureaucratic-authoritarianism resulted in the denationalization of ownership and decreased the authority and control that the state could exercise over domestic economic activity. However, in Korea and Taiwan, state policies have, to a large extent, determined the conditions under which access to their territories has been granted. Strict state control over the inflow of foreign capital and technology has allowed the Korean and Taiwanese economies to induce and utilize desired technical expertise while shaping the pattern of foreign direct investment in a manner that would protect and nurture the development of domestic industry.

It would surely be an exaggeration to claim that the Korean industrialization model could be replicated by similar state interventions in other developing countries. Development models are

configurations of political, institutional, and historical events and not merely a package of policies that may be implemented in similar fashion in different nations.¹² There are a number of circumstances that are unique to the Korean political economic situation which are related to the success of Korean economic development. Perhaps, one of the most important factors has been the relative openness of international (especially the United States) markets to Korean export goods. During the 1960's and 1970's, the likelihood of success of an export-led development strategy was far greater than today with the growing tendency of market protection in industrially advanced countries. A more protectionist world economy will limit the capacity of developing nations attempting to pursue an export-led growth strategy.

Although the Korean political economic environment has many unique elements, there are lessons to be learned from the Korean experience that may have implications for other development situations. Specific policies and strategies employed by the Korean state to initiate domestic industrial development and to manage interaction between the domestic economy and international economic forces can be employed in other developing nations. If effectively employed, these state interventions could increase the capacity of a developing country to initiate domestic production and to control foreign penetration.

There are four crucial areas where the Korean state actively intervened in the economic development process that could have direct implications for other developing countries. These four areas are:

- 1) a bureaucratic organization that is characterized by a dominant central planning agency with substantial authority to plan

12. Stephan Haggard and Tun-jen Cheng, op. cit., p. 128.

development initiatives, and subordinate bureaucratic institutions organized into functional units whose tasks are coordinated with centrally planned development objectives;

2) the development of state controlled financial institutions and policies that actively intervene to formulate domestic capital resources and to allocate them in accordance with state development plans;

3) the development of policies to induce domestic companies to initiate and expand production in targeted industrial sectors; and

4) the development of policies and mechanisms to control the inflow of foreign capital and technology to fit domestic development needs.

The development of a central planning agency and the organization of bureaucratic institutions into functional units coordinated with central planning objectives can serve the developmental interests of most developing countries. However, to be effective, the central planning agency needs to become the forefront institution in decision making and resource allocation. This central planning agency must be staffed with highly trained personnel who can realistically identify and plan sectoral development in a sequential manner. This agency also needs to possess sufficient authority to coordinate policies with other bureaucratic institutions and the private sectors. This requires the central planning agency to have budgetary control and the authority to control financial flows. Other bureaucratic institutions need to be organized on functional lines and held accountable to achieve specific tasks that are assigned by the central planning agency.

At the planning level, the central planning agency must have the capacity to identify sectors in which domestic producers are

technically capable of meeting production demands. These sectors should be reserved for domestic producers exclusively. Sectors in which domestic producers do not possess the necessary technical expertise to meet production demands but where it can be obtained through a technological transfer agreement should also be reserved for domestic producers. Targeted import substitution sectors in which domestic producers are incapable of meeting technological requirements and where required technology cannot be obtained through a transfer agreement, and export production sectors should be the only sectors open to foreign direct investment. The delineation of planned sectoral development in this manner will allow the state to channel foreign direct investment inflows in a pattern that will facilitate the implementation of development objectives without adversely affecting the development of domestic industry. The state must define long term development plans and redirect the global rationality of multinational corporations to fit domestic developmental needs.

In order to implement central development plans effectively, the state needs to formulate capital resources and control the pattern of their allocation so that they reflect development objectives. If resource allocation does not reflect the pattern called for in central development plans, development targets will not be achieved. The single most important factor in explaining the success of Korea in meeting development plan targets has been the state's capacity to allocate resources in a pattern that matched those identified in its plan. The state's capacity to control resource allocation is directly related to its control over financial institutions. If other developing countries wish to achieve their targets of central planning, control over capital allocation needs to be in the hands of

the state. Otherwise, capital investment will flow according to market mechanisms and the profit motives of individual financial institutions. Then, the development targets of the state become meaningless due to insufficient financing.

The state also needs to act aggressively in formulating domestic resources to finance development plans. Both public and private savings can be increased through effective state actions. Unnecessary state spending needs to be eliminated through responsible fiscal policy. Tax collection agencies need to enforce efficient tax policy that reasonably taxes all social strata. Efficient tax collection and fiscal policies will increase public savings that can be utilized to finance development. The state can also increase private savings by offering reasonable interest rates on saving accounts and by establishing savings institutions throughout the country to provide the public with easy access. The capacity of the state to facilitate domestic capital formation and to allocate it has a direct impact on the degree of autonomy that the state will have in its relationship with the international economic community. The greater the degree that development plans can be financed by domestic savings and implemented by domestic firms, the greater will be the control that domestic actors can exercise over economic decisions and the more those decisions will reflect the national needs.

The state of a developing country can also induce domestic firms into sectors planned for development by offering incentives. The Korean state has been highly successful at inducing domestic firms to enter targeted sectors and at nurturing them into mature, efficient, and competitive enterprises. Through state control of financial institutions, low cost financing can be allocated to domestic

producers willing to initiate or expand production in designated sectors. Tax concessions and other economic incentives can also be offered by the state. Preferential credit allocations and other incentives will remove a high level of the risk to entrepreneurs in specific sectors and provide the state with a high level of microeconomic control over sectoral development. In addition, the state should extend market protection to infant industries until they can develop and become competitive with foreign producers. By these means, a state can induce and nurture domestic producers to enter a wide range of industrial sectors. To assure effective use of resources, the state must develop means to monitor the actions of domestic producers who receive preferential treatment. These domestic producers must be held accountable for meeting objectives in level of output, quality of product, level of export, and other goals established by the state as conditions of access to financial and other state allocated privileges.

A particularly significant factor to the issue of contemporary industrial development is the degree of control that the developing nation has over its domestic economy. The examination of Korean industrial transformation has demonstrated that a state in a developing country does possess the capacity to influence the conditions under which foreign capital and technology flow into the domestic economy. A developing nation can participate in the international marketplace, acquiring needed capital and technology to facilitate the achievement of development plans, and maintain a high level of domestic ownership and control over its development. However, to achieve this, the state must be vigilant as to the structure of international relationships and the institutional means

through which these interchanges occur. The state must take an active role in managing foreign interaction so that it suits its own development needs and assures that domestically owned and operated industrial growth is a first priority.

In order to manage foreign penetration into the domestic economy, the state must develop institutional mechanisms that survey and regulate the inflow of foreign capital and technology. Such inflows must be coordinated with development planning and channeled to fill the sectoral needs that domestic producers are incapable of filling. As in the case of Korea, both legal and bureaucratic mechanisms need to be developed. Legal mechanisms coordinated with development planning can establish those sectors that are open and those that are closed to foreign penetration. Bureaucratic mechanisms can screen individual applications to assure their individual desirability to the needs of the domestic economy and monitor foreign actors after their arrival to assure their actions comply with agreed upon behavior.

Foreign loans can be utilized as a source of investment capital and should be preferred over foreign direct investment as a source of capital. Foreign loans can be channeled to domestic producers and increase domestic ownership over the means of production. However, the state must control the flow of borrowed capital to assure that it is utilized in a productive manner. That is, foreign loans should be filtered through state financial institutions and only allowed to flow to targeted industrial sectors and to domestic producers who possess sufficient technical and marketing expertise. In addition, the state should play an active role in the negotiations with foreign financial institutions to minimize the cost of loans. The state must also

monitor the behavior of the domestic producer to assure efficient use of borrowed funds.

Foreign direct investment should only be allowed to flow into targeted import substitution sectors that require the technology of foreign investors or into export production sectors. The state should develop mechanisms that prohibit foreign investors from formulating capital in the domestic capital market and from purchasing the production apparatus of domestic producers. When a foreign investment is allowed to enter the domestic economy, a detailed investment agreement between the investor and the state should be mutually agreed upon. When negotiating the investment agreements, the state should utilize its authority over access to the domestic economy to induce the foreign investors into specific projects and into joint ventures with domestic firms. Investment agreements should also specify the spacial location and size of investment, level of output, level of export, means of technological transfer, raw material supply, use of domestic technology and other inputs, and divestiture schedules whenever possible. Once a foreign direct investment is in place, the state must monitor the investor's behavior to assure compliance with the investment agreement. These policies, when implemented consistently and effectively by the state, can shape the pattern of foreign direct investment to reflect the needs of domestic development and will support the expansion of domestic industrial capacity.

The state can further facilitate the development of domestic industry by developing institutions that assist domestic producers in obtaining necessary foreign technology. A governmental institution should be developed to identify appropriate and necessary technology for the implementation of development plans and survey world markets

in order to locate the sources of this technology. When appropriate technology is located, the institution can negotiate terms for its transfer to a domestic producer. The state can then provide incentives for domestic producers to utilize appropriate technology in the desired manner and assist the domestic producers in training personnel. Through active state participation, technical licensing agreements, turnkey operations, machinery imports, and personnel training can supply a large share of necessary technical expertise to meet development objectives. Over time, these technical transfers will increase the level of domestic control over production and can greatly limit the need for foreign direct investment.

In conjunction with state assistance to domestic producers in gaining access to necessary technology, the state should also screen the importation of technical oriented goods. If a given technical import is available on the domestic market, the state should prohibit a similar import. This will aid domestic producers and the balance of payments.

The positive lessons learned from the Korean development experience should not overlook the social costs of such a development model to the labor class. The political coalition of military elites and the emerging industrialist class in Korea implemented development objectives utilizing low wage structures and restricted consumption levels. This, of course, increased domestic savings and made Korean goods more competitive abroad. However, it has required high levels of state coercion to repress movements by the labor class to unionize and to bargain collectively. Whether the excessiveness of the coercion was necessary to facilitate economic growth, or whether these political economic structures will allow for political stability in the long run is highly questionable.

Control over central planning and bureaucratic organization, financial allocation, foreign inflows, and the inducement of domestic enterprises to implement central development plans are four crucial areas of economic development that can be managed by the state in a developing country. Effective state control over these crucial areas can lead to industrial development that is predominantly owned and controlled by domestic producers. In order for a state to utilize its authority in this manner, the leaders of the state must be dedicated to the objective of economic development and put the highest priority on national control over the production apparatus. A consistent strategy must be employed, yet state policy must be flexible to meet the changing international environment and the changing needs of a growing economy. The state must possess a high capacity to plan development strategies and place obligations upon people of all social strata to assure compliance with government directives.

When examining economic development in the contemporary world, it is important to recognize the international economic system and the significant effects it can exert on a developing economy. However, transnational forces can be understood and largely mediated by the state through the selection and implementation of effective development strategies. When focusing upon the issue of economic development, the role of the state in facilitating capital accumulation, in allocating resources, and in shaping its relationship with the international economy becomes the crucial factor. The role the state plays in selecting economic priorities and the strategies it employs to achieve development objectives become the central explanatory variables of contemporary economic development.

APPENDIX

APPENDIX

Primary Data: Sources and Collection Techniques

This study has drawn on several sources of primary data that were collected by myself while conducting field research in Korea between August 1984 and December 1986. My research was aided by language skills and general knowledge of Korean culture that I had gained while serving in Korea as a Peace Corps volunteer from 1977 to 1979. While with the Peace Corps, I worked under the auspices of the Korean Ministry of Education as an instructor at Kangweon National University.

The primary data that I collected for this study can be broken down into three general categories:

- 1) Statistical yearbooks and other sources of published Korean government data and policy papers;
- 2) Internal Korean government documents and data made available to me directly from government officials who I interviewed; and
- 3) Data obtained from Korean business leaders, university professors, foreign businessmen, and foreign banking officials through questionnaires and interviews.

There are numerous books of data and policy papers published by the Korean government that are related to economic and fiscal performance and policy. These data sources and papers are published in the Korean language, and several of them are also translated into

English. The majority of these data sources and papers are compiled and circulated by the Economic Planning Board's Bureau of Statistics, the Ministry of Finance, the Bank of Korea, and the Ministry of Science and Technology. These data sources and policy papers are available to those who request and are granted permission to utilize government archives and the libraries of major Korean universities. I was granted permission to conduct research in the archives of the Korea Development Institute and the Bank of Korea as well as in the libraries of Yonsei University, Seoul National University, and Korea University.

During the course of my field research, I conducted approximately fifty interviews with Korean government officials who were directly involved in formulating or implementing economic policy. Those interviewed included officials in the Economic Planning Board, the Ministry of Finance, the Ministry of Trade and Industry, the Ministry of Science and Technology, the Bank of Korea, the Korea Development Institute, the Korea Institute of Economics and Technology, the Korea Advanced Institute of Science and Technology, the Korea Exchange Bank, the Korea Development Bank, and the Korean Overseas Trade Association. Those interviews provided me with extremely useful information regarding aspects of the internal government process in relation to sectoral planning and financing of strategic industries. Those interviews also provided very useful insight into the governmental processes involved in formulating policy toward foreign capital and technological inflows. Often, the interviewees provided me with internal documents and statistics that had not been printed and circulated for public consumption. With the few exceptions noted in the text, interviewees were assured of confidentiality.

A third source of primary data comes from both the domestic and foreign business community through questionnaires and interviews. I conducted approximately 20 interviews with Korean business leaders and university professors in business or economics. Interviews with Korean business leaders were primarily concerned with incentives and regulations utilized by the government to induce jaebols to initiate or expand production in a state targeted sector or concerned their corporate relations with a foreign joint venture partner. Interviews were conducted with officials at Lucky-Gold Star, Hyundai, Samsung, Daewoo, and Sunkyoung jaebols, and with several owners of smaller scale textile firms and electronic goods assembly firms. Interviews were also conducted with professors in the business school at Seoul National University and Yonsei University, and with economists at Yonsei University and Sogang University. These interviewees were also assured of confidentiality.

To obtain information from foreign financial institutions and foreign direct investors on their interaction with the Korean domestic economy and with the Korean government, I circulated questionnaires and conducted interviews. These questionnaires were intended to be exploratory in nature. Two questionnaires were made, one for the foreign banking community and one for foreign investors (copies of the questionnaires follow immediately in this Appendix).

The procedure followed to collect data from the foreign business community was to first meet personally with the respondents, explain the purpose of the research, and give the respondents the questionnaires with the understanding that I would return at a later date. On the second meeting, I would collect the completed questionnaires and conduct interviews. The interviews would be

focused upon expanding the scope of the information provided in the questionnaires or on other relevant aspects of the respondents' interaction with the Korean economy or with the Korean government. Through this method, I was able to gain qualitative information on the Korean investment climate from the foreign investors' perspective, on negotiating investment agreements with the Korean government, on conditions and relations with joint venture partners, on technological transfers, on the Korean government's monitoring of foreign firms, and on the inducement, usage, and regulation of borrowed foreign capital.

In 1985, there were approximately thirty-five foreign banks who had branches in Seoul. Eighteen of these foreign banks' general managers or vice-presidents agreed to complete the questionnaires and to be interviewed. The sample included American, Japanese, British, and French banks. Thirty-eight foreign investors agreed to complete the questionnaires and to be interviewed for this study. These respondents included American and Japanese investors. With the few exceptions noted in the text, these respondents were also assured of confidentiality.

Questionnaire for Foreign Bankers

1. Name of Interviewee:
2. Name of Bank:
3. Date:
4. Are you familiar with the Foreign Capital Inducement Act and its specifications for the entry of foreign loans into Korea?
yes no
5. Do you consider the Foreign Capital Inducement Act to be an accurate guideline to the actual policy of the Korean government in relation to the entry of foreign loans into Korea?

yes

no

6. Approximately, what is the total amount of capital that your bank has lent to the Korean economy?

7. Approximately, what proportion of your loans flow to the following sectors?

A. Infrastructure development:

1) Power facilities:

2) Communications:

3) Transportation and Shipping:

B. Heavy industry:

1) State owned:

2) Private Sector:

C. Light industry:

D. Electronics:

1) Consumer:

2) Industrial:

3) Computer or High technology:

8. Is the Korean government's screening and approval process of foreign loan applications consistent with stated government policy?

yes

no

9. What type of loan applications are most likely to be approved by the Korean government?

10. Has your bank ever had a loan application denied by the Korean government?

yes

no

11. If your bank has had a loan application denied by the Korean government, please specify the sector that the loan was intended to flow into and the reason why you believe the loan was denied.

12. Do you consider Korea to be a good risk for future loans?

yes

no

13. Approximately, what proportion of your loans to the Korean economy are funds formulated within the Korean domestic economy?

14. The entry of foreign capital into the Korean economy has predominantly been in the form of loans as opposed to direct investment at a rate of approximately 20:1. Please indicate the importance of the following criteria as an explanation of this foreign capital inducement pattern. Please mark: 1 for VERY IMPORTANT; 2 for IMPORTANT; 3 for NOT IMPORTANT; and 4 for NOT APPLICABLE.

___ 1) Reluctance of investors because of political instability.

___ 2) Reluctance of investors because of a lack of appropriate transportation and communication infrastructure.

- ☐ 3) Reluctance of investors because of excessive government regulation of foreign investment.
 - ☐ 4) A deliberate government strategy of preferring foreign loans over foreign investment in order to maintain a higher degree of national control and to limit foreign influence in the domestic economy.
 - ☐ 5) The domestic market is too limited to attract direct foreign investment at a larger scale.
 - ☐ 6) A positive debt servicing reputation attracts foreign loans to Korea.
 - ☐ 7) Please list any other reasons why you feel foreign loans have played such a large role in Korea in relation to direct foreign investment.
15. Does the Korean government's loan screening process allow the Korean government to control the size and sectoral direction of foreign loans entering into the Korean economy?
yes no
16. The Korean government's loan screening process is intended to allow for a relatively high level of certainty that a foreign loan entering Korea will be beneficial to the domestic economy. Please indicate the level of certainty that the loan screening process provides in the following areas. Please mark: 1 for A HIGH LEVEL OF CERTAINTY; 2 for A MEDIUM LEVEL OF CERTAINTY; 3 for A LOW LEVEL OF CERTAINTY; and 4 if NOT IMPORTANT IN THE LOAN APPROVAL PROCESS.
- ☐ 1) The loan will contribute to GNP growth.
 - ☐ 2) The loan will generate a rate of return that is in excess of the cost of the capital borrowed.
 - ☐ 3) The loan will contribute to an increase in export production.
 - ☐ 4) The loan will contribute to an increase in domestic capital formation.
 - ☐ 5) The loan will contribute to an increase in the diversification of goods produced.
 - ☐ 6) The loan will flow to sectors that are designated in the government development plans.
 - ☐ 7) The loan will flow to producers who possess sufficient technological skill and marketing expertise to assure efficient utilization of the capital borrowed.
17. Have you had experience in a similar executive capacity in another developing country?
yes no
18. If you have had experience in other developing countries, please list those countries.
19. Does the Korean government assume a more active role than other governments that you are familiar with in screening and regulating loan applications?
yes no

20. As the size of Korea's foreign debt has increased, has the influence of the foreign banking community or the International Monetary Fund to alter Korean government economic policy increased?
- yes no
21. If the answer to #20 is yes, please specify the manner in which the foreign banking community or the I.M.F.'s influence has been altered.
22. In attempting to gain access to the foreign capital required to finance economic development plans since 1965, has the Korean government deliberately followed a strategy whereby they encourage loans over direct foreign investment except in those cases where Korean technological or marketing expertise is insufficient and where these skills necessarily must be provided by a foreign investor?
- yes no
23. If the answer to #22 is yes, has this strategy allowed for a greater degree of national control over major domestic economic decisions than a similar level of direct foreign investment would have allowed?
- yes no

Thank you very much for your cooperation and time. If you would like to make any further comments, please list them on the following page.

Questionnaire for Foreign Direct Investors

1. Name of Interviewee:
2. Corporation:
3. Subsidiary of:
4. Type of investment (sector):
5. Is this investment a joint venture? yes no
6. Please indicate your joint venture partner.
7. What percent of equity does your company hold in this
venture?
8. Date when original investment arrived in Korea.
9. Does your corporation maintain control over managerial
operations in this venture?

yes no

10. Does your corporation maintain control over financial operations in this venture?

yes

no

11. What was the degree of importance of the following criteria for your corporation's decision to place the original investment in Korea? Please mark: 1 for VERY IMPORTANT; 2 for IMPORTANT; 3 for NOT IMPORTANT; and 4 for NOT APPLICABLE.

A. Economic motives:

- ☐ 1) Availability of water and power.
- ☐ 2) Availability of adequate communication and transportation infrastructure.
- ☐ 3) Availability of low cost labor.
- ☐ 4) Availability of educated and easily trainable labor.
- ☐ 5) Availability of relatively inexpensive real estate.
- ☐ 6) The potential profitability of investment in Korea as opposed to a similar investment in another country.

B. Marketing motives:

- ☐ 1) To maintain share of local market.
- ☐ 2) To develop a share of the local market.
- ☐ 3) To produce exports to the home market
- ☐ 4) To produce exports for a third market.
If important, please list principal third country markets.

C. Government motives:

- ☐ 1) Stability of the Korean governmental system.
- ☐ 2) Stability of the investment climate.
- ☐ 3) Five year tax holiday and subsequent 50 percent tax exemption.
- ☐ 4) Exemption on custom duties and commodity tax on imported goods used in your production process.
- ☐ 5) Other governmental incentives.
Please list the most important of these incentives.

12. Entering into an investment agreement in Korea:

- 1) Are you familiar with the Foreign Capital Inducement Act and its specifications for foreign investment in Korea?

yes

no

- 2) Do you consider the Foreign Capital Inducement Act to be an accurate guideline to the actual policy of the Korean government in relation to foreign investment?

yes

no

- 3) Are the terms under which your investment entered Korea consistent with the Foreign Capital Inducement Act?

yes

no

- 4) Does your parent corporation provide technology for your venture in Korea?
yes no
- 5) If #4 is yes, please specify the principal technology provided by your parent corporation.
- 6) Is the technology provided by your parent corporation specified in your investment agreement?
yes no
- 7) What proportion of your production output is exported?
- 8) What proportion of your production output is sold on the domestic Korean market?
- 9) Is the proportion of your production output that must be exported specified in your investment agreement?
yes no
- 10) Does your parent corporation provide raw materials for your venture in Korea?
yes no
- 11) Is the supply of raw materials specified in your investment agreement?
yes no
- 12) What are the principal raw material provided by your parent corporation?
- 13) Does your parent corporation provide marketing services for your Korean exports?
yes no
- 14) Is the utilization of your parent corporation's marketing services specified in your investment agreement?
yes no
- 15) Do you utilize domestic producers of intermediate goods or technology that are appropriate for your production process?
yes no
- 16) Is the utilization of the domestic market for intermediate goods or technology that are appropriate for your production process specified in your investment agreement?
yes no
- 17) In your production process, if you use intermediate goods or technology that your parent corporation produces in another country, can you import these goods or technology freely?

yes

no

- 18) Is there a government screening process whereby the government may refuse entry of goods or technology if similar goods or technology are available from the Korean domestic market?

yes

no

- 19) Has your corporation had an investment application denied by the government?

yes

no

- 20) If the answer to #19 is yes, please explain why you believe the application was denied.

- 21) Does your corporation carry out Research and Development activities in Korea?

yes

no

- 22) What percent of your Korean total sales is invested into Research and Development?

- 23) Has your corporation marketed a new product in the past five years as a result of Korean Research and Development activities?

yes

no

- 24) In financing your investment in Korea, what percent of your investment was formulated in the Korean domestic financial market?

- 25) Do Korean government financial policies constrain domestic capital formation by foreign enterprises?

yes

no

13. Government monitoring of foreign investment:

- 1) Subsequent to the arrival of your investment, has the Korean government monitored your corporate activities in order to assure compliance with your investment agreement?

yes

no

- 2) Which government agencies are involved in monitoring your corporate activities?

- 3) Does the government monitor your investment to assure that it flows to the exact project for which it was originally approved?

yes

no

- 4) Does the government monitor the percentage of your output that is exported to assure compliance with your investment agreement?

yes

no

- 5) Does the government monitor the level of intermediate goods and technology imported to assure that goods and technology that could be purchased on the Korean domestic economy are not imported?
yes no
- 6) Does the government monitor your corporate activities to assure that your corporate tax rate complies with your investment agreement?
yes no
- 7) What is the approximate annual rate of return on your investment in Korea?
- 8) Does the government monitor the rate of profit repatriation to assure compliance with your investment agreement?
yes no
- 9) In your opinion, has the Korean government's attempt to enforce compliance with your investment agreement been consistent with the original agreement?
yes no
14. Your corporate experience in Korea as compared to other countries:
- 1) Have you held a similar executive position in another foreign country?
yes no
- 2) If the above answer is yes, please list those countries you have worked in.
- 3) Does the Korean government have more or less control in determining the sectoral location of foreign investment than do most developing countries?
more less
- 4) Direct foreign investment in Korea from 1965 to 1984 totaled less than \$2 billion. This is a relatively small amount compared to many developing countries, and is less than 5 percent of the amount of foreign capital that Korea has borrowed. Please indicate the importance of the following criteria as an explanation of why direct foreign investment has not been greater in Korea. Please mark: 1 for VERY IMPORTANT; 2 for IMPORTANT; 3 for NOT IMPORTANT; and 4 for NOT APPLICABLE.
- (a) Government regulations controlling the sectors in which foreign investment may flow prohibit foreign investment into the more profitable sectors.

- (b) The political environment is unstable.
- (c) The domestic market is too limited to attract greater investment levels.
- (d) The lack of sufficient transportation, electrical, and communication infrastructure has limited foreign investment.
- (e) The Korean government's foreign capital inducement policy is designed to limit foreign investment in order to increase domestic control over major domestic economic decision making.
- (f) The Korean government's foreign capital inducement policy is designed to limit foreign investment opportunities to those that meet the government's perceived specific needs for technology or for access to markets that the foreign investor can provide.
- (g) Please list any other reasons why direct foreign investment has been relatively limited in Korea.

Thank you very much for your cooperation and time. If you would like to make any further comments, please list them on the following page.

BIBLIOGRAPHY

BIBLIOGRAPHY

- Ali, Sheikh, R. (1982). "Oil and Islam in the Middle East and Their Implications for Korea." Korea and World Affairs, Summer.
- Allen, G. C. (1972). A Short Economic History of Modern Japan. London: Unwin, Ltd. 3rd ed.
- _____ (1980). Japan's Economic Policy. New York: MacMillan.
- Allen, Richard (1960). Korea's Syngman Rhee. Tokyo: Charles Tuttle Publishers.
- Althusser, Louis (1971). Lenin and Philosophy and Other Essays. London: New Left Books.
- _____ (1972). Politics and History: Montesquieu, Rousseau, and Marx. London: New Left Books.
- Amin, Samir (1976). Unequal Development: An Essay on the Social Formation of Periphery Capital. New York: Monthly Review Press.
- Amnesty International (1986). Imprisoned Trade Unionists in the Republic of Korea. London: International Secretariat.
- Apter, David (1971). Choice of the Politics of Allocation. New Haven: Yale University Press.
- Bank of Korea (various years). Economic Statistics Yearbook. Seoul: Bank of Korea.
- _____ (1955). Annual Economic Review. Seoul: Bank of Korea.
- _____ (1983). Financial System in Korea. Seoul: Bank of Korea.
- _____ (1984). Overseas Investment System of Korea. Seoul: Bank of Korea.
- Baran, Paul (1952). "On the Political Economy of Backwardness." The Manchester School, January.
- Barnet, Richard (1971). Roots of War. New York: Pelican Books.
- _____ and Ronald Muller (1974). Global Reach. New York: Simon and Schuster.

- Barone, Charles A. (1983). "Dependency, Marxist Theory, and Salvaging the Idea of Capitalism in South Korea." Review of Radical Political Economics, Vol. XV, No. 1.
- Binder, Leonard, et al. (1971). Crisis and Sequences in Political Development. Princeton: Princeton University Press.
- Bornschier, Volker (1980). "Multinational Corporations and Economic Growth: A Cross National Test for the Decapitalization Thesis." Journal of Development Economics, June.
- Brandt, Vincent S. R. (1979). "Rural Development in South Korea Since the 1960's." Asian Affairs, January/February.
- Brewer, Anthony (1980). Marxist Theories of Imperialism: A Critical Survey. London: Routledge and Kegan Paul.
- Brown, Gilbert (1973). Korean Pricing Policies and Economic Development in the 1960's. Baltimore: Johns Hopkins University Press.
- Buss, Claude, A. (1982). The United States and the Republic of Korea: Background for Policy. Palo Alto, Ca.: Hoover Institute Press.
- Calverly, John (1982). Korea: Exporting to Survive. London: Euromoney Publications, Ltd.
- Caporaso, James A. (1978). "Dependence, Dependency, and Power in the Global System: A Structure and Behavioral Analysis." International Organization, Winter.
- _____. (1981). "Industrialization in the Periphery." International Studies Quarterly, September.
- Carnoy, Martin (1984). The State and Political Theory. Princeton: Princeton University Press.
- Chang, Dal-joong (1985). Economic Control and Political Authoritarianism: The Role of Japanese Corporations in Korean Politics, 1965-1979. Seoul: Sogang University Press.
- Choe, Boam Jong (1973). An Economic Study of the Free Trade Zones. Seoul: Korea Development Institute, Working Paper No. 7310.
- Choy, Bong-Youn (1971). Korea: A History. Rutland, Vt.: Charles E. Tuttle Co., Inc.
- Chung, Byung-soo (1976). The Choice of Production Techniques U.S. and Japanese Subsidiaries in Korea. Honolulu: Unpublished Ph.D. Dissertation, University of Hawaii.

- Clough, Ralph N. (1987). Embattled Korea: The Rivalry for International Support. Boulder, Colorado: Westview Press.
- Cole, David and N. Lyman (1971). Korean Development: The Interplay of Politics and Economics. Cambridge: Harvard University Press.
- _____ et al. (1980). The Korean Economy: Issues of Development. Berkeley, California: Institute of East Asian Affairs, University of California.
- _____ and Park Young Chul (1983). Financial Development in Korea. Cambridge: Harvard University Press.
- Collier, David, editor (1979). The New Authoritarianism in Latin America. Princeton: Princeton University Press.
- Coolidge, T. Jefferson, Jr. (1981). "The Realities of Korean Foreign Investment Policy." Asian Affairs, July/August.
- Coves, Richard E. (1983). Multinational Enterprise and Economic Analysis. Cambridge, England: Cambridge University Press.
- Crone, Donald K. (1983). The ASEAN States: Coping With Dependence. New York: Praeger Publishers.
- Cumings, Bruce (1981). The Origins of the Korean War. Princeton: Princeton University Press.
- _____ (1984). "The Origins of Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles, and Political Consequences." International Organization, Winter.
- Dahlman, Carl J., et al. (1984). Managing Technological Development: Lessons From Newly Industrializing Countries. Washington, D.C.: World Bank Staff, Working Paper No. 717.
- Devlin, David and George R. Kruer (1970). "The International Investment Position of the United States." Survey of Current Business, Vol. 50, No. 1.
- Deyo, Fred, editor (1987). The Political Economy of the New Asian Industrializing Countries. Ithaca, N.Y.: Cornell University Press.
- Diaz-Alejandro, Carlos (1978). Rich and Poor Nations in the World Economy. New York: McGraw-Hill Book Company.
- Dos Santos, Thetonio (1970). "The Structure of Dependence." American Economic Review, May.
- Easton, David (1981). "The Political System Besieged by the State." Political Theory, Vol. 9, No. 3.

- Economic Planning Board (various years). Major Statistics of Korean Economy. Seoul: Economic Planning Board.
- _____. (various years). Korea Statistical Yearbook. Seoul: National Bureau of Statistics.
- _____. (various years). Status of Foreign Capital Inflows. Seoul: Economic Planning Board.
- _____. (1983). A Handbook of Korea. Seoul: Korean Overseas Information Service, Ministry of Culture and Information.
- _____. (1977). Status of Foreign Loans Authorized by Industry. Seoul: Economic Planning Board.
- _____. (1962-1986). Five Year Economic Development Plans I-VI. Seoul: Economic Planning Board.
- Edwards, C. T. (1980). "South Korea's Industrial Development Strategy: Implications for Australia." Australian Economic Review, Spring.
- Epstein, Edward C. (1984). "Legitimacy, Industrialization, and Opposition in Exclusionary Bureaucratic-Authoritarian Regimes." Comparative Politics, Vol. 17, No. 1.
- Evans, Peter (1977). "Direct Investment and Industrial Concentration." Journal of Development Studies, Vol. 13, No. 4.
- _____. (1979). Dependent Development: The Triple Alliance of Multinational, State, and Local Capital. Princeton: Princeton University Press.
- _____, et al. (1985). Bringing the State Back In. Cambridge: Cambridge University Press.
- Fairbanks, John K. (1978). East Asia: Transition and Transformation. Boston: Houghton Mifflin Company.
- Fieldhouse, D. F. (1966). The Colonial Empires. New York: Delacorte.
- Frank, Charles R. (1975). South Korea: Foreign Trade Regimes and Economic Development. New York: Columbia University Press.
- Frobel, Folker, et al. (1978). "The World Market for Labor and the World Market for Industrial Sites." Journal of Economic Issues, December.
- Giddens, Anthony (1971). Capitalism and Modern Social Change. Cambridge, England: Cambridge University Press.
- Halliday, Jon (1975). A Political History of Japanese Capitalism. New York: Pantheon Books.

- Han, Young-ki (1971). Foreign Resources and Economic Growth: An Alternative Model for Korea. (Riverside, Ca.: Unpublished Ph.D. Dissertation, University of California.
- Han, Sung-joo (1974). The Failure of Democracy in South Korea. Berkeley: University of California Press.
- _____. (1974). "South Korea: The Political Economy of Development." Asian Survey, January.
- Harrison, Selig S. (1978). The Widening Gulf: Asian Nationalism and American Policy. New York: The Free Press.
- _____. (1980). The Security of Korea: United States and Japanese Perspectives on the 1980's. Boulder, Colorado: Westview Press.
- Hasan, Parvez (1976). Korea: Problems and Issues in a Rapidly Growing Economy. Baltimore: Johns Hopkins University Press.
- _____. and D. C. Rao (1979). Korea: Policy Issues for Long Term Development. Baltimore: Johns Hopkins University Press.
- Hatata, Takashi (1969). A History of Korea. Santa Barbara, Ca.: American Bibliographical Center-Clip Press.
- Hedberg, Hakan (1978). The New Challenge: South Korea. Seoul: Chongno Book Center.
- Hellmann, Donald C. (1972). Japan and East Asia: The New International Order. New York: Praeger Publishers.
- Henderson, Gregory (1968). Korea: The Politics of the Vortex. Cambridge: Harvard University Press.
- Heper, Metin, et al. (1980). "The Role of Bureaucracy and Regime Type: A Comparative Study of Turkish and South Korean Higher Civil Servants." Administration and Society, August.
- Hirshman, Albert, editor (1980). National Power and Structure of Foreign Trade. Berkeley: University of California Press.
- Hobson, John (1938). Imperialism: A Study. London: George Allen and Unwin, Ltd.
- Hofheinz, Roy, Jr. and Kent E. Calder (1982). The East Asian Edge. New York: Basic Books, Inc.
- Hong, Wontack and Anne O. Krueger (1975). Trade and Development in Korea. Seoul: Korea Development Institute.
- _____. (1975). Export Development in Korea. Seoul: Korea Development Institute.

- Huntington, Samuel P. (1968). Political Order in a Changing Society. New Haven: Yale University Press.
- _____. (1971). "The Change to Change: Modernization, Development, and Politics." Comparative Politics, April.
- _____. (1973). "Transnational Organizations in World Politics." World Politics, Vol. 25, No. 1.
- Hurst, Cameron III (1984). American Problems Doing Business in Korea. Hanover, New Hampshire: Universities Field Staff International Paper No. 19.
- International Bank of Reconstruction and Development (1978). Consolidated Balance of Payments. Washington, D.C.: World Bank, Economic Analysis and Projections Department.
- _____. (1983). World Tables, Vol. II, 3rd ed. Baltimore: Johns Hopkins University Press.
- International Monetary Fund Research Department (1985). Private Foreign Investment in Developing Countries. Washington, D.C.: International Monetary Fund, Occasional Paper No. 33.
- Jackman, Robert (1982). "Dependence on Foreign Investment and Economic Growth in the Third World." World Politics, Vol. 34.
- Jo, Sung Hwan (1977). Direct Foreign Investment in South Korea: An Economic Survey. Seoul: Korea Development Institute, Working Paper No. 7707.
- Johnson, Chalmers (1982). MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975. Stanford: Stanford University Press.
- Jones, Leroy P. and Il Sakong (1980). Government, Business and Entrepreneurship in Economic Development: The Korean Case. Cambridge: Harvard University Press.
- Keohane, Robert and Joseph Nye, editors (1972). Transnational Relations and World Politics. Cambridge: Harvard University Press.
- Keon, Michael (1977). Korean Phoenix: A Nation From the Ashes. Englewood Cliffs: Prentice-Hall International.
- Kesselman, Mark (1973). "Order or Movement: The Literature of Development as Ideology." World Politics, October.
- Kim, C.I. Eugene and Doretta E. Mortimore (1977). Korea's Response to Japan: The Colonial Period, 1910-1945. Kalamazoo: The Center for Korean Studies, Western Michigan University.

- Kim, Inchul (1984). Korea's Policy Response to the World Debt Crisis. Seoul: Korea Development Institute, Working Paper No. 8409.
- Kim, Joungwon Alexander (1975). Divided Korea: The Politics of Development, 1945-1972. Cambridge: Harvard University Press.
- Kim, Ki-hwan (1985). The Korean Economy. Seoul: Korea Development Institute.
- Kim, Kyong-dong (1976). "Political Factors in the Formation of the Entrepreneurial Elite in South Korea." Asian Survey, Vol. 16, No. 5.
- Kim, Seung-hee (1970). Foreign Capital for Economic Development: A Korean Case Study. New York: Praeger Publishers.
- Kohli, Atul, et al. (1984). "Inequality in the Third World: An Assessment of Competing Explanations." Comparative Political Studies, Fall.
- Koo, Bohn-young (1983). The Role of Foreign Direct Investment in Korea's Recent Economic Growth. Seoul: Korea Development Institute.
- _____. (1984). Industrial Structure and Foreign Investment: A Case Study of Their Interrelationship in Korea. Seoul: Korea Development Institute, Working Paper No. 8402.
- _____. (1984). The Role of the Government in Korea's Industrial Development. Seoul: Korea Development Institute, Working Paper No. 8407.
- Korea Exchange Bank (1984). The Korean Economy. Seoul: Korea Exchange Bank.
- Korean Traders Association (1984). Major Statistics of Korean Economy. Seoul: Korean Traders Association.
- Korea University (1972). Study on the Criteria for Foreign Direct Investment and Joint Venture in Korea. Seoul: International Management Institute, Korea University.
- Krasner, Stephan (1978). Defining the National Interest. Princeton: Princeton University Press.
- _____. (1984). "Approaches to the State: Alternative Conceptions and Historical Dynamics." Comparative Politics, Vol. 16, No. 2.
- Krueger, Anne O. (1979). The Developmental Role of the Foreign Sector and Aid. Cambridge: Harvard University Press.
- Kumar, Krishna (1982). Multinationals From Third World

Countries. Lexington, Mass.: Lexington Books.

- Kuznets, Paul (1977). Economic Growth and Structural Transformation in the Republic of Korea. New Haven: Yale University Press.
- Lee, Chul Hee (1980). Automobile Industry in Korea. Seoul: Korea Development Institute.
- Lee, Dong-ho (1980). "A Case Study of the Korean Textile Industry." Asian Economics, March.
- _____. (1981). "A Case Study of Korea's Electronic Industry." Asian Economics, March.
- Lee, Ho-sung (1980). "Agriculture in Korea." Korea Exchange Bank Monthly Review, February.
- Lehachman, Robert (1959). A History of Economic Ideas. New York: Harper and Row Publishers.
- Lim, Young-il (1968). "Foreign Influences on the Economic Change in Korea." Journal of Asian Studies, November.
- Lockwood, William (1968). The Economic Development of Japan. Princeton: Princeton University Press.
- Lyman, Princeton, N. (1966). "Economic Development in South Korea: Prospects and Problems." Asian Survey, Vol. 6, No. 7.
- Lyons, Gene, M. (1961). Military Policy and Economic Aid: The Case of Korea. Columbus: Ohio State University Press.
- Luxembourg, Rosa (1961). The Russian Revolution and Leninism and Marxism. Ann Arbor: University of Michigan Press.
- Mason, Edward (1980). The Economic and Social Modernization of the Republic of Korea. Cambridge: Harvard University Press.
- McGowan, Pat and Stephan Walker (1981). "Radical and Conventional Models of U.S. Foreign Economic Policy." World Politics, Vol. 33, No. 3.
- Miliband, Ralph (1969). The State in Capitalist Society. New York: Basic Books.
- Ministry of Finance (1984). Investment Guide to Korea. Seoul: Ministry of Finance.
- _____. (1985). Foreign Capital Inducement Act, Enforcement Decree, and Working Rules. Seoul: Ministry of Finance.
- Moran, T. H. (1974). Multinationals and the Politics of Development: Copper in Chile. Princeton: Princeton University Press.

- Moskowitz, Karl, editor (1984). From Patron to Partner. Lexington: Lexington Books.
- Moulton, Harold G. (1931). Japan: An Economic and Financial Appraisal. Washington, D.C.: The Brookings Institute.
- Muller, Edward and Mitchell A. Seligson (1987). "Inequality and Insurgency." American Political Science Review, Vol. 81, No. 2.
- Muller, Ronald (Winter 1973-1974). "Poverty is the Product." Foreign Policy.
- Myrdal, Gunnar (1968). Asian Drama: An Inquiry into the Poverty of Nations. New York: Twentieth Century Fund.
- _____. (1970). The Challenge of World Poverty. New York: Vintage Books.
- Nahm, Andrew (1973). Korea Under Japanese Colonial Rule. Kalamazoo: The Center for Korean Studies, Western Michigan University.
- Nam, Duk Woo (1979). "Korea: The Social and Economic Conditions for Sustained Economic Growth." Asian Affairs. November/December.
- Norman, E. H. (1975). Origins of the Modern Japanese State: Selected Writings by E. H. Norman. John Dower, editor. New York: Pantheon Books.
- O'Donnell, Guillermo (1973). Modernization and Bureaucratic Authoritarianism: Studies in Latin American Politics. Berkeley: Institute of International Studies, University of California, Politics of Modernization Series, No. 9.
- Ohkawa, Kazaushi and Henry Rosovsky (1973). Japanese Economic Growth: Trend Acceleration in the Twentieth Century. Stanford: Stanford University Press.
- Olsen, Edward A. (1980). "Korea Incorporated: The Political Impact of Park Chung-hee's Economic Miracle." Orbis. Spring.
- Ordlinger, E. A. N. (1981). On the Autonomy of the Democratic State. Cambridge: Harvard University Press.
- Oser, Jacob (1963). The Evolution of Economic Thought. New York: Harcourt, Brace, and World, Inc.
- Ozahi, Robert (1971). "Japanese Views on Foreign Capital." Asian Survey, November.

- Park, Chung-hee (1970). The Country, the Revolution, and I. Seoul: Chongno Book Center.
- _____. (1971). To Build a Nation. Washington, D.C.: Acropolis Books, Ltd.
- _____. (1979). Korea Reborn: A Model for Development. Englewood Cliffs: Prentice-Hall International.
- Park, Sung-jo, et al. (1980). Economic Development and Social Change in Korea. Frankfurt: Campus Verlag.
- Park, Young-ki (1975). "Labor and Business Environment in Korea." Asian Economics, December.
- Pempel, T. J. "Japanese Foreign Economic Policy: The Domestic Bases for International Behavior." International Organization, Vol. 31. No. 4.
- _____. (1982). Policy and Politics in Japan: Creative Conservatism. Philadelphia: Temple University Press.
- Pincus, John (1967). Trade, Aid, and Development: The Rich and Poor Nations. New York: McGraw Hill Book Co.
- Portes, Alejandro (1976). "On the Sociology of National Development: Theories and Issues." American Journal of Sociology, Vol. 82, No. 1.
- Poulantzas, Nicos (1969). "The Problems of the Capitalist State." New Left Review, November/December.
- _____. (1973). Political Power and Social Classes. London: New Left Books.
- Pyle, Kenneth B. (1978). The Making of Modern Japan. Lexington, Mass.: D.C. Heath and Company.
- Rees, David (1981). Crisis and Continuity in South Korea. London: Institute for the Study of Conflict.
- Reeves, W. D. (1963). The Republic of Korea: A Political and Economic Study. London: Oxford University Press.
- Rosenthal, Gert (1973). The Role of Private Foreign Investment in the Development of the Central American Common Market. Chicago: Adlai Stevenson Institute of International Affairs.
- Ruggie, John (1983). The Antinomies of Interdependencies. New York: Columbia University Press.
- Skocpol, Theda (1979). States and Social Revolutions: A Comparative Analysis of France, Russia, and China. Cambridge, England: Cambridge University Press.

- Smith, Adam (1965). Inquiry into the Nature and Causes of the Wealth of Nations. Edwin Cannon, editor. New York: The Modern Library.
- Smith, Tony (1981). The Patterns of Imperialism. Cambridge, England: Cambridge University Press.
- Stepan, Alfred (1978). The State and Society: Peru in Comparative Perspective. Princeton: Princeton University Press.
- _____. (1978). Authoritarian Brazil. New Haven: Yale University Press.
- Suh, Jong-suh (1980). "Shipbuilding Industry in Korea." Korea Exchange Bank Monthly Review, October.
- Suh, Sang-chul (1978). Growth and Structural Change in the Korean Economy: 1910-1940. Cambridge: Harvard University Press.
- Suk, Tai-suh (1977). Foreign Aid, Foreign Capital Inflows, and Industrialization in Korea: 1945-75. Seoul: Korea Development Institute, Working Paper No. 7712.
- United Nations, Economic Commission for Latin America (1965). External Financing in Latin America. New York: United Nations.
- _____. (1966). Yearbook of National Account Statistics. New York: United Nations.
- United States Agency for International Development (1976). United States Loans and Grants and Assistance from International Organizations, July 1, 1945 - September 30, 1976. Washington, D.C.: United States Agency for International Development.
- United States Department of Labor (1969). Labor Law and Practice in the Republic of Korea. Washington, D.C.: Government Printing Office.
- United States Department of State (1969). Korea 1945 to 1948: A Report on Political Development and Economic Resources with Selected Documents. New York: Greenwood Press.
- _____. (1979). Report on Human Rights Practices in Countries Receiving U.S. Aid. Report to Congress, February 8. Washington, D.C.: U.S. Government Printing Office.
- Valenzuela, J. S. and A. Valenzuela (1979). "Modernization and Dependency: Alternative Perspectives in the Study of Latin American Underdevelopment." Comparative Politics, July.
- Vernon, Raymond (1971). Sovereignty at Bay. New York: Basic

Books.

- _____. (1977). The Storm Over the Multinationals: The Real Issues. Cambridge: Harvard University Press.
- Voivodas, Constantin (1974). "Exports, Foreign Capital Inflows, and South Korean Economic Growth." Economic Development and Cultural Change, April.
- Wade, L. L. and B. S. Kim (1978). Economic Development of South Korea: The Political Economy of Success. New York: Praeger Publishers.
- Wallerstein, Emmanuel (1979). The Capitalist World Economy. Cambridge, England: Cambridge University Press.
- Wells, Louis and John Stopford (1972). Managing the Multinational Enterprise: Organization of the Firm and Ownership of the Subsidiaries. New York: Basic Books.
- _____. (1972). Product Life Cycle and International Trade. Cambridge: Harvard University Press.
- _____. (1983). Third World Multinationals: The Rise of Foreign Investment From Developing Countries. Cambridge: M.I.T. Press.
- Westphal, Larry, et al. (1977). Korean Industrial Competence: Where It Came From. World Bank Staff, Working Paper No. 469.
- White, Stephan (1987). "Economic Performance and Communist Legitimacy." World Politics, Vol. 38, No. 3.
- Whittaker, Edmund (1963). Schools and Streams of Economic Thought. Chicago: Rand McNally and Company.
- Wilber, Charles, K. editor (1978). The Political Economy of Development and Underdevelopment. New York: Random House.
- Woo, Ki-do (1972). "Labor Force, Wage Level, and Economic Growth in Korea." Asian Economics, September.
- Yoo, J. H. (1968). National Planning for Development: The Case of Korea. Ann Arbor: Unpublished Ph.D. Dissertation, University of Michigan.
- Yoo, Se-hee, editor (1983). Political Leadership and Economic Development: Korea and China. Seoul: The Institute for Sino-Soviet Studies, Hanyang University Press.
- Yu, Seung-pil (1979). The Development of Large Korean Corporations: Investment Behavior, Capital Structure, and Rate of Return. New York: Unpublished Ph.D. Dissertation, Columbia University.
- Yusuf, Shahud and R. Kyle Peters (1984). Savings Behavior and

Its Implications for Domestic Resource Mobilization: The Case of the Republic of Korea. Washington, D.C.: World Bank Staff, Working Paper No. 628.