

**Chapter IV**  
**Democracy and Economic Development in South Korea:**  
**An Application of Experiences to Transform North Korea\***

**Introduction**

The South Korean economy was highly praised by foreign economists as a successful model of development and proudly joined OECD in late 1996 as the world's eleventh largest economy with over \$10,000 of per capita income. Since then, a series of business bankruptcies and financial crisis resulted in the presence of IMF supervision by December 3, 1997 causing a shift in the political power. The new administration began to work for systemic reforms, which have been interrupted by the opposition in politics, entrenched Chaebols in economy, and labor unions in society.<sup>1</sup>

Despite the reform pressures from the people, the lack of driving forces reduced attracting direct foreign investment, which caused the stock index to fall from mid 500 in late February to low 300 by mid June 1998 coinciding with President Kim Dae Jung's (hereafter DJ) Washington visit. His party's victory in local elections and the promise of strong U.S. supports energized DJ to expedite reform programs. The progress may take longer than expected due to weakened political coalition, missed freshness of political appointees, unrelenting resistance of preoccupied interest groups, unbreakable old habits particularly in politics,<sup>2</sup> and unhealthy economic environment in the region including Japan and the countries experiencing the financial crisis.

Democracy and economic development have been interacting in the process of modernization in South Korea like most other Asian countries: authoritarian politics controlled the market while economic growth facilitated democratization. President Park Jung Hee launched a series of economic development plans (EDPs) in 1962, which enabled the government to allocate its resources by restricting political freedom in South Korea. The first three five-year EDPs proved to be very successful when the economy was small and inelastic. As the market grew, state intervention in the later period caused structural problems within the economy that eventually led to idle capacities and bottlenecks in the industries. With declined efficiency and competitiveness, President Park's early successes were becoming a fading memory by leaving oncoming structural problems.

The state intervention in the economy pursues either capitalistic efficiency or democratic equality, both which cannot be achieved simultaneously because of tradeoff between the two objectives. In fact, state intervention in lagged politics caused more

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\* Published by the *International Journal of Korean Studies* II (1) (Fall/Winter 1998): 69-99. Reprinted by the permission of the publisher. A Draft Paper was presented to the *Eighth International Economic Convention* held at the Korea University in Seoul, South Korea on August 18-19, 1998 sponsored by the Korean Economic Association.

problems than solutions in recovering market competition because of doing incorrectly or doing nothing for what the state should have done necessarily. Corrupted politicians collaborating with Chaebols can only result in the political-economic complex, which jeopardized the market function, forced economic decline and financial crisis requiring structural reforms with expensive costs. Since corrupt politics caused market failures and government failures, the theory of balanced development in politics with economy, rather than the Asian values, became persuasive in the age of globalization.<sup>3</sup>

The South Korean economy has been a role model of economic development. Newly faced with the financial crisis, it demanded a painful restructure of the entire system. So it is questioned whether the East Asian economic development model (EAM) is still alive. The Asian financial crisis was a happening in the process of economic development, where unresponsive politics ruined the economy. The EAM must be considered with a strong link to politics affecting its efficiency. Under the redefined EAM, the time span is extended to the advanced democracy stage. In this scenario, the three stages are considered for South Korea: first, economic takeoff under the authoritarian regime; second, conflicting interests between democracy and economic growth; and third, balanced development of subsystems in the age of internationalization.<sup>4</sup>

The economic experiences of South Korea provide valuable lessons for late coming transition economies particularly in North Korea. If North Korea pursues a systemic change towards the market economy, then Pyongyang needs to follow the course of openness that took place in China. The Chinese model teaches how to smooth out the freedom waves coming from economic openness and the South Korean model teaches how to maximize efficiency of resource allocation in the takeoff stage. The mixture of both experiences in China and South Korea will provide indispensable lessons for North Korea in the process of political and economic transformation when the DJ's engagement policy is realistic and mutually beneficial for inter-Korean economic cooperation.

The study sets three goals to be discussed in three main chapters. In the first, the study investigates the role of state in the South Korea economy in terms of market failures and government failures. Secondly, redefining the EAM with explaining that the model is not dead but alive under progress, the study discusses major issues on structural reforms arising in the final stage of South Korean economic development. Thirdly, it analyzes lessons learned from the South Korean economy to be applied to oncoming transitional woes of the North Korean economy. The study's findings will contribute to making policies for structural reforms in South Korea and to transforming the system of China, Vietnam, and North Korea by reducing trial and errors in efforts to escape from the poverty.

### **The Role of State in the South Korean Economy<sup>5</sup>**

The welfare economic theorem states that a government cannot do any better than the market, and market efficiency is achieved by the Pareto optimal allocation of resources, which defines that no one could be better off by reallocating resources without making someone else worse off. Under this theorem, government intervention is justified to recover the efficiency in case of market failures due to imperfect competition, external effects, and public goods.<sup>6</sup> Imperfect competition is caused by uncertainty coming from inadequate information, increasing returns to scale, and entry barriers.<sup>7</sup> The government attacks imperfect competition and external effects to overcome *market failures* while it pursues public goods hurting more or less free competition in the market.<sup>8</sup>

A serious problem of state intervention in the market appears in conflict and tradeoff between capitalistic efficiency (dollars) and democratic equality (rights).<sup>9</sup> If a government favors efficiency measures to correct market failures by ignoring equality values, income distribution is worsened and social security is threatened. If a government favors equality measures to secure the social welfare by ignoring efficiency values, the market fails by losing free competition. The dilemma of state intervention, therefore, is an issue of political choice voting for a certain candidate among three categories: a conservative toward efficiency, a liberal toward equality, and an independent toward neutrality or compromise. The choice depends on the political climate though it always shifts from one to another by power dynamics between parties as well as government branches.

*Government failures* are another problem of the role of state in the economy raising social costs without achieving goals, caused by failures of commission and failures of omission.<sup>10</sup> The former comes from improper state intervention such as in public enterprises, budget allocation, and private sector control, while the latter comes from negligence of state intervention in matters necessary to be done such as in maintenance of infrastructure, foreign exchange rates, and interest rates. Government failures are caused by administrative incapability or interruption of government function due to the political-economic complex involved in corruption. The problems of developing countries are largely caused by both reasons, but those of South Korea belong to the latter.

The nature of power shows increasing returns to scale, so that incumbent political power is used to acquire economic power which makes it possible to acquire additional political power.<sup>11</sup> This kind of chain actions generates the monopoly power in politics and economy by creating the political-economic complex in the system. In the legislative branch, for example, candidates running for the office of National Assembly are not chosen by primary elections in each electoral district, but are nominated by a committee of the central party. This allows incumbent party bosses to strengthen the factional power in politics so that a failed candidate runs for the presidential race repeatedly. The lack of political competition interrupts new candidates to enter national politics, weakening democratic function of check and balance. So it is possible that President rules over the National Assembly while politicians are secured from legal charges, which is a starting

point of government failures.<sup>12</sup> Similarly in both administrative and judicial branches, bureaucratic monopoly by regionalism and school faction jeopardizes societal fairness and reduces efficiency.

The rise of Chaebols is a byproduct of market failures and government failures. First, the government provided them with an easy access to financial institutions for loans and credits through cross-finance guarantees withheld from non-group companies. Their monopoly power terminated small businesses and created a series of subcontracts worsening quality of products as shown in the collapse of bridges and buildings. Secondly, Chaebols obtained most government contracts through disguised competition. It is a well-known secret that former presidents used to collect campaign funds from the presidential office, and endless scandals in government contracts were disclosed after power transfers. Thirdly, the export-led growth strategy provided import licensing, tax exemptions, and export subsidies to businesses for import substitution and export promotion without considering negative effects and regional fairness.<sup>13</sup> As a result, over expansion, heavy debts, bad investment, and high overhead costs from wastes caused a series of bankruptcies of South Korean firms.

Labor monopoly was another form of government failures. The labor union leaders have claimed that a large part of Chaebols' wealth should be shared with the workers since Chaebols accumulated wealth at the workers' cost by monopolistic profits, tax exemption, privileges and subsidies, and low wages by suppressing labor movement. The claim is justifiable, though the consensus to achieve the goal is difficult. When the labor movement became violent and politicized, the government collaborating with Chaebols sold some generosity of compromise to labor unions by prohibiting layoffs to secure jobs and allowed them a wrong routine of "no work and get paid" without improving the social security measures. The rigidity of labor market has forced domestic industries to move abroad and foreign firms to hesitate direct investment in South Korea.<sup>14</sup>

The relations between democracy and economic development have been inconsistent but positive signs resulted in many cases including South Korea.<sup>15</sup> Joseph Schumpeter viewed that there is no necessary relation between socialism and democracy since the one can exist without the other. At the same time he saw that there is no incompatibility between them since the socialist engine can be run on democratic principles in appropriate states of the social environment.<sup>16</sup> He emphasized democratic conditions including human material in politics, effective political decision, bureaucratic capability, democratic self-control, and effective leadership competition.<sup>17</sup> The issue lies in whether the economic system is expected to be democratic. The fall of communism in 1991 evidenced that capitalism is a necessary, though not sufficient, condition for democracy, but democracy is not a precondition for capitalism though it is necessary for sustainable growth in the long run.<sup>18</sup>

Democracy is essential for sustainable growth since it facilitates check and balance in politics and promotes competition in the economy by minimizing corruption and maximizing efficiency. An efficient modernization of a nation requires coordinated efforts of the entire system by integrating vertical elements as well as horizontal elements of subsystems including politics, economy, national security, society, and others. If the economy moves quickly forward while politics remain lagged, the second class politics interrupt market competition, which distorts resource allocation. As a result, adjustment costs become expensive in the future, which the EAM has faced.

The theory of balanced development between politics and economy is controversial since the initial conditions are different in various countries including transition economies.<sup>19</sup> First, China chose *the autocratic path* in its modernization by pursuing economic growth first and moving gradually toward democracy later by adopting the South Korean model where political sacrifice was compensated by rising income for a while. Secondly, Russia chose *the democratic path* by pursuing democratization first and economic reforms later, resulting in regime's collapse since the economy could not support liberalized politics.<sup>20</sup> Thirdly, *the balanced path* is in simultaneous interactions between political opening and economic reforms in development.<sup>21</sup> Taking the autocratic path in the early stage, South Korea has been forced to choose the balanced path by pursuing simultaneous development of politics with economy since the financial crisis hit its economy.

China has survived while the USSR perished in the process of economic transformation. Economic reform proceeded political one in the former, while political reform proceeded economic one in the latter. The collapse of the USSR is explained by the fact that its failing economy could no longer support country's vast political-military system, and the bankrupt government could no longer guarantee law and order. In contrast, Deng Xiaoping adopted a gradually opening policy, attracting foreign capital, promoting exports, and pursuing economic transformation followed by political reform.<sup>22</sup> Deng achieved economic success, but he did not expect freedom waves from openness to hit a Beijing's square so fast and violently in 1989 similarly to that President Park saw the same in the major cities in South Korea, threatening survival of his regime.

The political-economic interactions are investigated by the two ways viewing from economy toward politics or vice versa. On the one hand, economic development facilitates democratization.<sup>23</sup> Firstly, economic growth is accompanied by trade expansion by taking comparative advantage of a country, which requires more education and training to produce better quality of products to win foreign competition. The knowledge gained from education and training awakens self-recognition respecting democratic values of freedom and equality, which refuse to accept the authoritarian rule ruining humanity in the society. Secondly, trade expansion raises the volume of transportation and communications through the border. The border traffics are controllable when the economy is small and simple, but it is too expensive to control when traffics are heavy. Expanded foreign trade with advanced technology expedites

information flow and spreads western civilization, which stimulates liberalization. Thirdly, the rise of household income widens the band of economic middle class, which allows more people to receive education and to travel often to the world. The wider middle class demands more political power and strengthens the majority rule in the process of decision making by money power, which contributes to democratization. Finally, foreign trade expedites internalization recognizing the importance of reciprocity, which respects foreign values as much as own ones. The openness of local markets to foreign firms abolishes cultural barriers<sup>24</sup> and reduces self-determination of domestic politics due to increasing interdependence between nations of trade partners. The politics cannot remain closed in the market economy though the authoritarian regime tries to keep continuously their existing interests in politics and economy.<sup>25</sup>

On the other hand, democracy is necessary to maintain sustainable growth of capitalistic economies by maximizing efficiency. The South Korean economy remained efficient in the three five-year EDPs (1962-1976)<sup>26</sup> despite excessive intervention by the authoritarian regime because of following reasons. The economy was small and the market was inelastic, so government intervention was desirable until the market recovered competition. The EDPs were well prepared for resource allocation by forcing the economy to move from labor- towards capital- and technology-intensive industries with proper investment in infrastructure. The driving forces were aggressive like in the revolutionary period of Soviet Union by mobilizing available capital and labor. The export-led growth strategy and continuous policy adjustment to environmental changes were successful in moving from import substitution toward export promotion by accumulating capital and technology. Finally, the government coordinated properly with business and labor, which were motivated by hungry spirits with a pride of nation building in fatherland modernization.<sup>27</sup>

However, when the economy became complicated in the second half of 1970s, government intervention distorted resource allocation, which reduced efficiency and growth. The shipbuilding industry, for example, was expanded due to government subsidies when the world demand began to decline, so that the level of capacity utilization remained below 40% until mid-1980s, which lowered factor productivity and increased foreign debt.<sup>28</sup> Corrupt politics and bureaucrats sold monopoly power to favored businesses and labor unions by receiving bribes in returns, which caused market failures, government failures, financial crisis, and economic recession at the end. It is a reciprocal example to the former that corrupt politics have ruined the economy in South Korea.

What are the sources of corruption in details?<sup>29</sup> Firstly, corruption is accompanied by the lack of transparency and accountability in government and business. Corrupt public officials use their power for personal gains by receiving bribes, while private donors get what they want from the government. Secondly, policies and regulations having gaps between demand and supply invite corruption since businesses and individuals try to avoid red tapes by offering bribes to reduce costs and to save time. The thriving underground economies try not to evade tax as in rich economies, but mainly

to dodge the red tape and the inevitable bribes in the formal sector.<sup>30</sup> Thirdly, if corrupt individuals are rarely detected and punished, or if expected returns of breaking laws are much higher than expected costs, or if social justice does not exist in the system, the system itself facilitates corruption. Finally, if the salary is low and job loss would not be a problem, it is easy to be corrupt since benefits are much higher than costs of punishment.

Then, what can be done about entrenched corruption in South Korea? The answer lies in the three categories: to enhance democratic function of check and balance in politics and government, to promote competition in economy and business, and to organize active citizens' groups for social interactions for consensus buildup by watching civil services and providing policy input.<sup>31</sup> The first category should focus on to reduce the discretionary power of government official, to enforce anticorruption laws, to reform the civil service, and to increase the accountability of government to citizens.<sup>32</sup> It is essential for the people to see and to believe that anyone who violates laws must pay the price sooner or later for one's wrong doing in the society without exception.

### **The East Asian Development Models Is Still Under Progress**

The EAM, the rapid growth model of Japan, Taiwan, and South Korea, can be understood as a combination of both economic and non-economic factors. The former includes high investment ratios, small public sectors, export orientation, labor market competition, state intervention in the economy, large and efficient investments in human capital, and well-developed capacities to absorb new technologies. The latter includes ethnic and linguistic homogeneity, relatively compact geography, manageable population size, and Confucian tradition; which influence labor productivity, savings behavior, and other aspects of economic performance.<sup>33</sup> However, the Asian values became retarded and voices demanding to consider political elements are heard in defining the model.<sup>34</sup>

Economic growth sources are defined by both factor input mobilization and productivity growth, the shares of which vary according to country, period, and estimation method.<sup>35</sup> Dale Jorgenson estimated that the share of economic growth generated by capital and labor input is three quarters of total growth. In his study, U.S. economic growth from 1948-1979 was fostered by growth of capital input (45.6%), growth of labor input (30.7%), and productivity growth (24.7%).<sup>36</sup> The rise of savings affected by consumption behavior generates growth in capital input, while population growth generates increase in labor input which is affected by production behavior such as labor-leisure choices. Paul Krugman argues, by comparing the EAM to the Soviet Union in its early period of economic development, that East Asian growth is driven not by productivity growth in terms of efficiency gain, but rather by resource mobilization. He explains that input driven growth continuously and intensively supplies capital and labor consequently yielding diminished economic returns and a sharp deceleration of growth. Meanwhile, the diffusion of technology will place huge strains on Western society, so that no technological convergence between East and West is expected. He

viewed that state intervention in the Asian economies would not make any visible difference.<sup>37</sup>

While Krugman presents sound arguments about problems of government intervention, he misconstrues important points on the EAM where investment is not a simple accumulation of fixed capital. In major equipment purchases from advanced countries, Seoul requires extensive transfer of technology. The transfer also naturally occurs through the learning-by-doing process on the jobs at joint-venture facilities. The World Bank estimated that the contributing share of total factor productivity to total growth was over 33% for Japan, Taiwan, and South Korea during the period of 1960-1989.<sup>38</sup> This number is much higher than Jorgenson's estimate of 24.7% for the United States. As long as the marginal return of capital exceeds its cost, the growth based on rapid capital accumulation would be highly desirable though its marginal productivity is likely to decline, not sharply as Krugman worried, but gradually as the capital stock deepens.

Due to the following short comings in its definition, the EAM needs to expand its scope to include the advanced stage of democracy. First, even though economists have disregarded the influence of political elements in the model, democratization has, in fact, largely affected economic development. It is fundamental to consider political elements in accurately defining the EAM from the view of political economy. Secondly, the time-line of the EAM considered only the two stages of economic takeoff and growth expansion. But the model must include the advanced stage of democracy to be built after structural adjustment since the financial crisis is a process of economic development. Thirdly, technological advancement in transportation and communications has made the world closer and faster than ever before. The trade relations largely affect foreign relations as recently seen between the United States and China. The globalization of the information age must be considered in defining the economic development model.

South Korean economic history is divided into three periods of major political changes. In the initial stage of *economic takeoff under the authoritarian regime (1962-1979)*, President Park controlled the one-half market economy by suppressing democracy. By crushing the opposing freedom movement, he fortified an authoritarian regime and allocated resources by launching a series of EDPs. An input-output analysis by this author indicated that the export-led growth strategy of South Korea was the best choice among available alternatives.<sup>39</sup> This strategy produced the largest GDP for the same level of aggregate final demand. Import substitution required a huge amount of physical and human capital which could be financed by export earnings, while export promotion required advanced technology which could be accumulated by import substitution; both were mutually supportive and complimentary. The movement of comparative advantage due to the shorter product-life cycle transformed the industrial structure absorbed by import substitution, and proper adjustment helped to maintain its competitiveness. Finally, a supportive strategy of domestic demand expansion was desirable only if market openness did not suppress consumption of domestic products in



fair competition, though it proved to be wrong because of government failures.

The export-led growth strategy exploited economies of scale through foreign trade despite a narrow domestic market. Taking comparative advantage with favorite patterns of trade through efficient resource allocation, South Korea improved its products' competitiveness. Protection and subsidization allowed monopolistic profits to export industries rapidly promoting exports, and trade expansion widened the production possibility frontier in the economy. Though the overall economic returns from export promotion were larger than the cost, the incentives became a serious problem. As the economy grew, inefficiency developed due to poor allocation of resources, income inequality widened between favored and disfavored, and heavy social costs compounded from the suppression of democracy by the authoritarian regime.<sup>40</sup>

Thus, the government could achieve neither efficiency nor equality, and voices demanding freedom and democracy became louder. It was analyzed that "inefficiencies have been imbedded in the economy.....government-initiated investment activities as well as protective measures such as import restriction and monopolization, have weakened economic versatility and hindered proper functioning of the market mechanism.....the inequalities between income classes and regions were aggravated."<sup>41</sup> During the second half of 1970s the entire South Korean system declined in efficiency because political development lagged far behind economic growth. It was proven that government intervention caused market failures by the time of President Park's assassination.

In the second stage of *conflict between democracy and economy (1980-1997)*, President Chun and Roh relaxed control but politics remained only half-democratic as Chaebols strengthened their monopolistic power. Seoul did not have westernized intellectuals to incite military revolution against President Park in early 1960s, but situations became changed when economic development expanded education.<sup>42</sup> In fact, anti-government sentiments began to evolve in 1972 when President Park revised the constitution to include his life long rule. The suppression forces of authoritarian regime were strong enough in 1970s when the driving forces for democratization was relatively weak. The Park's assassination amidst social instability in 1979 temporarily reduced problems but little progress was made by his two successors.

President YS Kim allowed full freedom of expression not like his predecessors, but could not make any visible difference because system and people remained unchanged. As the first civilian president, he removed military culture from the government and pursued ambitious social reforms. However, his lack of professional knowledge and experience made him ignore the democratic process of decision making in the system, and his authoritarian leadership caused many trial and errors. After the Hanbo scandal he lost control of his presidency which was shared with DJ at his private home since elected. Conflicting political and economic interests plagued the period, and the confused leadership failed to integrate differing social interests. Seoul experienced government failures, and the external forces of the IMF took control its economy. The

political situations, which should change in the third stage, was the major reason for this external supervision.

In the third stage of *balanced development of politics with economy (1998-2015)*,<sup>43</sup> the South Korean economy pursues a balanced development for its structural reforms, where followings must be considered. First of all, the market forces are not enough to remove the monopolistic power prevailing in the nation's entire system; the lack of driving forces slows reform. Only government intervention will promote efficient reform by rooting out resistance from the anti-reform groups including politicians and Chaebols. In order to avoid errors, the reform priorities should be fairly delineated through professional evaluation free from the persuasive pressures of political interest groups. Temporary state intervention will help to reconstruct fair competition in South Korea.

Secondly, the burdens caused by reforms should be shared fairly in a manner acceptable to each party. The political opposition, Chaebols, and labor unions do not want to lose any part of their interests, but no reform will succeed without downsizing and cutting costs. The leadership should force each party to share burdens coming from systemic reforms. The Tripartite Committee consisting of labor, business, and government should united constructively for the goal of recovering economic strength. If not, the South Korean people will pay the highest costs.

Thirdly, the initial conditions for fair competition should be seriously considered in reforms. The wealth of Chaebols came not from fair competition but from monopoly power, provided by the corrupt government, which devastated nearly all small businesses in the past. The revival of small and medium sized businesses is essential in reforms so that the government should bar Chaebols from participating in government contracts except in certain industries, which are not available for the small businesses, until the initial conditions are fully recovered. This kind of compensation for small businesses would correct distorted initial conditions that suppressed fair competition.

Fourthly, in banking reforms, it is essential to investigate the real demand of funds and to set available resources. Previous management should be brought to justice for their misconduct and replaced by fresh, new, efficiently operating management teams. The Bank Supervision Commission should be controlled not by the office of Prime Minister but by the Bank of Korea in order to assure its political neutrality. It is dangerous to amend the banking laws by allowing Chaebols to enter the banking business; such amendments oppose the direction of economic reforms.<sup>44</sup>

Fifthly, the Bank Supervision Commission should strictly force the bank to maintain each firm's debt-equity ratio below 200% through removal of cross finance guarantee. The Fair Trade Commission should closely watch internal transactions between group companies to root out monopolistic practices that violate antitrust laws. Consistent supervision increases efficiency and expedites structural reforms. It is neither

reasonable nor helpful that Chaebols incite nationalistic sentiments in order to avoid foreign competition, and that labor unions reinforce workers' hatred against foreign investment to insure union cohesiveness. Particularly, the labor market jeopardizes economic reforms by expelling domestic firms to foreign countries and forcing foreign firms to hesitate in direct investment activities, which jeopardizes job creation in South Korea.<sup>45</sup>

Sixthly, in the course of economic recovery, Seoul should reduce the negative effect on the economy from excessive military expenditures. The U.S.-Korea security alliance deters external threats from the North, establishing a low-cost national defense. If DJ's engagement policy with the North yields a peace treaty and disarmament agreement as a preliminary step for unification, the two Koreas can divert military spending to future economic development. The leaderships of the two Koreas should use disarmament benefits by compromise as soon as possible.<sup>46</sup>

In sum, South Korean economic recovery is optimistic since it has highly educated labor forces, accumulated capital and technology through advanced industries, world-class management and marketing experience, and a mature and self-adjusting democratic leadership. When South Koreans pursue speedy reforms by equally sharing burdens for structural adjustment, the recovery will be successful, proving that the EAM is not dead but progressing, alive with continuously rapid growth. As mentioned in introduction, however, reforms and recovery can be significantly delayed if conflicting interests weaken the driving forces as seen in lagged politics.

We can consider the following three possible scenarios. (a) If the DJ leadership pursues speedy and aggressive structural reforms with the right direction, South Korea will regain its previous economic strength and growth rate within three years. (b) If the DJ leadership fails to integrate productive reform elements because of conflicting interests within the system, economic recovery will take more than a decade as was witnessed in Latin American countries. (c) If the DJ administration fails in promoting expeditious change but maintains a desirably focused reformative direction, the result will lie somewhere between these two extreme cases, taking five to seven years. However, it is too early to predict the economic recovery since there are various obstacles hindering structural reforms in South Korea such as political skirmish, Chaebol's resistance, and labor strikes. Swift success of system reforms depends on the people's ability to mobilize all possible resources, which will be honestly judged by the second generation in the history.

### **An Application of ROK Experiences to Transform DPRK**

As discussed previously, South Korea experienced the political-economic relations while modernizing from authoritarian rule to the western standard of democracy. Democracy, reducing intervention costs through its feedback adjustment mechanism, is essential to maximize capitalistic efficiency. The balanced development

of system minimizes costs induced by lagging subsystems. Government intervention in lagged politics causes market failures, and corruption from the political-economic complex results in government failures becoming a heavy burden of growth. The EDPs are efficient in the early stage of economic takeoff when the economy is small and inelastic. But in the later period when the economy becomes large and complicated, problems in efficiency and equality emerge due to misallocation of resources without competition in the market.

If South Korea had chosen a different strategy, the adjustment costs would have taken a different form. As long as the difference between integrated returns from the chosen growth strategy and those from other strategies are larger than reform costs, the costs must be the lowest price that South Korea has to pay for adjustment. If, from the beginning, Seoul had chosen a strategy that balanced economy with democracy, it would not have experienced today's frustration since no such a great performance could have appeared in its history of economic growth.<sup>47</sup> Once recovered, Seoul's economy will be stronger than ever before, having advanced democracy and market economy through structural reforms. Through this financial crisis with the help of external forces, South Korea matured towards political and economic internationalization.<sup>48</sup>

The South Korean experiences provide following lessons for transition economies of China, Vietnam, and North Korea. (a) Use a series of economic development plans in the early stage of economic takeoff by restricting political freedom. The aggressive driving forces will expedite the big push effect on the economy. The planning period must be less than fifteen years.<sup>49</sup> (b) Reduce government intervention gradually after ten years, and pursue the balanced path between politics and economy by leaning fair competition. It is necessary for the leadership to watch corruption closely. (c) Start from import substitution of labor-intensive products and move to export promotion of the same industries. Start to enter import substitution of capital- and technology-intensive products and move to export promotion of the same. (d) Supply proper capital by selling ownership except energy, transportation, communications, finance, and media businesses. Invest aggressively in education and training with research and development, but try to minimize protection of infant industries. (e) If politics remain unchanged, the economy loses efficiency and equality, which reduces exports, employment, and income. Then, the economy will have a problem in the balance of payments, which threatens continuous growth. Then, make sure that time is essential in this case to reduce adjustment costs for recovery. (f) Be aware that balanced growth of politics and economy is essential, and that other sectors are also important to reduce adjustment costs. Minimize defense budget not to hurt the economy. (g) The subsequent policy reforms for adjustment are necessary to make the economy efficient, reducing accumulated costs arising from state intervention. It is dangerous to maintain improper or outdated policies without correction, which raises unnecessary costs in the future.<sup>50</sup> The speedy policy adjustment is possible by making people work together with the system through the democratic process with qualified economists.

In the case of China, system transformation has faced obstacles in justifying its ideological shift, improving privatization and managerial efficiency, and struggling with corruption. “Building a socialist economy with Chinese characteristics means developing a market economy under socialism and constantly emancipating and developing productive forces....The party and the state have shifted the focus of their work from the practice of ‘taking the class struggle as the key link’ in the past to socialist modernization with economic construction as the core.”<sup>51</sup> The party conservatives need excuses for transformation since they, who have enjoyed the old system of equality, are not used to the new system of efficiency.<sup>52</sup> China has set four goals for building its socialist economy through reform programs: to readjust its ownership structure, to improve its socialist market economy, to enhance its the system of income distribution based on the ownership of productive means, and to liberalize its domestic market to the world. Those are in pursuing efficiency with equality.

The starting point of economic transformation in China is allowing property rights and privatizing state-owned enterprises by introducing the price system into the market. This generally invites three major problems: bankruptcy due to poor corporate management, unemployment due to efficiency improvement, and inflation from high growth and poor financial policies.<sup>53</sup> A survey suggests that the authorities suspend production for unprofitable products, make calculations in light of real market conditions, and drop production plans that are not cost-effective.<sup>54</sup> Meanwhile, the unemployment rate in China has approached 20% in major cities such as Harbin and Shenyang. The government fears high unemployment causing social instability. Fortunately, the authorities could curb inflation, while the yuan values were appreciated due to fall of the Asian currency values.<sup>55</sup>

Corruption has been a persistent problem in China.<sup>56</sup> Properties in the socialist economies belong to the state, and the political power sets the privatization rules and distributes state owned properties to qualified individuals. The phenomenon of corruption has emerged along with the rise of private property and ownership, so China instigated the radical cure of corruption as follows.<sup>57</sup> Firstly, China maintains ideological guarantee, which opposes corruption and advocates cleanness by enhancing party building and education in ideology and ethics. Secondly, China provides better administration to remove the soil and conditions for rising corruption by formulating regulations and institutions. Thirdly, China launches a comprehensive project of system engineering for effective supervisory mechanisms to oppose corruption and to advocate cleanness. Since the initial political conditions were based on proletariat dictatorship and Marxist class struggle, political monopoly has caused corruption, and helped the second generation of bureaucrats to own privatized corporations. This would be the same in transforming the North Korean economy.

Military confrontation in the Korean peninsula has remained unchanged for half a century despite paying unnecessary prices: acceptance of authoritarian political rules, economic burdens from national security, and extreme dichotomy in societal values.

Pyongyang has paid the price of confrontation directly and indirectly more than South Korea has because of the fall of the Soviet Union and its satellite countries. In applying other's lessons, it is necessary to revisit the reasons why the North Korean economy has hopelessly fallen similarly to the fall of communism.

The DPRK's problems are caused by the entire system.<sup>58</sup> The centrally planned economy with projected consumption and production by the state causes inefficiency by creating bottlenecks and idle capacities in industries. Marxist ideology does not allow personal property rights, and a small interest group holds the power under the name of proletariat dictatorship. Royalty, as opposed to performance-based compensation for workers, undermines motivation and reduces productivity. Heavy military spending from the dual economic system reduces investment in infrastructure and manufacturing facilities, raising overhead costs in the economy. Government censorship threatens communications, socialist brainwash interrupts creative ideas, and lack of education and training with research and development delays technological advancement, reducing productivity. Self-sanctioned autarkic economy makes it difficult for North Korea to exploit comparative advantage and to mobilize resources, and thus their production possibility frontier remains declined. North Korea misuses the resources by policing its own people, particularly intellectuals and political dissidents, in order to prevent internal uprising. The rigidity and inflexibility of centralized power interrupt self-adjustment, which reduces efficiency and productivity. While China is expediting economic transformation towards the market economy, Pyongyang wastes its golden time in playing fruitless games. It is the same as losing money or economy to ignore the value of time.

Pyongyang faces a dilemma: the openness threatens survival of the regime, but the economy cannot revive without openness. The only choice for the regime's survival is in the strategy of soft landing and multi-dimensional, simultaneous, and gradual transformation of the system. In multi-dimensional and simultaneous, all subsystems of North Korea including politics, security, economy, and society should be developed simultaneously with balance. Gradual transformation means that the reform starts partially in a specific region such as the Rajin-Sunbong area in the first step, and gradually expands to other locations such as Wonsan at the east coast and Nampo at the west coast, thus minimizing shocks from freedom waves. Then, openness can be applied to the entire area of North Korea after building confidence and immunity to external culture.<sup>59</sup>

Time is essential in economic development. Let's assume that Pyongyang wants to build a manufacturing plant for fertilizer in the suburban area of Wonsan. The first thing to be done is to build infrastructure including power stations, water and sewage lines, highways and byways, railways, sea ports, airports, and communications facilities, which may take at least five to seven years. The second step is to build the manufacturing plant itself including buildings and equipment, which may take at least three to five years without financial problems. The third step is to recruit and train employees and to assign jobs including overseas marketing, which is accompanied by operating plants and selling

products to the world, that will take three to five more years. Pyongyang needs at least ten years in normalizing the plant without constraints. There is no time to waste.

The reality of North Korean economy is rather serious. Interviews with North Korean refugees suggest that “over 25% of population in many villages.....have died, with the height of the crisis occurring in fall 1996....even isolated instances of cannibalism are simply too widespread and too specific to be dismissed.....a major humanitarian disaster has already occurred with tens of thousands of people already dead from starvation and starvation-related illness.”<sup>60</sup> The central government has been losing political influence over provincial and local authorities due to lack of grain power. The private market activities throughout the country are accepted, and the household responsibility system is selectively implemented. But no reforms have yet been observed.

North Korea has burdened China by demanding economic aids and producing influx refugees into the border provinces.<sup>61</sup> Meanwhile, South Korea has been a partner with China whose trade and investment to grow. Despite rhetoric of equidistance, China began to recognize that its economic interests in Seoul are more significant than its strategic interests in Pyongyang, and that unified Korea is not dangerous to China’s security. As the Sino-American relations improve, China’s economic interests become more important than its strategic one. So China may agree that the status quo seems not to be sustainable on the Korean peninsula.<sup>62</sup> It is true that the ball of North-South game is waiting for self-determination towards peace and prosperity of the Korean people.

A study from China maintains that a ‘soft landing’ is the most feasible strategy towards Korean unification.<sup>63</sup> Firstly, the risk of destruction caused by war is unacceptable to both sides and war does not correspond with the interests of the relevant parties when North and South both have serious economic problems. Secondly, China wants to strengthen traditional friendship with the North while to improve its economic relations with the South. The United States does not want heavy casualties by war, and Japan does not want the second Korean War threatening its national security. Finally, the achievements of quadripartite talks will help find a way towards a rational settlement of the Korean peninsula issue in terms of relaxation, cooperation, and consultations as a gradual process. This view represents the reality honestly judged by Chinese intellectuals.

The United States and South Korea pursue constructive engagement with North Korea, and the regional powers are supportive for peace and prosperity. The international community becomes closer through market openness by removing barriers towards globalization, so that it is the best way for Pyongyang to lean with the wind to avoid its disadvantages. South Korea wants to save military spending to recover the economy and to repay external debts. Further suppression of the North Korean economy pushes the regime towards collapse, which Seoul does not want. Possible returns from negotiations are limited and continuous demand for concessions from the North wastes time without gains. If the Pyongyang cannot make constructive relations with DJ, another five more

years would be necessary to meet a next leadership who may not be as friendly as DJ.

DJ's engagement policy towards DPRK includes three principles: no allowance of armed offense from the North, no intention to harm or to absorb the North, and pursuance of conciliation and cooperation between North and South.<sup>64</sup> The theory is realistic and mutually beneficial; North Korea can transform its system without external risks while South Korea can minimize unification costs as a result of Northern self-generation. Both sides can save and divert resources from defense to economic purposes by signing a peace treaty with disarmament. It was not wise for the hard liners in the North to cause the submarine incident and armed infiltration when the two sides try to pursue cooperation. If DJ loses patience, Pyongyang becomes a loser by prolonging its difficulties.

The lessons from experiences of South Korean and Chinese reforms prove to be meaningful as North Korea faces difficulties of capital formation in its transformation. DPRK's capital comes from external loans, foreign direct investment, foreign assistance, war compensation, cooperation with Seoul, disarmament, domestic savings, sales of state properties, and labor exports. Its resource allocation should coordinate the structural balance with South Korea, invest early in agriculture, substitute imports of labor-intensive products, provide sufficient infrastructure, and educate human resources.<sup>65</sup> If Pyongyang hesitates to transform the system due to absorption phobia with DJ's engagement policy, it may permanently lose the chance of recovery.<sup>66</sup> Now is the time for the two Koreas to engage with each other for economic revival and peaceful reunification.

### **Summary and Conclusion**

**In summary**, we viewed the role of state in the economy, survival of the EAM with reforms, and application of South Korean experiences to transform North Korea. First, the EDPs were efficient in the early development stage when the economy was small and inelastic. As the economy grew in scale and complexity, government intervention invariably caused market failures, and a corrupt political-economic complex led to government failures. Economic development facilitates democracy being essential for sustainable growth. In turn, democracy promotes check and balance in politics to minimize corruption while enhancing competition in the economy by maximizing efficiency. So the theory of balanced development between subsystems becomes persuasive while the Asian values have been controversial. The direction of structural reforms for South Korea points towards promotion of fair competition in the entire system of politics, economy, and society by removing the monopolistic power preoccupied by the old interest groups.<sup>67</sup>

Secondly, the financial crisis is a stage of economic development and the EAM is still valid and under progress. Krugman argued that the EAM is driven not by productivity growth but by resource mobilization, which we can reject since its



contributing share of total factor productivity to growth proved to be over 33% during 1960-1989. The South Korean economy is optimistic owing to highly educated labor forces, accumulated capital and technology, world-class management and marketing experiences, and mature leadership and democracy with a self-adjustment function. If the DJ leadership pursues speedy and aggressive reforms, the economy will start to recover by the year 2000. The South Korean reforms require government intervention in restructure, appropriate burden sharing, equalized initial conditions, tight bank supervision, fair trade supervision, disarmament and resource conversion, and no leadership corruption.

Thirdly, the experiences of South Korea reveal to North Korea how to take off the land of vicious circle, while those of China teach them how to transform the system towards openness by smoothing out freedom waves. Since inter-Korean economic cooperation is fundamental for revival of the DPRK economy, Pyongyang may permanently lose the chance of recovery if it hesitates to change the system due to absorption phobia from the South. DJ's engagement policy is realistic and mutually beneficial since the North can transform the system without external risks, the South can minimize unification costs by Northern self-generation, and both sides can save costs by diverting resources from military to economic purpose. It is necessary in supplying and allocating resources for North Korea to consider industrial structure of unified Korea, to invest in the agricultural sector first for self-sufficiency, to substitute imports of labor-intensive products, to provide sufficient infrastructure for inexpensive overhead costs, and to educate and to train human resources.

**This study concludes** with three as policy recommendations: first for the South, second for the North, and the last for the world. ***Recommendations to Seoul:*** South Korea is now in the third stage of political and economic development approaching the western standard of democracy and market economy. The DJ leadership was successful in managing the financial crisis in the early stage, but the people began to question his capability and intention towards structural reforms. DJ must maintain speedy and aggressive driving forces with the consistent direction to recover fair competition within the system. In rooting out corruption, DJ must fairly investigate campaign fund scandals related to corrupt politicians and contributing businessmen who violated the laws; which is a starting point to make the system fair by bringing the wrong doers to justice. South Korean people should not confuse nationalism with patriotism. In domestic capital formation, it is better for South Korea to sell ownership to foreign investors than to borrow funds from foreign banks when domestic firms are weak in financial creditability and technological competitiveness. The nationalism is not patriotic since it hurts the economy in the age of globalization.

***Recommendation to Pyongyang:*** The North Korean leadership pursues survival of its regime with economic recovery. As long as the Juche regime holds old principles, the economy will not fully recover the strength in the long run. Pyongyang must shift ideological orientation, as did China, from the equality of Marxist class struggle towards

efficiency of classless competition by removing the monopolistic power of proletariat dictatorship in the system. The dual economic system separating military from the economy hurts integrated policy formulation. The independent military sector expedites arms buildup and reduces investment in infrastructure and capacity generation, jeopardizing productivity growth. Both peace treaty and disarmament agreement between the two Koreas is urgent to divert resources from military to commercial purpose. Inter-Korean economic cooperation is essential for recovery in the North. Be sure that the South is the most helpful partner for the North in the world. The DPRK must recognize that economic interests in the post cold war period became heavier than political-military interests due to nonexistence of external threats.

***Recommendation to the World:*** The world should help the two Koreas to pursue balanced development of democracy with economy. The constructive engagement between the United States and China became visible since President Clinton's China visit in late June 1998. Since the powers want peace and stability in the region, they should cooperate to build a peaceful regime between the two Koreas. Particularly, China should do a better role in constructing a peaceful regime between Seoul and Pyongyang since unified Korea is more beneficial than divided one. Politically, China has been successful in transforming the system, so that the freedom waves from unified Korean would not be a threat. Economically, China's capital market is mature enough to absorb foreign capital so that a shift of South Korean capital from China to North Korea would not be a matter. China's trade with unified Korea would be much larger than that with divided one. Strategically, unified Korea could not be a threat to China since their economic relations will grow faster than expected, shadowing China's strategic worries as long as the balance of power exist in the region.

### Endnotes

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<sup>1</sup> Koh Young Jae, "Sunshine: Kim Dae Jung's Dilemma," *The Internet Hankyoreh*, July 14, 1998.

<sup>2</sup> Observed old habits: (a) The DJ administration placed the Commission of Bank Supervision under the control of the Office of Prime Minister. The Commission should be under the control of the Bank of Korea to keep political neutrality. (b) The Parliament stopped the Real Name System in financial transactions namely to promote flow of hidden funds, with which the DJ Party collaborated though it was criticized that the revision would help to avoid transparency of campaign funds. (c) The DJ party allows Chaebols to own banks, which was restricted in the previous administrations. "The Ruling Party Allows Bank Ownership to Chaebols," *Joongang Ilbo Internet*, June 8, 1998. (d) The five top Chaebols absorbed over 76% of total amount of corporate bond sales during the first five months in 1998, which is another type of corporate debts that should be reduced. Yoo Seung Ho, "Big Five Alone Ate All Funds, 27 Trillion Won by Selling Bonds," *Hankook Ilbo from Korea Link*, June 25, 1998.

<sup>3</sup> President Kim Dae Jung emphasized that balanced development of politics with economy is

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necessary in order to avoid the political-economic complex in his speech delivered to the invited guests of Korean-Americans at the Residence of ROK Ambassador to the United States in Washington, DC on June 9, 1998.

<sup>4</sup> For further reference, see WheeGook Kim, *Evolution of Democracy and Economic Development: A Case of Korea*, Washington, DC: East-West Research Institute (Monograph), February 1998, pp. 15-20. This was presented to the Philadelphia Symposium on Korea's Challenges Ahead held at the University of Pennsylvania on February 13, 1998.

<sup>5</sup> WheeGook Kim, *The South Korean Economy and The Cahebols*, Washington, DC: East-West Research Institute (Monograph), May 1998, pp. 3-8. This was presented to the 1998 Annual Conference on held at Adams Mark Hotel, Columbia, South Carolina on May 15-17, 1998 sponsored by the University of South Carolina.

<sup>6</sup> World Bank, *World Development Report 1997: The State in A Changing World*, New York:Oxford University Press, 1998, p. 27. The governments provide public goods for infrastructure, defense, law and order, education, public health, antipoverty programs, disaster relief, and so on as measures largely for equality.

<sup>7</sup> Amartya Sen, Nicholas Stern, and Joseph Stiglitz, "Roundtable Discussion, Development Strategies: The Roles of the State and the Private Sector," *Annual Conference on Development Economics 1990*, Washington, DC: World Bank, 1991, pp. 421-435.

<sup>8</sup> The exceptional cases can be seen in government investment for production capacity generation.

<sup>9</sup> Arthur M. Okun, *Equality and Efficiency: The Big Tradeoff*, Washington, DC: The Brookings Institution, 1975. P. 120. "In that sense, capitalism and democracy are really a most improbable mixture. Maybe that is why they need each other – to put some rationality into equality and some humanity into efficiency."

<sup>10</sup> Anne O. Krueger, "Government Failures in Development," *The Journal of Economic Perspective* 4(3) (Summer 1990): 9-23. Vito Tanzi and Hamid Davoodi, *Roads to Nowhere: How Corruption in Public Investment Hurts Growth*, Washington, DC: World Bank, 1998. Lack of infrastructure investment is a case of government failures.

<sup>11</sup> Adam Przeworski and et al, *Sustainable Democracy*, New York: Cambridge University Press, 1995, p. 40. The author quoted from Frederic C. Lane, *Profits from Power: Readings in Protection Rent and Violence Controlling Enterprises*, Albany, New York: State University of New York Press, 1979.

<sup>12</sup> WheeGook Kim, "Check and Balance: Watching Revival of Local Elections in South Korea," *Hankook Ilbo (Washington)*, April 14-17, 1995. A series of three days article.

<sup>13</sup> Larry E. Westphal, "Industrial Policy in an Export-Propelled Economy: Lessons from South Korea's Experience," *Journal of Economic Perspectives* 4(3) (Summer 1990): 41-59. Mrinal Datta-Chaudhuri, "Market Failure and government Failure," *Journal of Economic Perspectives* 4(3) (Summer 1990): 25-39. Both viewed with positive results of state intervention because corruption effects were hidden under the surface at that time.

<sup>14</sup> Kevin Sullivan, "Thousands of Strikers Demonstrate in Seoul: Workers Protest New Labor Legislation," *The Washington Post*, December 12, 1996, p. A14. WheeGook Kim, "A Big Shake of Labor Laws in South Korea," *Hankook Ilbo (Washington)*, January 4, 1997, p. 3. Unemployment measures have not been considered seriously.

<sup>15</sup> Adam Przeworski and Fernando Limongi, "Political Regimes and Economic Growth," *Journal of Economic Perspectives* 7(3) (Summer 1993): 51-69. Jacob De Hann and Clemens Siermann, "Political Instability, Freedom, and Development," *Economic Development and Cultural Change* 44(2) (January 1996): 339-350. Michael A. Nelson and Ram D. Singh, "Democracy, Economic Freedom, Fiscal Policy, and Growth in LDCs: A Fresh Look," *Economic Development and Cultural Change* 46(4) (July 1998): 677-696.

<sup>16</sup> Joseph Schumpeter, *Capitalism, Socialism, and Democracy*, London: Routledge, 1992, p. 284.  
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For the source of inefficiency under socialism, see Fredrich Hayek, *Knowledge, Evolution, and Society*, London: Buttler and Tanner, 1983. For Asian cases, see Robert A. Scalapino, *The Politics of Development: Perspectives on Twenties Century Asia*, Cambridge, MA: Harvard University Press, 1989. S. P. Huntington and J. M. Nelson, *No Easy Choice: Political Participation in Developing Countries*, Cambridge, Mass.: Harvard Univ. Press, 1976.

<sup>17</sup> *Ibid.*, pp. 289-296. Jongryn Mo and Chung-in Moon, "Democracy and ROK Economic Crisis," NAPSNet Forum Online, Berkeley, California: Nautilus Institute, March 18, 1998 discussed by Hugo Wheegook Kim and others on March 24, 1998. <http://www.nautilus.org/napsnet/fora/index.html/>.

<sup>18</sup> Peter L. Berger, "The Uncertain Triumph of Democratic Capitalism," in Larry Diamond and Marc F. Plattner, Ed., *Capitalism, Socialism, and Democracy Revisited*, Baltimore: Johns Hopkins University Press, 1993, p. 1-10.

<sup>19</sup> Minxin Pei, "The Puzzle of East Asian Exceptionalism," in Larry Diamond and Mark F. Plattner, Ed., *Economic Reform and Democratization*, Baltimore: Johns Hopkins University Press, 1995, pp. 112-125.

<sup>20</sup> Andres Aslund, "The Case for Radical Reform," in Larry Diamond and Marc F. Plattner... p. 74-85.

<sup>21</sup> Joan M. Nelson, "Linkages between Politics and Economics," in in Larry Diamond and Marc F. Plattner..... p. 45-58. Jusup Wanandi, "East Asian Domestic Policy and International Stability after the Currency Crisis," 1998 *Pacific Symposium on the Asian Financial Crisis: Security Risks and Opportunities* held at the U.S. National Defense University, Washington, DC on May 5-6, 1998.

<sup>22</sup> WheeGook Kim, "The Impact of Sino-American Relations on Korean Unification," *The Journal of East Asian Affairs* XI(1) (Winter/Spring 1997), p. 21. For further, see Paul Kennedy, *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000*, New York: Vintage Book, 1989. William H. Overholt, *The Rise of China: How Economic Reform Is Creating A New Superpower*, New York: W. W. Norton, 1993.

<sup>23</sup> Francis Fukuyama, "Capitalism and Democracy: The Missing Link," in Larry Diamond and Marc F. Plattner, Ed., *Capitalism, Socialism, and Democracy Revisited*..... pp. 94-104.

<sup>24</sup> Adam Przeworski, "The Neoliberal Fallacy," in Larry Diamond and Marc F. Plattner, Ed., *Capitalism, Socialism, and Democracy Revisited*..... pp. 39-53.

<sup>25</sup> The transition economy such as in China has faced similar conflict between political conservatism and economic liberalism. In line with this, DPRK has hesitated to open the economy due to conflict between different interests of politics and economy. The engagement policy of DJ administration tries to compromise the differences by separating economy from politics despite transitional challenges from internal and external adversaries. The human rights movement in developing countries is considered as a similar process of democratization.

<sup>26</sup> Economic Planning Board, *The Fifth Five-year Economic and Social Development Plan 1982-1986*, Seoul: Government of Republic of Korea, 1982, p. 10.

<sup>27</sup> Pam Woodal, "Survey East Asian Economies," *The Economist*, March 7<sup>th</sup>-13<sup>th</sup> 1998, p. 12. The sources of Asian crisis include the virtue of high investment, small government, good government, flexibility, the virtues of long-term relationships, and education in the survey.

<sup>28</sup> WheeGook Kim and Moonsug Chang, *Mobilization and Industrial Potential for War: A Case Study of Republic of Korea*, Seoul: Korea National Defense University Press, 1987, p. 92. The government took over bankrupt firms by tax money and sold those businesses to a third party with low prices.

<sup>29</sup> The World Bank, World Bank Development Report 1997, pp. 99-109.

<sup>30</sup> Pranab Bardhan, "Corruption and Development: A Review of Issues," *Journal of Economic Literature* XXXV(3) (September 1997): 1320-46, quoted from Francis T. Lui, "An Equilibrium 154 Chapter IV. Democracy and Economic Development in South Korea

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Queuing Model of Bribery," *Journal of Political Economy* 93 (4) (August 1985): 760-81.

<sup>31</sup> Staff, "175 Assembly Members Signed Anti-corruption Law," *Digital Chosun Ilbo*, August 4, 1998.

<sup>32</sup> Sudan-Rose-Ackerman, "Corruption and Development," in Boris Pleskovic and Joseph E. Stiglitz, Ed., *Annual World Bank Conference on Development Economics 1997*, Washington, DC: The World Bank, 1998, pp. 35-57. Laws and programs breeding corruption rather than promoting competition must be eliminated, but deregulation and privatization should be carried out with care not to worsen the existing problems. Michael Johnson, "What Can Be Done about Entrenched Corruption?," in the same book, p. 82.

<sup>33</sup> Paul W. Kuznets, "An East Asian Model of Economic Development: Japan, Taiwan, and South Korea," *Economic Development and Cultural Change* 36(3) (April 1988): S11-S43. For further, see World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, New York: Oxford University Press, 1993.

<sup>34</sup> For Asian values, Fareed Zakaria, "A Conversation with Lee Kuan Yew," *Foreign Affairs* 73(2) (March/April 1994): 109-126. Kim Dae Jung, "Is Culture Destiny? The Myth of Asia's Anti-Democratic Values," *Foreign Affairs* 73(6) (November /December 1994): 189-194. Staff, "Asian Values Revisited," *The Economist* July 25<sup>th</sup>-31<sup>st</sup>, 1998, pp. 23-28. "The attachment to the family becomes nepotism. The importance of personal relationships rather than formal legality becomes cronyism. Consensus becomes wheel-greasing and corrupt politics. Conservatism and respect for authority become rigidity and an inability to innovate. Much-vaunted educational achievements become rote-learning and a refusal to question those in authority."

<sup>35</sup> Herbert Giersch, Ed., *Towards an Explanation of Economic Growth*, J. C. B. More, Tubingen: Institut fur Weltwirtschaft an der Universitat Kiel, 1981. Jose Edgardo Campos and Hilton L. Root, *The Key to The Asian Miracle: Making Shared Growth Credible*, Washington, DC: The Brookings Institution, 1996.

<sup>36</sup> Dale W. Jorgenson, "Productivity and Postwar U.S. Economic Growth," in Dale W. Jorgenson, Ed., *Productivity Volume I: Postwar U.S. Economic Growth*, Cambridge, Mass: MIT Press, 1996, pp. 1-23. Dale W. Jorgenson and Zvi Griliches, "The Explanation of Productivity Change," in the same book, p 53 & 85. Robert M. Solow, "A Contribution to the Theory of Economic Growth," *Quarterly Journal of Economics*, in R. Becker and E Burmeister, Ed., *Growth Theory Volume I*, Brook Field, Vermont: Edward Elgar, pp. 2-32. Edward F. Denison, *Trends in American Economic Growth 1929-1982*, Washington, DC: Brookings Institution, 1985, pp. 28-30. For further references, William J. Baumol, Richard R. Nelson, and Edward N. Wolf, Ed., *Convergence of Productivity: Cross-National Studies and Historical Evidence*, New York: Oxford University Press, 1994. John Middleton, Adrian Ziderman, Arvil Van Adams, Ed., *Skills for Productivity: Vocational Education and Training in Developing Countries*, New York: Oxford University Press, 1993.

<sup>37</sup> Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73(6) (Nov./Dec. 1994): 62-78. The others view differently such as in Steven Radelet and Jeffrey Sachs, "Asia's Reemergence," *Foreign Affairs* 76(6) (Nov./Dec. 1997): 44-59. Asian corruption is equivalent to a tax on foreign firms of 20% or more, quoted from Shang-Jin Wei, "How Taxing is Corruption on Inter-national Investors?" *NBER Working Paper* No. 6030, 1997.

<sup>38</sup> World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, New York: Oxford University Press, 1993, p. 58. Staff, "The Asian Miracle: Is It Over?" *The Economist*, March 1<sup>th</sup>-7<sup>th</sup>, 1997, pp. 23-25. Paul Krugman used Alwyn Young's estimates for 118 countries over 1970, which were proved to be incorrect.

<sup>39</sup> WheeGook Kim, *An Alternative Growth Strategies of North Korea: Lessons from Experiences of South Korea and Taiwan*, Washington, DC: East-West Research Institute (Monograph), January 1996, p. 28. This was presented to 1996 Annual Conference of Allied Social Science Associations  
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held in San Francisco, California on January 5-7, 1996.

<sup>40</sup> Since 1961, the authoritarian regimes faced difficulties due to the lack of legitimacy and political consensus. Political operations exhausted funds collected from Chaebols expecting corresponding returns. Since the judicial system was controlled by politics, social justice was seriously damaged. The weakness of check and balance caused corruption in personnel and financial affairs in every field of the society and provided special benefits to interest groups, deepening income inequality between rural and urban, East and West, owners and workers, and favored and disfavored. The flow of information was monopolized and controlled by the authorities to avoid antigovernment movement. The intelligence agencies and national police used huge funds to collect information to dry up student turmoil, and to destroy organized activities of opposition parties and human rights groups. The planned economy lost efficiency in resource allocation due to centralized decision-makings. Political instability and government inefficiency discouraged savings and foreign investment. The tenure system for university faculties was used by the government in order to force loyalty or at least passive silence from intellectuals of the academic circle. The authorities made the office corps of armed forces not have time to read and to think in order to avoid military uprising against the regime. For further references, see Staff, "South Korea: A New Society," *The Economist*, April 15th-21th, 1989, pp. 23-26.

<sup>41</sup> Economic Planning Board, *The Fifth Five-Year Economic and Social Development Plan 1982-1986*, Government of the Republic of Korea, 1982, p. 10. *The Korean Economy at the Turning Point*. The South Korean government recognized that its intervention through economic plans caused serious problems in the period of *The Fourth Five-Year Economic Development Plan 1977-1981* in terms of high inflation, inefficiency, and inequality.

<sup>42</sup> WheeGook Kim, "Problems and Remedies of the North Korean Economy: A Strategic Approach," *The Korea Journal of Defense Analysis* VIII(2) (Winter 1996): 223-268. \_\_\_\_\_, *The Impact of Regional and Global Developments*, Washington, DC: East-West Research Institute (Monograph), September 1996, pp. 20-21. \_\_\_\_\_, "Openness, Coexistence, and Peaceful Unification," *Hankuk Ilbo (Washington)*, August 8, 1994, the third article of a six days series.

<sup>43</sup> The third stage is set until 2015, which is based on 18 years of the political cycle in the previous periods. The extension does not necessarily mean the EAM to be successful. Whang In-Joung, *Economic Transformation of Korea 1945-1995: Issues and Responses*, Seoul: The Sejong Institute, 1997, pp. 9-40. This author divided the period into three segments including the nation-building stage 1945-1961 but excluding the period after 1995.

<sup>44</sup> The reasons why Chaebols should not own banks are as follows: (a) Chaebols may use the banking system for their own interests rather than for general public. Chaebols should not own infrastructure, financial institutions, and media. (b) The debt-equity ratio of top 30 Chaebols was 518.9% by the end of 1997 so that they should reduce the ratio to below 200% by selling existing bank stocks to keep their main industries. (c) The concept of a leading bank insisted by the Daewoo owner is no more than that of banking monopoly. Chaebols try to stimulate nationalism as a tactic in order to gain bank ownership, but the existence of a couple of foreign banks is beneficial for consumers to improve competition. (d) Since the funds for bank restructure come from taxes, the bank ownership should be transferred to the people not to Chaebols, which raises savings and improves income distribution. (e) Chaebol's participation in banking business helps revival of old corruption coming from the political-economic complex.

<sup>45</sup> The Chaebol reforms have been often interrupted by politics due to campaign fund raise for coming elections as seen in June and July 1998 under DJ leadership. The next election for the National Assembly in the year 2000 may cause the same. If the DJ administration fails in reforms by that time, the driving forces towards reforms will be largely reduced and the regime may fail in reforms. If this is the case, the EAM loses hope for survival. Morton I. Abramowitz and James T. Laney, *Managing Change on the Korean Peninsula*, Task Force Report, Washington, DC: The 156 *Chapter IV. Democracy and Economic Development in South Korea*

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Council on Foreign Relations, Inc., 1998, p. 41. The Cost of Unification (quoted).

<sup>46</sup> Daryl M. Plunk, "A silver Lining in Korea's Crisis: New Pledges Signal Hope for Economic Recovery and Peaceful Reunification," *F.Y.I.* No. 169, Heritage Foundation, January 15, 1998. Selig Harrison, "A Dual Effects of Disarmament," *The Internet Hankyoreh*, January 14, 1998.

<sup>47</sup> Kim Sung Woo, "An Essay: Evolution of Democracy and Economic Development," *Hankook Ilbo from Korea Link*, January 9, 1998.

<sup>48</sup> Lee Jong Soo, "An Interview with Dr. Guy Surmont, A French Critic: The Korean Crisis Is A Development Process," *Hankook Ilbo from Korea Link*, January 21, 1998.

<sup>49</sup> The duration is based on the initial political-economic conditions of South Korea in 1962.

<sup>50</sup> Ching-yuan Lin, "East Asia and Latin America as Contrasting Models," *Economic Development and Cultural Changes* 36(3 Supplement) (April 1988), p. S156. "What set the experiences of Taiwan and South Korea apart from those of Chile and Argentina, therefore, were not the initial conditions and the incentive systems, which were largely similar, but the subsequent policy reforms, which were successful in Taiwan and South Korea, but not in..."

<sup>51</sup> Zeng Peiyan, "Develop Socialist Economy with Chinese Characteristics," Beijing Qiushi, October 16, 1997, No. 20, pp. 2-6, from *The World News Connection*, February 23, 1998, FBIS-CHI-98-030. Wei Shi, "Social Justice Plus Market Economy," Beijing Zhenli De Zhuiqiu, February 4, 1998, from *The World News Connection*, February 6, 1998, FBIS-CHI-98-035.

<sup>52</sup> An interview held on November 7, 1997 with Dr. Dyu In Yu, an immigrant from Moscow to New York, indicated that his most difficult problem after immigration was competition for survival in the free market to which he had not been used previously.

<sup>53</sup> Chi Feng, "China Finalizes Economic Principles for 1998," Hong Kong Kuang Chiao Ching, February 4, 1998, from *The World News Connection*, February 6, 1998, FBIS-CHI-98-035.

<sup>54</sup> Shi Xiaohong, "Strengthen Enterprise Management, Increase Competitive Power," Beijing Jingji Guanli, June 5, 1996, from *The World News Connection*, November 1, 1996, FBIS-CHI-96-212. For the case of Poland, see Jeffrey Sachs, *Poland's Jump to the Market Economy*, Cambridge, Mass: The MIT Press, 1993.

<sup>55</sup> Erik Eckholm, "On the Road to Capitalism, China Hits a Nasty Curve: Jobless," *The New York Time on the Web*, January 20, 1998. "Most of the state industries haven't yet laid off the workers they should, so the problem is still being hidden....In the rural areas where a majority of China's 1.2 billion people still live, 130 million workers are already surplus, neither needed for farming nor employed by rural industries." Chen Yen, "Poll Shows Inflation Problem No Longer Sensitive; Unemployment Issue Becomes Focus of Popular Attention," *Hong Kong Ming Pao*, February 2, 1998, from *The World News Connection*, February 8, 1998, FBIS-CHI-98-033.

<sup>56</sup> Ye Tan, "Zhu Rongji Openly Said: 'Leave No Route of Retreat,'" Hong Kong Ching Pao, July 7, 1998, from *The World News Connection*, July 8, 1998, FBIS-CHI-98-188. Staff, "Nationwide Anticorruption Campaign Begin," Beijing Xinhua, July 8, 1998, from *The World News Connection*, July 9, 1998, FBIS-CHI-98-189. Editorial, "Launch a Large-Scaled Struggle Against Smuggling," Beijing Xinhua Domestic Service, July 15, 1998, from *The World News Connection*, July 16, 1998, FBIS-CHI-98-196.

<sup>57</sup> Ruan Chongwu, "Perfecting Mechanisms, Opposing Corruption, Advocating Honesty and Cleanness," *Beijing Renmin Ribao*, May 16, 1996, from *The World News Connection*, June 20, 1996, FBIS-CHI-96-120. Zheng Hongfan and Cui Shixin, "The Test of Time--Account on the Building of Clean and Honest Party Style in the New Period," *Beijing Renmin Ribao*, June 27, 1996, from *The World News Connection*, Aug. 8, 1996, FBIS-CHI-96-153.

<sup>58</sup> WheeGook Kim, "Problems and Remedies of the North Korean Economy," pp. 234-240. See *Northeast Asia Peace and Security Network Daily Report*, July 12, 1996, Discussions by the same author.

<sup>59</sup> This is the Chinese model, which is in line with the DJ's engagement policy.

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<sup>60</sup> USIP, Special Report: North Korea's Decline and China's Strategic Dilemmas, Washington, DC: U.S. Institute for Peace, October 1997, p. 2. See further Chen Jian, *The China Challenge in the Twenty-First Century: Implications for U.S. Foreign Policy*, Washington, DC: United States Institute of Peace, 1998, Peaceworks No. 21., Conclusion: Living Peacefully with China in the 21<sup>st</sup> Century, p. 24.

<sup>61</sup> Staff, "The Grain Dependency of North Korea to China Rose Largely," *Digital Chosun Ilbo*, March 2, 1998. North Korea imported 1.135 million tons of grains (US\$194 Million) including corn, wheat, and rice from China in 1997, that is over two times higher than 1996 imports from the same country which was 0.497 million tons.

<sup>62</sup> Robert Scalapino, "An Interview: Two Korea Relations, Advancement or Stalemate," *Hankuk Ilbo from Korea Link*, January 30, 1998. He believes that China would not give up its interests in North Korea. However, we can consider the time when economic interests become larger than strategic interests between the United States and China.

<sup>63</sup> Su Guiyou and Liu Yusheng, "An Analytical Report on the 1997-1998 International Situation," *Beijing Zhongguo Xinwen She*, January 26, 1998, from *The World News Connection*, January 29, 1998, FBIS-CHI-98-026.

<sup>64</sup> "Inaugural Address of 15<sup>th</sup> President," *Digital Chosun Ilbo*, February 25, 1998.

<sup>65</sup> WheeGook Kim, "Problems and Remedies of North Korean Economy.....", p.249.

<sup>66</sup> USIP, Special Report: Challenges of Building a Korean Peace Process," Washington, DC: USIP, June 1998.

<sup>67</sup> WheeGook Kim, "The Initial Conditions in Competition," *The Professors Newspaper*, July 13, 1998, p. 3. A Korean version published in Seoul.