

EVOLUTION OF DEMOCRACY AND ECONOMIC DEVELOPMENT: A CASE OF SOUTH KOREA

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I. INTRODUCTION

1. The peoples of South Korea have been proud of country's rapid economic development, which was highly praised by many foreign economists as the East Asian economic development model. Seoul aggressively joined OECD in December 1996 as the 11th largest world economy with \$10,000 of per capita income by promising a wider and rapid liberalization of its domestic market. But in early 1997 the Hanbo financial scandal exploded and shook the whole nation when eleven suspects including a son of President were tried and jailed.² The Hanbo incident was the beginning in a series of eight bankruptcies among thirty largest conglomerates or Chaebols in South Korea.

2. The Minister of Finance and Economy tried to conceal the seriousness of these problems in order to minimize the negative impact for the ruling party candidate on coming presidential election.³ By the middle of November 1997, the Minister recognized an imminent default due to the incapability of commercial debt repayments, mainly \$80.2 billion for short term debts which was 52.5% among \$153 billion of total foreign debt. The IMF agreed and signed \$57 billion rescue program with the South Korean government on December 3, 1997.⁴ Angry South Koreans elected Kim Dae Jung (hereafter DJ) of the opposition party candidate in hopes of change. Owing to strong support from the U.S. leadership with a promise of structural reforms by the President-elect, the financial situation has been improving and the country is regaining confidence in the world financial market as shown in the recent adjustment of foreign exchange rates and stock prices.⁵

3. The fiscal crisis is a small portion of iceberg appeared on the surface, which is deeply related to the entire system of South Korea: politics, economy, and society. In the process of modernization, President Park Jung He launched a series of economic development plans based on the export-led growth strategy by suppressing freedom and democracy of the people. President Chun Do Hwan and Roh Tae Woo followed their predecessor, so that the system remained at the level of one-half democracy and three-quarter market economy. President Kim Yong Sam's authoritarian style and lack of knowledge and experience begot troubles in domestic politics and foreign relations. The

three presidents of Chun-Roh-Kim were all far below the average in terms of quality of presidency; they enjoyed the power but did not have philosophical ideals to lead the country either in politics or in economy. As a result, the democracy of South Korea has remained in the lagged position without appropriate check-and-balance function in the system. Meanwhile, the bureaucrats monopolized the power of administration, and became a super machine to protect interests of conglomerates by creating the political-economic complex.

4. South Korea has faced two types of monopolies. A political monopoly dominated by preoccupied interest groups of politicians and bureaucrats has been influential owing to weak function of check and balance caused by nonexistence of the primary election. A business monopoly dominated by top Chaebols has been powerful owing to government protection which interrupts resource allocation in the economy. The monopoly in both politics and economy reduces efficiency and equality in the system of South Korea. Since democracy is essential to maximize economic efficiency and political equality, the balance between evolution of democracy and economic development must be indispensable. Even if a country pursues rapid economic growth by reserving democracy, lagged politics interrupt the advanced economy to move forward so that adjustment costs will be required in the future. The recent financial crisis requires adjustment costs which South Korea has to pay for reserving democracy in the past.

5. The purpose of this study lies in four directions as follows. Firstly, it investigates the root of financial crisis in South Korea by focusing on the political-economic complex which bred corruption and inefficiency in the economy. Secondly, the study discusses applicable policies to be considered by the coming DJ administration in terms of structural reforms in politics and economy. Thirdly, it evaluates the East Asian economic development model by analyzing the relationships between economic development and democratization in South Korea. Finally, the interrelations between economic growth and national security on the Korean peninsula are reviewed.

6. The study consists of six sections including the first section of this introduction. The second section analyzes the root of financial crisis in South Korea. In the third section, the study discusses policies of economic restructure in South Korea for the new administration to take care of. The fourth section evaluates the South Korean case of East Asian Model in economic development, which may affect other country's policies including transition economies. In the fifth section, the study investigates recent and future developments of inter-Korean relations for constructive engagement owing to the change of political and economic environment. My response to KMC's arguments is included in this section by covering military expenditures among famine, the existence of U.S. Forces in South Korea, a permanent peace mechanism on the Korean peninsula, human rights, and human values in North Korea. The last section includes summary and conclusion and provides policy recommendations to both Seoul and Pyongyang governments.

II. THE ROOT OF FINANCIAL CRISIS IN SOUTH KOREA

7. It is shameful for South Korea to face a foreign currency crisis recently as KMC criticized. KMC

wrote "The South Koreans developed crony capitalism and ended up a basket case by amassing some US\$200 billion in foreign debt, to be put into an IOU by the IMF. Once hospitalized by the IMF, the patient has little chance of being discharged."⁶ But his argument is not valid from history as shown in the Mexican economy in 1995 which was recovered within two years. The symptoms of financial crisis in South Korea were recognized in early 1997 by policy analysts in the government and economists in major research institutes.⁷ The Hanbo scandal proved the seriousness of bad loans particularly to the First Korean Bank and Seoul Bank. Since the scandal became a political issue as a preliminary battle for the coming presidential election, commercial banks became strict in business loans not to be a target from politics. Several conglomerates including the Kia Group, eighth-largest business group and third-largest car company, went bankrupt threatening their subcontractors of mostly small-sized businesses. This amplified the problems of financial institutions, and the fragility of the South Korean economy appeared on the surface.⁸

8. In the meantime, the decline of currency and stock values in the neighboring countries including Thailand, Indonesia, Malaysia, and Philippines has weakened the competitiveness of South Korean products in export markets, widening the trade deficit. Major foreign investors in neighboring countries began to lose interests in Asian markets and withdrew invested funds.⁹ They did likewise in South Korea to avoid the risks after recognizing financial problems, which expedited the shortage of foreign currencies in Seoul and the country's credibility fell rapidly. When the depreciation of Korean Won was expected, major consumers of foreign currencies in Seoul began to purchase U.S. dollars to avoid losses from the decline of foreign currency values. Since the Bank of Korea lacked sufficient foreign reserves, it could not defend the rapid decline of Korean Won so that its value fell to over 2,000 Won per U.S. dollar in December 1997 from below 900 Won before the crisis. In fact, the value of Korean Won before the crisis was highly appreciated considering the purchasing power parity. This stimulated consumption of imported goods in the domestic market and reduced competitiveness of export goods in the foreign market, which caused trade deficit continuously and so did the shortage of foreign currencies in South Korea.

9. The fact of the financial crisis is quite simple in statistics. The total South Korean debt was \$153 billion by the end of 1997 borrowed by financial institutions (64.6%) and corporations (28.2%). Among them the short term debt was \$80.2 billion (52.5% of total debt) which South Korea has to pay within three to six months.¹⁰ The government has responsibilities for "lax prudential rules and financial oversight, which led to a sharp deterioration in the quality of bank loan portfolios." as Stanley Fischer of IMF pointed out.¹¹ The foreign governments having troubled loans to Asian countries have the same responsibilities supervising their banks. South Korea became successful in restructuring \$24 billion of short term debts to long term debts to be repaid within one to three years with government guarantees.¹² If the crisis were a temporary shock, the foreign exchange shortage could have been resolved by \$57 billion of IMF rescue funds, extension of debt repayments, restructure to longer term debts, and additional loans. However, the seriousness of financial crisis in South Korea lies in the rapid decline of efficiency and competitiveness in the economy which may become unable to sustain the burden of external debts.

10. The major causes for the financial crisis can be investigated through the long history of

political-economic complex. The merger of politics with economy in South Korea started when President Park Jung He launched the First Economic Development Plan in 1962. In the early stage of economic takeoff, it was necessary for the Korean government to allocate limited resources to specific industries based on the unbalanced growth strategy.¹³ President Park provided various subsidies for import substitution and export promotion by suppressing labor movement like in other developing countries, and special favors went to selected business owners in his home province. This created a fortified political base for him to defend the weakness of regime's legitimacy and to supply easy funds for political operations, which helped maintain his life-long dictatorial rule against anti-government movement until his assassination in December 1979.¹⁴

11. As a result, the Korean version of conglomerates, so called Chaebols, monopolized the domestic market. President Chun and Roh followed the same pattern by enjoying the existing premium, which expedited Chaebols bigger and stronger. The labor union leaders in Seoul claims that they have accumulated the wealth with people's costs through monopolistic profits, various subsidies and privileges, and suppressed low labor costs, so that a large part of their wealth should be shared with the people.¹⁵ The three theories can be considered here. Firstly, labor movements were suppressed by authoritarian regimes so that a portion of workers compensation unfairly went to business owners. Secondly, Chaebols accumulated monopoly profits which were provided by corrupt bureaucrats, and some parts of profits should go to consumers. Thirdly, Chaebols borrowed money for business, but invested in real estate and gained huge profits illegally.

12. The corruption is deeply rooted in the mixture of preoccupied interest groups in all of society which are closely connected by region or school. The privileged individuals have enjoyed special treatment on the jobs and have had better opportunities for education, assignment, and promotion in government as well as in business. Senior positions of powerful ministries have been occupied by a dominant interest group, and the number of generals in the Armed Forces was far below the population share by region. Only one of the three-star generals in the Korean Army was from the Cholla provinces as of January 1998. Major positions even in research institutes have been occupied by the privileged group, and their heads have tried to justify government policies. The peoples from Cholla provinces were treated like the third-class citizens suffering from a long history of discrimination.¹⁶ Even successful individuals from Cholla provinces in the government could not consider them to belong to the mainstream of bureaucrats. Lost justice and equality reduced efficiency.

13. The financial crisis in South Korea was caused more or less by corrupt politics, over-expanded business, and not compromised labor. Corrupt politics forced financial institutions to give loans to business groups without proper examination of credit qualification, so businesses had easy access to the financial market. This caused business overexpansion through debt-finance raising the capital cost in production. Meanwhile, the Parliament passed labor laws prohibiting layoffs, so the workers can force employers to comply with continuous demand for wage increases. The high labor cost made businesses prefer investment in foreign countries to seek lower wages, which expedited capital outflow and shortage of foreign exchange reserves. In short, the politics sold their generosity to business as well as to the labor for easy compromise, which cannot survive

forever in the economy. High costs of capital and labor reduced the country's economic efficiency and competitiveness and invited economic decline. Let us investigate these three contributors.

(a) Politics and Government Subsystem

14. The government has been a main source of corruption to protect Chaebols' interests, owing to the lack of check and balance in politics, bureaucratic monopoly within the administration, and judicial injustice influenced by a special interest group. There exists no primary election in Seoul politics. The candidates of major elections such as for Parliament Members or Provincial Governors are nominated by political party bosses without primary elections, so that personal royalty of each candidate to the party boss is essential for nomination. The dictatorship in political parties, as a result, is unavoidable, and those elected officials are not free from the control of party bosses. In other words, the boss of both ruling and opposition party steals voting rights of primary elections in each electoral district, strengthens his or her own political power in the party, and monopolizes party politics. The main source of corruption in South Korea is lack of check and balance between legislative and administrative branches.¹⁷ The Parliament should impeach President Kim Young Sam from his office in May 1997 for the Hanbo scandal, but his son and his personal staff were jailed instead. DJ won the election in his fourth attempt for presidential candidate, which can never happen in the United States, which introduced the primary election system one hundred years ago, so no dictatorship in the political party can survive.

15. The bureaucratic monopoly has interrupted administrative efficiency in Seoul. The Ministry of Finance and Economy monopolized fiscal and financial planning function by controlling central banking, financial supervision, and budget allocation. This Ministry has been a bureaucratic machine of political-economic complex to protect the interests of Chaebols as Lenin pointed. The Ministry provided or removed regulations for their interests under the guise of efficiency or national interests. In addition to structural and functional problems, the Ministry has been dominated by a special interest group connected by region and school, which was linked to Chaebols. The planning office of Chaebols, which is planned to be closed in the new administration,¹⁸ had better access to updated information produced by the government despite the lack of information flow between ministries. The government bureaucrats have shown to be rigid without managerial capability in the nation's emergency.¹⁹ The lack of transparency in government contracts has been a source of corruption. Weak coordination between agencies and structural overlapping caused inefficiency.

16. The social justice problems have prevailed in South Korea. The judicial system, particularly in terms of senior positions of judges and prosecutors, has been dominated by a special interest group, the graduates of Law School of Seoul National University. Many trial cases evidenced that judge-prosecutor-defense attorney were closely connected by their law school alumni gatherings. Meanwhile, the Supreme Court has been a rubber stamp in major political cases. As a result, many Koreans have the general perception "small fish are caught while large fish run away." This expression must be not far from the reality in light of the Hanbo scandal. Seven big fish serving prison terms have been released including a son of President, a personal staff for President, and an influential Parliament Member of opposition party.²⁰ The non-interference

theory to the judicial system by administration and by prosecutors set off a transactions of bribes, which became a understandable routine of subsidization or social welfare in the system.²¹ If social norms and rules are relaxed by not forcing violators to pay appropriate prices for their wrong doing, the social justice disappears and goodness is destroyed by badness. If the better quality of human resources is expelled by the worse one, the inefficiency with high costs may prevail in the society.

(b) Economy and Business Subsystem

17. Chaebols have overexpanded under the government protection, and their monopoly power caused problems in the country's economy. Those problems include overlapping allocation of limited resources, heavy debt-financed capital structure, cross-finance guarantee system and lack of transparency, and money-talk pollution with unfair income distribution.²² The Korean business has a problem of resource allocation owing to flexible access to bank loans, debt-financed capital structure, and ownership dominance by one family in a business group. The Chaebols have expanded the business recklessly without considering the domestic industrial structure creating idle capacities in one industry and bottlenecks in the other. The overlapping investment with limited resources expedited a shortage of capital and introduced foreign currency problems. For example, Samsung Group entered the automobile industry in 1994 when South Korea had suffered from over capacities in that industry. Hanbo Group, the fourteenth-largest Chaebol, collapsed by leaving \$5.8 billion in bad loans in building a steel plant. Hyundai Group was planning to enter the steel business while Dongbu Group announced plans to enter the semi-conductor business, though they shelved the plans after the financial crisis. These raises adjustment costs for industrial restructuring in the future. It is fortunate the IMF rescue program can force corrections, though old habits die hard.²³

18. Heavy debt finance in the business raised the capital cost weakening global competitiveness. The Chaebols could reach bank loans relatively easily owing to the cross-finance guarantee system with political supports from the ruling party, so businesses preferred bank loans to public offering of company's stocks for governance of company's decision making. The average debt of thirty Chaebols was 3.33 times of their average net worth by the end of 1996 such as Hanjin 5.57, Kia 5.23, Hanwha 7.78, and Hanra 20.67 times.²⁴ The high debt-equity ratio raised the capital cost and prices of their products. High costs reduced competitiveness and exports, which resulted in a trade deficit and caused balance of payment problems. The high labor costs pushed domestic industries to seek overseas investment for lower production costs and easy access to the market, which expedited capital outflow and reduced foreign exchange reserves. The stock-finance must be safer if the business is riskier, but the debt-finance would not be bad if the business seems to be profitable. The border line lies in the survival of business having strong competitiveness in the world market in terms of costs for the same quality products in the same industry.

19. The cross-finance guarantee system within the group companies and lack of accuracy with transparency in financial statements made heavy debt finance possible. A company is legally allowed to be financially guaranteed by other companies within the group to get bank loans, which means that companies in a group are mutually supportive in finance that was not available to non-

group companies. This jeopardized fair competition between group and non-group companies in the same industry, so that the Chaebols killed most of small and medium sized businesses. This kind of monopoly introduced a chain of subcontract system in South Korea, which raised overhead costs charged by various middlemen in subcontracts. Therefore, available funds for the last subcontractors became far shorter than actual production costs, which threatened the quality of output products and invited the collapse of bridges and apartments in Seoul in recent years. The lack of transparency in financial statements helped Chaebols to hide their financial weakness in loan applications.²⁵ This made also possible for Chaebols to avoid paying proper amount of taxes for their transfer of assets to the second generation by giving stocks or property ownerships.

20. Monopolistic profits of Chaebols worsened income distribution and widened the gap between rich and poor. The Chaebols have largely contributed to contaminating traditional values of the society by spreading a wrong idea that bribes can make everything possible as evidenced in the Hanbo scandal and the trials of former presidents. The pollution of "bribe talks" confused the people about truth, justice, love, equality, and efficiency in the society and invited antisocial crimes of the young generation.²⁶ The corruption is the main source of inefficiency and inequality.

(c) Society and Labor Subsystem

21. It is understandable that labor unions became violent, aggressive, and noncompromising in negotiations to recover the exploited interests in past authoritarian regimes. An Input-output analysis shows that the share of employee compensation in GDP in manufacturing industries for South Korea and Taiwan was 31.8% and 44.3% in 1974, 41.8% and 47.1% in 1980, and 42.6% and 50.0% in 1986 respectively. This implies that employees of South Korea gained 8.3% less compared to those of Taiwan in terms of GDP share.²⁷ Assuming other factors were not much different between two economies, the labor in South Korea lost over 8.0% of GDP in average labor income than that in Taiwan during the period of 1974-1986, which went to business owners. However, the workers have partially contributed to current financial problems since 1988 by creating high labor costs, prohibition of layoffs, and other costs caused by labor unions.

22. The labor unions have become powerful in wage negotiations with Chaebols since 1988 when their members gained more compensation than productivity growth on average. The high wages raised production costs and reduced the competitiveness in foreign markets, which lessened exports. On the other hand, the business has searched low-cost labor in foreign countries for investment such as in China, Vietnam, Indonesia, India, and eastern European countries. Both export reduction and capital outflow for overseas investment expedited the shortage of foreign currencies.

23. When the business loses its competitiveness, sales go down and employment falls, then layoffs become necessary for survival. The labor unions should understand that the collapse of business will cause them to lose entire jobs as a natural consequence. Under the IMF program, forced layoffs are unavoidable in the process of economic restructuring. It is workers' right to force both government and business to do proper responsibilities in structural adjustment, but layoffs are a

different issue. The prohibition of layoffs is a kind of socialism which is not for efficiency, but for equality. This is not acceptable to survive in competitive markets of the age of globalization.

24. The employees who do not work should not get paid. The current labor laws, through the latest revision prohibits union staffs to receive wages from members' employers. However, union leaders have tried to regain that privilege in negotiations with the Tripartite Committee. The rule of "no work and get paid" cannot survive in the capitalist economy. It is unbelievable for union staff to try to receive their payrolls from the employer for labor activities against management through negotiations. This is labor's collaboration with management or a kind of cheating by themselves, which is not ethically acceptable. The high overhead cost in the business reduces its competitiveness in the market and its efficiency in the economy.

III. REFORM MEASURES FOR ECONOMIC RECOVERY IN SOUTH KOREA

25. The IMF prescriptions require a restructure in financial institutions and business governance, which should have been done long time ago by South Koreans themselves. But corrupt politics and bureaucrats delayed reforms to enjoy the honey leaked from business flowers. It would not be an exaggeration to say that the foreign currency crisis in South Korea provided an involuntary excellent opportunity for all subsystems of the nation including government, business, and labor to root out fundamental causes of problems: corruption, inefficiency, and inequality. South Korea is now at the crossroads where the nation led by the new DJ administration can break the thirty-five years old chain of political-economic complex toward economic efficiency and political equality through rational consensus of the people.

26. Since IMF wanted to negotiate with the real power in the coming administration, President-elect DJ became directly in charge of the country's economic problems as soon as he was elected on December 18, 1997 with the consent of current President.²⁸ Since the ROK economy under the IMF austerity program invites problems of bankruptcy and unemployment in the process of restructure, it is understandable for DJ to emphasize burden sharing.

Firstly, DJ coordinated with foreign leaders to avoid declaring a moratorium. The ROK was under the process of negotiations with creditors to extend short term debt repayments, to restructure short term debts to longer term debts, and to borrow more funds from various sources.

Secondly, DJ declared to downsize his new administration with structural reshuffles and budget reduction. He has emphasized that the government should share the pains with the people voluntarily during adjustment.

Thirdly, DJ requested Chaebols to restructure the business. He forced business leaders to accept a five-point pledge,²⁹ which outlines solutions to the major source of structural problems in the South Korean economy. This must be the first step of historical departure from corruption.

Finally, DJ asked labor unions to accept revision of labor laws by reintroducing layoffs which the current laws prohibit. He initiated the Tripartite Committee of Labor, Business, and Government with labor's consent to coordinate differences between them.³⁰

27. As a result, South Koreans as well as the world community recognize DJ politics to lead the economy toward the right direction in the time the country needs historical reforms of the economy. It is fortunate for South Koreans to elect DJ as President, a former dissident who suffered many years as a political prisoner.

*DJ's ideals are like IMF prescriptions based on the free market economy by reducing government intervention which has been a main source of corruption and inefficiency. He stayed in the United States during his exile for years, so he saw the American system of capitalism and the free-market economy prosperous.

*The power of special interest groups in domestic politics and economy is so strong that no other candidate if elected could have force structural reforms as strongly as DJ since he has been in the shadow without ruling power until now. DJ has nothing to owe to Chaebols, making him free to institute aggressive policy reforms.

*One of main obstacles for reforms is in labor unions which have supported DJ for a long time because DJ has been in their side of unprivileged and suppressed groups. Many people in the DJ camp have been close friends of labor unions so that the negotiations through the Tripartite Committee have been cooperative despite noises.

*The financial crisis has shaken the whole nation, and the Chaebols have been a main target for the blame. The voters in eastern provinces have belonged to a privileged group with Chaebols, but they came to know that they are also victims of the crisis. So, DJ receives support from both east and west of the country, which will harmonize the long-standing emotional conflict between Cholla and Kyongsang provinces. This trend can be applied to the conservative middle class living in the apartment areas in large cities, becoming supportive to the DJ leadership.³¹

*Although he has only a high school diploma, DJ has obtained proper knowledge to govern the nation through continuous reading and various experiences, which is superior to his three predecessors. Additionally, he has many friends in foreign countries particular in the United States,³² which must be an important asset for him to coordinate with international politics.

28. After the election, DJ has periodically mentioned the balanced development of politics and economy by saying that "the former authoritarian governments forced democracy sacrificed for economic gains.....however, coming our administration will pursue the balance between democratic politics and economy.....the business having competitiveness in the world market only can survive in the age of globalization."³³ DJ's diagnosis of the crisis is correct at this moment, and his guideline for the economic recovery seems to be appropriate. A nation's system is composed of several subsystems including politics, economy, security, society, education, and others. If the economic subsystem advances rapidly by big push while other subsystems remain unchanged, the economy cannot advance further because of adjustment costs interrupted by other lagged subsystems.³⁴ If the society's values in South Korea remain corrupted, for example, the recovery of its economy is delayed due to additional adjustment costs. If the DPRK suddenly collapsed, additional costs to secure national defense would delay economic revival. So, reform measures for economic recovery should encompass all lagged subsystems. In this sense, our discussions for reform efforts in this section include three major categories: politics and government, economy and business, and society and labor. The subsystem of national security is

discussed in the separate section in terms of future development of the two Koreas.

(a) Structural Reforms in Politics and Government

29. The reforms in politics and government have two directions. One is to root out corruption by reviving “check and balance” within the system through removal of political monopoly power enjoyed by favored interest groups. The other is to improve organizational efficiency by maximizing productivity while minimizing costs, which requires a smaller government with less workers and a reduced budget. The loss of preoccupied interests will be painful, but no privileges can be sustained if not fairly earned. It is important for the people to believe that pains from reforms will be equally shared by related parties without exceptions. The Tripartite Committee of government, business, and labor initiated by the DJ leadership is an excellent idea to share the burdens coming from economic adjustment in South Korea.³⁵

30. The Parliament should revise laws by introducing the primary election into both central and local elections, which is the first step to eliminate the dictatorship of the party boss and to remove monopoly power occupied by a small interest group in the political party. The primary election introduces fair competition in politics and provides equal opportunities for qualified candidates to run for public offices without any obstacles. In addition, Parliament Members become free from dictatorial power of his party, and the government system can maintain the force of check and balance between legislative and administrative branches. The bicameral system needs to be introduced to Parliament where Upper House ratifies political appointees and Lower House controls government budget allocation. The Upper House should require public hearings for political appointees to clear their qualifications for nominated positions.³⁶

31. The Parliament Audit System should be discarded since this function belongs to the Inspector General, and Parliament should focus on budget allocation only. A five-year tenure of the presidency needs to be revised to double terms of four years starting by the year 2000, to be synchronized by Parliament election years to make coordination easier in politics. The campaign funds should be strictly regulated and watched by the Election Management Committee and law enforcement authorities. The political parties do not need to maintain the office of electoral district, which requires huge expenses. The Parliament activities should be aired by television as many as possible, which helps voters to force disqualified Members be out of the chambers. The function of Parliament Research Service should be improved for better utilization of research products in law making.

32. The administrative branch should eliminate bureaucratic monopoly by restructuring the organization and by removing individuals who enjoyed special interests by connections. The Bank of Korea must be independent from the Administration as in the United States to control central banking with supervision of financial institutions. The budget function should be separated from the Ministry of Finance and move to under direct supervision of President as an independent agency because economic planning function is no more necessary in the ROK economy.³⁷ The Ministry of Construction and Transportation should be divided into the Ministry of Transportation

and that of Housing to reduce monopoly power. The function of the Ministry of National Unification should be merged with that of Foreign Affairs for efficiency. The DJ team may consider structural reforms of intelligence agencies.

33. The government owned corporations particularly in energy, transportation, and communications should be fully privatized as soon as possible for efficiency. The corporations funded by the government should be restructured by inviting free competitions with self-funded corporations. The downsized government becomes less intervening but more efficient due to more qualified workers with advanced technology. The layoff numbers for government employees must be the same level of private corporations. It is necessary for the government to adopt an open system of hiring qualified workers to mid-career positions, which stimulates workers' motivation by supplying fresh blood into the system. The DJ leadership is free to replace political appointees and senior officials who have enjoyed political connections in the past administrations.³⁸

34. DJ is going to control both personnel and budget directly by Central Personnel Committee and Budget Planning Office, and indirectly by Supervision Commission for Financial Institutions, Fair Trade Commission, and Administrative Coordination Commission. They are not under a ministry but under the Presidential Office or Office of Prime Minister. However, the Supervision Commission for Financial Institutions should be under the Bank of Korea since the banking functions should not be controlled by politics.³⁹ This is like the previous government where the President has intervened in banking function for his political goals. It is a great progress for the function of export promotion to merge into the Ministry of Foreign Affairs and Trade in the plan.⁴⁰

35. The DJ administration should clearly distinguish reward and punishment based on responsibility and authority, particularly in the case of financial crisis by strictly investigating misconduct of administrative power for their personal interests. Angry voices of the people are heard everywhere in South Korea. "The Ministry of Health and Welfare has lost several billion dollars of pension funds by mistake, the Ministry of Construction and Transportation has wasted huge amount of tax money in construction of the Seoul-Pusan Electric Highway by planning errors, and the Ministry of Education forced high costs of private education to the people because of the wrong system. But no responsible persons have been tried yet.... the Ministry of Finance and Economy destroyed the entire economy by inviting the financial crisis with easy-going behavior....."⁴¹

36. It is essential in governmental reforms to protect social justice by forcing individuals to pay fines for violation of laws. The law school curriculum should move from the undergraduate toward the graduate school, which provides mature professionals in the judicial system and is helpful to solve the problem of school connection on the job. It is necessary for the court to introduce a ceiling system in personnel management by limiting no more than 25% for first initial hiring and 10% for senior positions occupied by the same law school or the same region. This may reduce the monopoly power of a special interest group in the system. Then, a smart student will favor entering less popular law school to avoid severe competition in hiring and promotion without reducing the quality of education. The judge, prosecutor, and defense attorney for a case should

be selected from different schools and different regions, which will minimize unfairness in trials. As once discussed by the DJ team, the Attorney General of local governments should be elected.⁴²

(b) Structural Reforms in Economy and Business

37. DJ met heads of four top Chaebols who announced a five-point statement as a Chaebol's pledge after the meeting on January 13, 1998, as follows:

1. We provide annual, consolidated financial statements audited by outside firms.
2. We discontinue the practice of cross-funding and cross-loan payment guarantees among their subsidiaries.
3. We drastically improve our financial structure.
4. We streamline their business and focus on a few key areas.
5. We dispose of their own assets to raise funds for restructuring their businesses.⁴³

The direction of Chaebols' reforms should satisfy the following: removal of monopoly power given to Chaebols in the past, improvement of business efficiency and competitiveness by reducing costs and specializing industries with economies of scale, and introduction of additional foreign capital to write off outstanding external debts. The level of structural reforms should be acceptable to the middle-income class and the labor unions who see themselves as primary victims of the crisis.⁴⁴

38. The government should remove Chaebol's monopoly power by complying with the five-point pledge consistent with the IMF program. The consolidated financial statements for companies within a group should be audited by an externally qualified firm for transparency and reliability of companies. This should be applied at least 50 Chaebol groups to eliminate hidden internal transactions which are the source of monopoly and corruption. The system of cross-finance guarantee between business group companies should be prohibited immediately, which interrupts fair competition in funding with non-group companies in the same industry. Reliable financial statements and no cross-finance guarantees are essential for fair competition between group and non-group companies and for overall efficiency in the economy.⁴⁵

39. The Chaebols should pursue efficiency through cost minimization and productivity growth. The structural weakness of Chaebols lies in the high debt-equity ratio in financial structure and overexpansion in business operations. The government should amend laws requiring company's debt to be no more than 100% of its equity.⁴⁶ The bank loans should not exceed the equity so that companies should be financed by either selling stocks or holding profits. The owner finance by selling stocks is less expensive and safer for company's financial security than bank loans which may not be favorable when the business is booming.

40. As a remedy to cure business overexpansion, the government should limit the number of specialized industries in a business group to be no more than three to five including such as steel, automobile, electronic, and computer. In the process of business restructuring, the controlling power of big companies are exchanged between Chaebols, which is called "big deal" improving

financial foundation and specialization by expediting merger and acquisition. The subsidiaries in the group should also be sold to other companies, becoming small or medium-sized companies, which are specialized by doing their parts. So small businesses will revive in South Korea like Taiwan by eliminating a series of subcontracts.⁴⁷ As a result, the group is specialized in key industries with more funds and specialization, which improves their competitiveness in the world market. However, the 50 Chaebols should not be allowed to own energy, transportation, communications, financial institutions, and media companies including newspaper, radio, television, and others. If Chaebols own either financial institutions or media facilities, they are going to use the power of finance and media to expand their key industries, which jeopardizes fair competition, and noisily commercializes public instruments as South Korea has experienced in three daily newspapers owned by Chaebols. Particularly, the financial institutions should be open to foreign banks, encourage consolidation, tighten supervision and regulation, improve accounting and disclosure, and cut links between bankers and politics.⁴⁸

41. The ROK government allowed foreigners to purchase maximum 50% of a company's stocks under the agreement with IMF program by December 3, 1997, so the merger and acquisition became easier than before. The DJ administration is planning to expedite 30 Chaebols to finish structural reforms within 1998 by passing a tax reduction bill for the big deals, which is desirable for Chaebols to invite M&S by foreign companies which will reduce foreign debts in South Korea. The big deals with foreign companies would be more comfortable than extension of debt repayments or additional foreign loans to escape from the foreign debt burden because it is selling the ownership to foreign companies.⁴⁹ The "big deal" strengthens business competitiveness via financial and technological integration. The DJ administration has planned to provide appropriate environment for the "big deal" between groups not by forced exchange by the government but by invisible hands.⁵⁰

42. The separation of ownership and management in Chaebol companies remains another issue for reform. The shares of equity owned by Chaebol's head are less than 6% of total stocks in average for 10 largest Chaebols as of January 19, 1998.⁵¹ However, they manage the group with sole decision-making power and their dominance has caused huge loss to other shareholders in many cases. There is no legal provision to protect small shareholders from dictatorial power in business management. We have heard the voices of legal provision to separate management from ownership to be included in structural reforms in the new administration.⁵²

(c) Labor and Social Reforms

43. The South Korean workers have been proud of their labor movements against authoritarian governments as a driving force for democratization. The workers have been victims of the corrupt system generated by politicians, bureaucrats, and conglomerates as evidenced in the recent financial crisis. So, they have been aggressive and non-compromising in wage negotiations. But the workers also have partially contributed to the financial crisis in terms of high wages, prohibition of layoffs, payment without working, and union's demand for subsidies. The victim feeling of the labor community is so serious that the DJ team initiated the Tripartite Committee of

Labor-Business-Government to reach a compromise, which is necessary for economic reforms and IMF requirements. The Committee was successful to set the ten agenda items to be discussed for structural reforms and legal provisions.⁵³ Among others, their concern was in job security and unemployment compensation, social security and welfare measures, improvement of the wage system, and expansion of labor's political activities.

44. The Committee announced the "Declaration for Fair Burden Sharing" to make the people understand what the nation must undergo for economic recovery, which includes the following.

- *The government will investigate reasons and responsibilities of the financial crisis to provide the cornerstone of economic development in the future,

- *Businesses must expedite structural reforms, but should minimize layoff in the process of adjustment,

- *Labor unions must improve productivity of workers and quality of products to revive business, to recover competitiveness, and to cooperate in adjusting wages and working hours in order to minimize layoff, which is possible only in urgent managerial reasons,

- *Both business and labor must solve problems peacefully through communications and compromise, and

- *The tripartite of labor, business, and government must provide proper conditions to attract foreign capital and should submit the resolution to the Parliament of the coming session.⁵⁴

45. Parliament should pass a revised version of labor laws including removal of layoff prohibition, no work no pay provision, and no business subsidies for unions. Labor should accept the reality because the demand for revision of laws was initiated by the IMF program, economic restructure cannot avoid layoff problems, the new leadership provides unemployment compensation and other remedies, and the business has been cooperative for structural reforms though it is premature to judge the level of reforms. If business reforms satisfy the level of labor's demand, no further reasons exist to create contention.⁵⁵

46. The DJ leadership should minimize unemployment shock in the process of economic restructuring though layoff waves are coming to reality of a half million to a million. The South Koreans have never experienced this kind of huge unemployment, so that the society will be shakier and noisier than expected.⁵⁶ The remedies to reduce shock include minimization of layoff, to create additional new jobs, to provide unemployment compensation, and to make the people accept the reality to cure feelings of victimization harmoniously. Any company wanting efficiency should try to reduce the number of workers since a maximum reduction in employment is necessary to minimize production costs and to make the business competitive. If the government forces the business to minimize layoffs, it interrupts labor flexibility. As long as each employee keeps their current working hours, the number of laid off workers will remain unchanged. The only solution to reduce layoffs is to reduce working hours and the saved hours are reallocated to laid-off workers. The flexibility of the labor market should not be interrupted, which is essential to regain competitiveness and to attract foreign capital.

47. The DJ's transition team plans to provide unemployment compensation for workers who are not able to gain employment for over three months. The team will try to raise unemployment funds from current \$1.4 billion to \$2 billion, which will make the government pay 50% to 70% of payroll to unemployed workers for maximum 6 months.⁵⁷ Nevertheless, this must be a temporary remedy without future employment by attracting foreign investment and by promoting exports. The former will reduce bankruptcy of domestic business while the latter creates more jobs. The first stage of economic reforms requires austere conditions. Many companies will fail but the opportunities for new business will be reduced due to declined consumption. The only way to create a job is in export industries that would be profitable at current exchange rates: low Won and high dollar. The speedy restructuring of Chaebols would be helpful to create new jobs from adjustment. DJ may create new jobs in environmental protection and public health services to hire laid-off workers while reducing the level of foreign workers gradually.

48. It must be dangerous if DJ allows the Jaminryon Party to make some kind of compromise with Chaebols in terms of legal provision and other measures, which must be strictly watched. DJ should keep in mind that the ideals of French revolution did not go through because conservative groups including landowners resisted consistently to keep their interests. The reform spirits in South Korea have been in the people's mind for long time but were not activated since the united power of bureaucrats and conglomerates was strong enough to protect themselves and to neutralize the organized power of labor unions. It was shameful for intellectuals and media who were silent standing by the side of power while the labor unions were active. If South Korea stops reforming, the East Asian economic development model may be buried.

49. The DJ leadership should try to reach reasonable consensus of the people to harmonize the society, to strengthen the cohesiveness, and to maximize the efficiency. As the DJ's team intends, the Tripartite Committee would be necessary continuously to adjust differences as a mechanism for cooperation and coordination. DJ must expedite structural reforms of Chaebols through legal provision and informal pressures. Conflict between business and labor should be resolved with industrial efficiency and competitiveness first for survival of the South Korean economy. The DJ leadership should try to persuade the labor to share the burden.

50. As labor unions have demanded, the DJ leadership should investigate reasons and responsibilities for the financial crisis and bring the case to justice. All responsible parties in the Ministry of Finance and Economy should be tried and jailed without exceptions. All bankers who participate in bad loans and all politicians who used office power to make bad loans should also be tried and jailed without exceptions.⁵⁸ The new leadership should try to establish democratic disciplines in the society by demanding strict responsibilities upon authorities given by government positions. The loss of fairness interrupts social justice, reducing public support for the leadership.

IV. ECONOMIC DEVELOPMENT AND DEMOCRATIZATION IN SOUTH KOREA

51. In the modernization process, the political leadership in developing countries emphasizes

economic development to escape from the vicious circle of poverty. Authoritarian leaders organize resources to build the economy by reserving political freedom which can be partially compensated by economic gains. As the economy grows, it becomes possible for business power to purchase politics by bribes. Corrupt politics provides monopoly power to certain business owners in returns, which reduces efficiency and competitiveness in the world market. The loss of competitiveness gradually reduces the country's exports, employment, and income, which invites recession to the economy. The economy would not revive until the corruption is removed because the lagged politics interrupt economic efficiency. So, the policy of balanced development between politics and economy is introduced. The corruption requires adjustment costs for the system to balance the differences between two subsystems in development.⁵⁹

52. The financial crisis in many Asian countries brought a question whether the East Asian model of economic development is alive or not because they are in doubt of continuous growth. The major problems are rooted in not-harmonized interrelations between political evolution and economic development which we are going to discuss in this section. In the first, the South Korean economy is evaluated by three stages in terms of relations of politics and economy. Secondly, the decline of the East Asian economies needs to be examined in terms of efficiency decline due to government intervention. Thirdly, the lessons from South Korean experiences are examined, to be applied for two groups of followers such as Asian developing countries and transition economies including China, Vietnam, and North Korea.

(a) Evolution of Democracy and Economic Development in South Korea

53. The growth of South Korean economy can be divided by three stages by considering political development: the first stage is the President Park's period of economic takeoff under the authoritarian regime (1962-1979), the second stage is the post Park's period of conflict between democracy and economy (1980-1997), and the third stage is structural adjustment and harmonious growth between politics and economy (1998-).⁶⁰ Since the third stage is just a beginning of the new administration, it includes future development and desirable policies or actions with which the DJ leadership and next administrations should improve the system similar to many western industrialized nations: full democracy and full market economy. Since we already discussed reform measures and the dynamics of politics and economy previously, the third stage will not be discussed here.

54. *First stage (1962-1979) Economic Takeoff Under Authoritarian Regime:* There was no democracy but one-half market economy in this period when President Park Jung He began to take over by military revolution. He fortified an authoritarian regime by suppressing all freedom factors against him and launched a series of five-year economic development plans beginning in 1962 by which the Economic Planning Board allocated available resources and managed overall development affairs. The Korea Development Institute supplied quality research for policy recommendations to the government as a dominant think tank in Seoul. South Korea pursued the export-led growth strategy in terms of import substitution by balanced growth and export promotion by unbalanced growth. Meanwhile, the industrial structure began to shift gradually from

labor-intensive to capital-intensive industries during this period as projected by the EPB which merged into the Ministry of Finance and Economy in December 1994 to reduce government intervention.

55. An input-output analysis by this author indicated that the export-led growth strategy of South Korea was the best choice among available alternatives due to following reasons. This strategy generates the largest amount of GDP for the same level of aggregate final demand. Import substitution requires a huge amount of physical and human capital which can be financed by export earnings, while export promotion requires advanced technology which can be accumulated by import substitution, so both are mutually supportive and complimentary. Since export promotion is accompanied by increasing demand for imports, profits coming from exports decline significantly without import substitution. Movement of comparative advantage due to the product-life cycle requires structural changes to be absorbed by import substitution, which helps to maintain international competitiveness of domestic products. Finally, the supportive strategy of domestic demand expansion is desirable when market openness does not suppress consumption of domestic products in fair competition.⁶¹ The government intervention was successful in the early stage of economic takeoff until the third five-year Economic Development Plan ending by 1976, but caused serious problems in efficiency, equality, and democratization in later years.

56. The purpose of government intervention in the free market is to achieve two goals: either efficiency or equality. The export-led growth strategy exploits economies of scale through trans-border trade despite narrow domestic market. The competitiveness of domestic products is enhanced by taking comparative advantage with favorite patterns of trade via efficient resource allocation. This expands the production possibility frontier. The competitiveness is reinforced by both protection and subsidization, which allows monopolistic profits to export industries. The cost of incentives became serious in South Korea though overall returns from export promotion was larger than costs of incentives in the economy. Three problems became serious as the economy grew. The first was inefficiency from distorted industrial structure due to poor resource allocation, the second was income inequality between Chaebols (plus corrupt bureaucrats plus collaborating intellectuals) and others, and the third was heavy social costs coming from suppressed democracy by authoritarian regime. So, the government could not achieve both efficiency and equality, and voices demanding freedom and democracy became louder in South Korea. The South Korean government analyzed that "inefficiencies have been imbedded in the Korean 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."⁶² The assassination of President Park in 1979 among social instability partially reduced the problems.

57. *Second stage (1980-1997) Conflict Between Democracy and Economy*: This was a period of three presidents of Chun, Roh, and Kim. The Chun-Roh period was one-half democracy with three-quarter market economy when accumulated freedom-fighting forces challenged regime's legitimacy. President Kim Young Sam allowed full freedom of democracy, but there was no difference from previous regimes in the political decision-making process. Corrupt politics sold

generosity to business and labor which invited structural problems in the economy by creating a lack of efficiency and competitiveness. Since we have discussed the reasons why corruption introduced inefficiency in Section II and III, our discussions here is limited to dynamics of interactions between economic development and democratization in society.

58. When people are poor, bread is more important than freedom and democracy. South Korea did not have enough westernized intellectuals to incite military revolution against President Park Jung He in 1960s. But the situation gradually changed. Firstly, the export-led growth strategy of Park's government expanded foreign trade which required more education and training internally and externally. Education and training awakened people toward ideals of freedom and democracy against the authoritarian rule. Secondly, trade expansion and technological advancement accelerated information flow between individuals without national borders due to more transportation and communications, which prevented the government monopolizing sources and means of information. The public became aware of the outside world, so that no authoritarian leaders could fool the people, which expedited democratization in South Korea. Thirdly, as the economy expanded exports rapidly, accumulated profits from exports created a wider middle-income class who paid more taxes and wanted more political power. An increasing middle class liberalized society due to strong voting power. Finally, increasing trade relations and foreign direct investment forced public policies vulnerable to foreign pressures such as human rights, trade liberalization, and other interests, which expedited democracy. In other words, economic development with export promotion in South Korea invited greater education and training, more information flow, wider middle-income class, and rapid internationalization so that driving forces for democratization became aggressive.⁶³

59. Anti-government sentiment, in fact, began to evolve in 1972 when President Park revised the constitution by force for life-time rule. The suppression forces of authoritarian regime were strong and the driving forces of democratization by the people were relatively weak so that there were no hopes for further liberalization. However, liberal politicians and underground labor supported by left wing students accumulated driving forces for democratic revolution. The Kwangju incidents with aggressive freedom fighters forced President Chun transfer the power to President Roh, which reduced authoritarian rigidity, but the system remained unchanged. President Kim (YS) was the first civilian president and tried to remove military culture from the government. He allowed full freedom and liberty in politics, but his lack of knowledge and experience made him ignore the democratic decision-making process, and his style of authoritarian leadership caused trial and errors. After the Hanbo scandal he lost control of his presidency and President-elect DJ became in charge of a one-half presidency at his private home since December 18, 1997.

60. Economic development and democratization are closely related as shown in history. China has survived while Soviet Union perished in the process of economic transformation. Economic reform proceeded politically in the former, while political reform proceeded economically in the latter. "The collapse of the USSR can be explained by the fact that its failing economy could no longer support the country's vast political-military system, and the bankrupt government could no longer guarantee law and order. In contrast, Deng Xiaoping adopted an open policy, which attracted

foreign capital and promoted exports, pursuing economic transformation followed by political reform."⁶⁴ Deng's open policy increased foreign trade and overseas education, but he did not expect freedom waves coming from openness to hit a Beijing's square so fast and violently in 1989. Similarly, President Park pursued the export-led growth strategy, but he did not expect freedom waves hit the streets of major cities so violently by threatening his regime. Economic development requires foreign trade, which brings freedom waves into society. Any authoritarian regime can delay the freedom waves for a while but cannot stop it.

(b) The East Asian Economic Model Is Under Progress

61. The East Asian economic model is characterized by "high investment ratios, small public sectors, export orientation, labor-market competition, and government intervention in economic matters." "Large and efficient investments in human capital and well-developed capacities to absorb new technology are two other economic features." Those factors caused rapid growth in such economies as Japan, Taiwan, and South Korea. Non-economic characteristics such as "ethnic and linguistic homogeneity, relatively compact geography, manageable population size, and Confucian tradition.....have undoubtedly influenced labor productivity, savings behavior, and other aspects of economic performance."⁶⁵ The model has been successful until the recent financial crisis.

62. The sources of economic growth are explained by both factor input growth and productivity growth, which shares contributing to growth varies according to country, period, and the method estimated. Dale Jorgenson estimated that the share of economic growth generated by capital and labor input is three quarters of total growth. For example, U.S. economic growth during the period 1948-1979 was contributed by growth of capital input (45.6%), growth of labor input (30.7%), and productivity growth (24.7%). Savings generate growth in capital input, which is affected by consumption behavior, while population growth generates growth in labor input which is affected by production behavior such as labor-leisure choices. Robert Solow and others emphasized the importance of advanced technology and productivity growth in economic development.⁶⁶

63. Paul Krugman argued that East Asian growth is driven by mobilization of resources, not by productivity growth in terms of efficiency gains by comparing the model with Soviet Union. He explains that input driven growth supplies capital and labor continuously and intensively, so the economy yields diminishing returns, and growth will slow down sharply. Meanwhile, the diffusion of technology will place huge strains on Western society, so that no apparent convergence of technologies between East and West is expected. He believes that the government intervention such as plans and policies in East Asian countries would not make any visible difference.⁶⁷

64. However, his essay is misses important points on East Asian economic growth. Investment is not a simple accumulation of fixed capital. South Korea requires technology transfer in purchasing major equipment from advanced countries including the United States and Japan. If a seller does not want technology transfer, the deal goes to the other country. That is why the United States lost some deals with Seoul in the past. Technology is also transferred by learning-by-doing on the jobs

at joint-venture facilities, which moves from import substitution to export promotion as well as from labor intensive to capital and technology intensiveness. The World Bank estimated that the contribution of total factor productivity to total growth was higher than 33% for Japan, Taiwan, and South Korea during the period of 1960-1989.⁶⁸ This number is much higher than Jorgenson's estimates of 24.7% for the United States. If the marginal return of capital exceeds its cost, growth based on rapid capital accumulation would be highly desirable though its marginal productivity is likely to decline gradually not sharply as the capital stock deepens. The evidence is enough to dismiss Krugman's arguments of "sharp decline of productivity growth" in capital accumulation due to constrained technology transfer.

65. Krugman's arguments about the effectiveness of government plans and policies have both positive and negative responses according to situations. For example, President Park Jung He in South Korea launched the first five-year economic development plan in 1962 and allocated limited resources efficiently to maximize growth. This was necessary for and successful in the economic takeoff and became a cornerstone for future development. On the other hand, government intervention has caused corruption problems⁶⁹ and resource misallocation by creating bottlenecks and idle capacities in the economy since late 1970s, and invited the financial crisis as discussed in the second section. In the early stage of economic development, well organized plans and policies contribute to efficiency and economic growth in the takeoff stage but reduces the efficiency when the economy becomes larger and complicated.

66. The East Asian model is alive and under progress actively because the South Korean economy is alive and expected to grow fast again after a couple of years of recovery. As investigated in previous sections, the problems of ROK economy lie in external debt-financed overexpansion, foreign exchange shortages, and structural inefficiency with corruption, which are able to be fixed by the new leadership. The accumulated capital in South Korea deepens with continuous high saving and investment, labor forces are well trained with high quality education, technological know-how has been built for over thirty years, and managerial skill of entrepreneurs with international marketing is well developed. As soon as structural problems are adjusted, the ROK economy will recover to the previous level and will accelerate growth by market forces aggressively. Krugman will see opposite outcomes to his earlier essay which spreads a pessimistic view of the Asian model.

67. The experience of South Korean modernization suggests the following. Firstly, the democratic system is essential to maximize capitalistic efficiency by reducing bureaucratic intervention costs through immediate feedback adjustment. Democracy provides a self-adjustment mechanism that is indispensable to reduce accumulated costs despite training costs. Secondly, the balance between democratization and economic development in the process of modernization is desirable to minimize adjustment costs interrupted by lagged subsystems. Lagged politics with government intervention invited corruption which reduced efficiency and became a heavy burden in growth. Thirdly, the economic development plans were efficient in the early takeoff stage, the first ten to fifteen years in South Korea. But in the later period, government intervention caused problems by

reducing both efficiency and equality. Fourthly, if South Korea chose a different strategy, the adjustment costs would be a different form. If the integration of returns from chosen growth strategies are larger than that from other strategies, the adjustment costs are the lowest prices that South Korea must pay. "If South Korea chose the balanced modernization between democracy and economy, it would not have today's frustration. However, there would be no such an impressive performance in the economy as that to be frustrated."⁷⁰ Finally, the East Asian model is alive and under progress. The financial crisis is one of the happenings in the process of economic development. Since South Korea will have both advanced democracy and market economy through this crisis, its economy would be ever stronger than before as soon as it gets recovered. The financial crisis provided an opportunity for its people to reach the highly matured stage in politics as well as economy.⁷¹

(c) Lessons from South Korean Experiences for Followers

68. As an East Asian model, the South Korean model of economic development may provide good lessons from its previous experiences, which would be beneficial for other developing countries as well as transition economies such as China, Vietnam, and North Korea. The lessons are as follows.

- *Use a series of economic development plans in the early stage of takeoff even by reserving political freedom. The well-organized driving forces will expedite the big push effect on the economy. The planning period would be a minimum of ten years but no more than fifteen years.

- *Reduce government intervention gradually after ten years, and pursue balanced development between politics and economy, focusing on democratization. The leadership's priority should be given to watching corruption of politicians and bureaucrats.

- *Start from import substitution of labor-intensive products and then move to export promotion of the same products. Enter import substitution of capital- and technology-intensive products and then move to export promotion of the same products.

- *Supply capital by selling stocks, but by loans in banking, energy, transportation, and communications. Invest aggressively in education and training plus research and development. The period protecting infant industries should be minimized.

- *If the 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 such as current South Korea, which threatens continuous growth. In that case, time is essential to reduce adjustment costs by catching up immediately.

- *Be aware that balanced growth of politics and economy is essential, but do not ignore development of other sectors such as national security, society, and education.

69. The Chinese transition economy has faced serious problems in the process of economic reforms including justification of ideological shift, privatization and managerial efficiency, and struggle against corruption. Socialist ideology has controlled the system in the lengthy period in the past. It is justified that "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.”⁷² 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.⁷³ China has set four goals to build a socialist economy: to readjust and improve the ownership structure, to improve the socialist market economy, to improve the income distribution system based on the ownership of productive means, and to liberalize domestic market to the world.

70. The starting point of Chinese economic transformation has been to allow property rights and to privatize state-owned enterprises by introducing the price system into the market and has invited three major problems: bankruptcy due to poor corporate management, unemployment due to efficiency improvement, and inflation from high growth and poor financial policies.⁷⁴ A survey on the Hanan Iron and Steel Corporation, for example, suggests that “suspend production for unprofitable products..... make calculation considering real market conditions and drop production plans that were not cost-effective.”⁷⁵ On the other hand, China’s unemployment rate has approached 20% in major cities such as Harbin and Shenyang. “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.”⁷⁶ The Chinese government fears unemployment causing social instability. Chinese financial authorities managed inflation soon after the problem occurred, so inflation is not an issue though the Asian financial crisis appreciated its relative currency value.

71. In the process of privatization of transition economies, corruption has been a severe problem. Since the properties in the socialist economies belong to the state, the political power sets the rules of privatization and distributes state owned properties to qualified individuals. “The phenomenon of corruption has emerged along with the rise of private property and private ownership.” China suggests the radical cure of corruption as follows.⁷⁷

*Enhancing party building and education in ideology and ethics is the ideological guarantee for fighting corruption and advocating cleanness.

*Completing and perfecting administration through formulating regulations and institutions to remove the soil and conditions for the rise of corruption step by step.

*Opposing corruption and advocating cleanness is a comprehensive system engineering project that calls for effective restrictive and supervisory mechanisms.

Since initial political conditions of the transition economy lies in Marxism of proletariat dictatorship with class struggle monopolizing politics, the political-economic complex invites corruption, and the second generation of bureaucrats owns privatized corporations. North Korea will have the same problem of corruption if it moves toward a market economy.

V. FUTURE DEVELOPMENT OF TWO KOREA RELATIONS: THE TIME OF CONSTRUCTIVE ENGAGEMENT

72. A half century of military confrontation in the Korean peninsula remains despite unnecessary prices in politics, economy, and society. The confrontation between Pyongyang and Seoul has been a burden of democratization in South Korean politics. The expansion of armed forces after the Korean War increased education and training for military officers, which became a political basis for three general presidents until 1992. The politicians and bureaucrats became extreme right wing hard liners, which made the system inflexible, particularly in the decision-making process. The threat from the North provided a sweet justification for three authoritarian rules, and Pyongyang even helped the ruling party to win elections by taking military actions in the DMZ and elsewhere just before elections though this scheme did not work in the DJ election. The political retardation in South Korea has caused economic losses as we discussed previously.

73. The military confrontation between the two Koreas became a heavy burden for the economy. National security provides peace and stability which are indispensable for investment and economic growth, but military spending reduces investment in private sector, which generates no other utilities than security except some fractions.⁷⁸ If the security becomes no more utility on the Korean peninsula, funding and manning for national security would not be necessary or at least would be reduced dramatically in both sides. The conversion of resources from defense to non-defense sector would bring huge benefits to both economies. Army tanks and anti-aircraft missiles are necessary only for war if we ignore arms exports. The costs of purchasing and maintaining equipment and weapons are a waste of resources if there is no war. When the funds go to building infrastructure, education facilities, and hospitals and recreation centers, the quality of life would be improved. The other point is the existence of threat from the North increased a country's risk, which reduced foreign direct investment into South Korea and raised the cost of risk premium.⁷⁹ Whenever the Korean peninsula has an foreseeable or explosive threat, the Japanese media exaggerated the threat so that South Korea lost business because the buyers changed the destination to Tokyo.

74. The military confrontation has brought a dichotomy in theories and practices in South Korean society. There was no gray area where heaven and hell could coexist. Society is not a kind of being white or black. If one is qualified to enter neither heaven nor hell, where should he or she go? We need compromise in the gray area. For example, an opposition leader Lee Chul Seung was in a compromising position with the ruling party of President Park but was accused as a collaborator (Sakura) and lost the power in the party. Society lost freedom of thought and expression because the government censored major social activities under the name of anti-spying operations. This interrupted information flow and reduced social development. No South Korean students were allowed to read Das Kapital until the collapse of Soviet Union. The security investigation for government employees and its contractors was misused by authorities to strengthen the political power base of President Park-Chun-Roh. For example, a qualified officer passed an examination for a position of military attaché, but the Army rejected to assign him to that position due to security reasons, which was not acceptable to him. Later years he was allowed to come to the United States for graduate studies, but not returned. Division and confrontation of the two Koreas have been a heavy burden for social integration in various ways.

75. North Korea has paid the prices of confrontation directly and indirectly more than South Korea has done. One of the worst mistakes that Kim Il Sung made in history was to ally with communist countries, which produced current situations of North Korea. The problem of North Korea lies in the declining economy which cannot provide proper foods and necessities for the people. The root of economic problems lies not simply in the economy but in the entire system, which has not been seriously recognized by the leadership. The origin of problem can be explained as follows.⁸⁰

*The planned economy causes problems. Projected consumption and production by the government causes inefficiency by bottlenecks and idle capacities in industries.

*Marxist ideology does not allow private property rights, and a small interest group holds the power under the name of proletariat dictatorship. Royalty- but not performance-based compensation for workers lessens motivation and reduces productivity.

*Heavy burden of military expenditure reduces investment for infrastructure and manufacturing facilities, which raises overhead costs in the entire economy.

*Heavy censorship in the system threatens borderless communications and royalty-oriented brainwash interrupting creative ideas, and lack of education and training as well as research and development cause technology problems and reduces productivity.

*Self-sanctioned autarkic economy makes North Korea to exploit its comparative advantage in the economy, so that the production possibility frontier remains not expanded. It is also difficult for the DPRK to mobilize resources to increase input factors for production.

*Pyongyang has used much of its resources to prevent an internal uprising by policing its own people, particularly intellectuals and political dissidents. It is a waste of resources which makes the economy inefficient.

*The rigidity and loss of flexibility by centralizing the power interrupts self-adjustment which reduces efficiency and so does productivity.

*The leadership of Pyongyang must understand the importance of time cost: time is money. Other transition economies expedite reforms to survive in the competitive markets, but Pyongyang has wasted time by delaying coming opportunities through peace talks.

76. What are the alternatives, and which emerges as the best choice for Pyongyang? Unfortunately, Pyongyang has faced a dilemma: the openness threatens survival of the regime, but the economy cannot revive without openness. The only choice for survival of the regime is in the strategy of balanced soft landing: multi-dimensional, simultaneous, and gradual transformation of the system.⁸¹ The concept of multi-dimensional and simultaneous means that all subsystems of North Korea including politics, national security, economy, and society should be developed simultaneously with balance. The concept of gradual transformation means that the openness should start partially in a specific region such as Rajin-Sunbong area in the first step and should gradually expand to other locations such as Wonsan of east coast and Nampo of west coast to minimize the shock coming from freedom waves. Then, the openness can be applied to the entire area of North Korea after building confidence and immunity. This is the similar method that China applied since 1978, which we can name the Chinese Transition Model. It is essential for Pyongyang to save time in openness and transformation of the economy. Pyongyang has wasted time in negotiations with Washington and Seoul; however, any gains from negotiations seem to be

far less than the time cost considering concessions from the counterparts were extremely limited.

77. The importance of time cost in economic development can be explained as follows. Let's assume that Pyongyang wants to build a chemical manufacturing plant in the suburban area of Wonsan. The first thing to be done is to build infrastructure including power stations, water lines, highways and byways, seaports, airports, and communications facilities, which will take at least five to seven years with intensive investment. The second step is to build the manufacturing plant itself, including buildings and equipment, which will take at least three to five years without financial problems. The third step is to recruit and train employees and to assign the jobs including overseas marketing, which will be accompanied with operating the plant and selling the products to the world. This will take at least three years. The minimum time span to normalize the business would be five years by adjusting to the international market environment. If North Korea decides to go now, the location search and designs may take a couple of years. The total number of needed years must be a minimum of ten to fifteen years without any other problems. Pyongyang does not have time to waste or to delay.

78. Now is the time for Pyongyang to choose the strategy of constructive engagement with Seoul. This is the right time and cannot be missed because of following reasons.

Firstly, the international community becomes closer and friendlier by pursuing openness and removing ideological barriers and economic borders toward globalization for mutual prosperity. It is the best way for Pyongyang to lean with the wind to avoid relative disadvantages.

Secondly, the strategy of national security in both the United States and South Korea pursues the constructive engagement with North Korea. The powers in the region including China, Japan, and Russia are supporting the engagement for peace and prosperity.

Thirdly, the South Korean economy does not have any problem to pay 3.5% of GDP for defense budget continuously even in the period of IMF supervision. However, Seoul wants to save military spending to repay external debts as soon as possible.

Fourthly, the North Korean economy has reached its worst situation, and starvation passed the limit which society is being patient. The horrible execution maybe helpful to maintain the regime, but further suppression will cause the regime's collapse which Seoul does not want.

Fifthly, the possible gains from negotiations are very limited and continuous demanding concessions will waste time without gains, which is not beneficial for the North. It must be a net waste for the North Korean economy to lose time without gains.

Finally, President-elect DJ has been in the milder position with North Korea and is trying to make a friendly relation with Pyongyang. If the DPRK cannot provide constructive relations with his administration, another five years or more would be necessary to meet a next counterpart.

79. The reality of the 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."⁸² The central

government has been losing the political influence over provincial and local authorities due to lack of grain power. Private market activities throughout the country are accepted, and the household responsibility system is selectively implemented. However, aggressive reforms based on the Chinese model has not been observed yet. North Korea has been a burden of China because of demanding economic aids and spreading refugees into border provinces while South Korea has been a nice partner with growing trade and investment. China has own problems of unemployment in privatization. Despite rhetoric of equidistance, China began to recognize that its economic interests in Seoul are larger than strategic interests in Pyongyang, and that unified Korea would not be dangerous to China's security. The Sino-American relations, meanwhile, moved to constructive engagement. The status quo seems not to be sustainable on the Korean peninsula, which China may agree.⁸³

80. An analytical report on the 1997-1998 international situations published by the China Strategy and Administration Research Society suggested that a 'soft landing' is the most feasible way toward unification of the two Koreas.⁸⁴ 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 have serious economic problems to be solved immediately. Secondly, China wants to strengthen its traditional friendship with the DPRK and to improve its economic relations with the ROK. The United States does not want heavy casualties by war, and Japan does not want the second Korean war which will threaten its national security. Finally, the achievements of quadripartite talks will help find a way to a rational settlement of the peninsula issue, the main theme of which is relaxation, cooperation, and consultations as a gradual process.

81. Recently, the national priority in Seoul lies in debt repayment and economic revival to escape from IMF supervision, so the inter-Korean issues seems to have fallen to secondary importance.⁸⁵ However, President-elect DJ has expressed the importance of constructive engagement between the two Koreas by proposing the North-South summit, so that the inter-Korean relations seems to be improved gradually in various ways.⁸⁶ This section discusses the issues that KMC argued in his debate with me. The key issues for debate are in Pyongyang's military buildup among famine, the existence of U.S. Forces in South Korea, a permanent peace mechanism between the two Koreas, human values, and human rights in North Korea. The following discussion will clear up the reasons why there have been fundamental differences between the two entities.

(a) Military Buildup and Famine

82. KMC wrote "With the Cold War rather sharpening in the part of Far East, the North Koreans have every good reason to take precautionary defense steps in the best national security interests." However, it is believed that "the arms race of North Korea against the South is a losing ground because of the amount of defense expenditures available. As long as North Korea remains an hostile enemy against the South, Seoul will allocate at least 3.5% of GDP for defense budget which is two third of North Korean total GDP as of 1993, but the gap will become larger as the economy of South Korea grows."⁸⁷ Theoretically, the heavy defense burden causes a budget deficit which reduces investment. Lack of investment particularly in the infrastructure provides insufficient

supply of energy, transportation, and communications which in return raises overhead costs in the economy. Lack of investment in various sectors reduces productivity growth and causes the economy to decline. Since the utility of armed forces is to secure national sovereignty against external threats, the maintenance of excessive forces must be a waste of resources jeopardizing the economic growth.⁸⁸ The DPRK should understand the concept because it explains one of reasons why the North Korean economy declines continuously as we discussed previously.

83. Selig Harrison of the Woodrow Wilson Center suggested disarmament between the two Koreas particularly to President-elect DJ of South Korea by insisting that disarmament will reduce tension and economic burden.⁸⁹ He is not the only person to emphasize the importance of disarmament. "Disarmament through a peace treaty between North and South Korea may provide very important source of funds. If Pyongyang and Seoul leaders agree to cut defense expenditures by one half, the total of \$10 billion (around \$3 billion from Pyongyang and \$7 billion from Seoul) can be saved each year, and that amount may rise as the economy grows."⁹⁰ However, the DPRK does not want to talk with the ROK except food aids. If the DPRK diverts resources from military buildup to purchasing grains, its people would not die from starvation of famine, and so called "Painful March" would not be necessary. Seoul will never attack the North first as long as Pyongyang remains peaceful.

(b) U.S. Forces in South Korea

84. KMC wrote "the cause of the Korean question is the American military intervention in Korea." Of course, the division of the Korean peninsula is a byproduct of World War II: the two superpowers of the cold war period divided the peninsula. The U.S. Forces in South Korea, however, is justified by the agreement of security alliance between Washington and Seoul signed in 1954. This is a strong commitment for the United States not to allow North Korea to attack South Korea in the future as Pyongyang did in 1950 under Moscow's direction, which evidenced in historical documents recently released by Russian Archive.⁹¹ This verifies that the KMC's argument of "interventionist, aggressive role of the Americans" has no scientific validity. If Pyongyang does not have any intention to attack Seoul, this alliance would not threaten the DPRK or any neighbors because it is purely defensive and preventive against external threats.

85. Secondly, the forward deployment of U.S. Forces in Asia including South Korea is a part of U.S. military strategies to protect her national interests.⁹² The U.S. foreign policies are formulated by her own decision-making process, not by Pyongyang's needs or crying. It is believed that North Korea is not in the position to intervene in U.S. domestic politics. If North Korea wants to justify its position, do come to the world community immediately by respecting international norms and rules through transparency, and try to persuade the leadership of Washington. They are always ready to listen to various voices from different interest groups.

86. Thirdly, the DPRK had a similar treaty with former Soviet Union though the Russian Duma refused military commitment on the Korean peninsula. It was unfortunate to North Korea for the USSR and its satellite countries fell down in early 1990s, but no countries did force Pyongyang to

join the communist block for self-defeating. The disappearance of Marxism on the earth is a natural course of truth and justice which North Korea cannot control. It must be unfair and not acceptable to Seoul if the loss of Pyongyang's opportunities should be a cost of South Korea.

87. In fourth, Pyongyang has spent several years by arguing the U.S. Forces in South Korea, which is the long-standing reality not-negotiable. It is not a smart strategy in negotiations to waste time without any gain. Pyongyang should understand that the United States is the only superpower to maintain the world healthier in the post-cold war period. No country can take advantage by fooling the United States without paying appropriate prices. Look at Cuba, Libia, Iran, and Iraq. They are still paying the price for their misbehaving. The leader who loves his people must be smart enough not to be a leader of those terrorist countries threatening and killing innocent peoples. If there are no proper price payments such as U.S. air strikes or economic sanctions for their wrongdoing, the world is unable to maintain its law and order for most of the peace-loving nations and their peoples. Pyongyang may know well what its transcripts have indicated.

88. Finally, KMC wrote that "the Korean people suffered at the hands of foreign forces," implying that the South Korean people suffered at the hands of the U.S. Forces. This is not true. Remember that fifty thousand of young Americans were killed in combat activities during the Korean War to protect freedom and liberty of Koreans against communist aggression. Most of South Korean people highly respect and deeply appreciate for the sacrifice of U.S. citizens for democracy, which is now blooming in the country as shown in the recent presidential election. The ROK people cannot forget U.S. economic aids during the reconstruction period after the war. Even in the recent financial crisis in South Korea, the leadership of the United States has strongly supported to solve the problem properly.⁹³ So the KMC's term of "suffered" has no foundation from the reality.

(c) A Permanent Peace Mechanism

89. The Agreement on Reconciliation, Nonaggression, and Exchanges and Cooperation Between the South and the North entered into force as of February 18, 1992. The Article 5 in this Agreement defines "The two sides shall endeavor together to transform the present state of armistice into a solid state of peace between the South and the North and shall abide by the present Military Armistice Agreement (of July 27, 1953) until such a state of peace has been realized." This means that there is no reason for the DPRK to violate the Armistice Agreement in the DMZ. However, Pyongyang violated the Agreement by withdrawing its representatives from Panmunjom and by pulling its combat forces into and out from the DMZ several times in 1995. Making noises, the DPRK began to demand a US-DPRK peace treaty to replace the present armistice agreement.

90. At the Cheju Summit in April 1996, U.S. President Bill Clinton and ROK President Kim Young Sam announced that they had invited DPRK and PRC "to join four-way talks at replacing the armistice agreement...with a permanent peace settlement." A solid state of peace mechanism was desirable and was already agreed in 1992 between the two Koreas. Pyongyang delayed its commitment with the proposal by demanding more foods, removal of U.S. economic sanctions, and some more. In fact, there is no reason why Seoul and Washington hurry to push Pyongyang

to come to the proposed peace talks if it does not want to cooperate. The time is on the side of proposers when North Korea is on the losing ground due to economic difficulties.

91. The United States has been a strong ally of South Korea since 1950. If Washington agrees a peace treaty with antagonistic Pyongyang against South Korea, it must be a double deal breaking the long-standing alliance agreement, which is not politically and diplomatically acceptable. As the DPRK wanted, the nullification of US-ROK military alliance can make the deal possible, but this is against the U.S. national interests. In other words, the best peace mechanism on the peninsula to replace the armistice agreement must be a DPRK-ROK peace treaty guaranteed by the United States and China. It is desirable for North Korea to be a U.S. friend and to join the world diplomatic community. Welcome to Washington anytime with qualification! This would be the first step for Pyongyang to be a member of the world community following the norms and rules.

92. The fundamental role of the United States is to maintain peace and prosperity in the region as a balancer or a honest broker sometimes. It must be a wrong idea that Pyongyang can control South Korea through the United States, which is not acceptable to the South Korean people. It is similarly not acceptable to Pyongyang if South Korea tries to control North Korea through China or Russia. If Pyongyang wants to be treated sincerely by the South, it should treat Seoul honestly without tricks. John Lock said that a state of equality lies in "all the powers and jurisdiction is reciprocal, no one having more than other."⁹⁴ It is essential for the Pyongyang government to do the same for Seoul as it wants to be treated by the Seoul government.

93. KMC wrote "Korea for the Koreans and by the Koreans, who will become masters of their own life and destiny," which justifies the meaning of an inter-Korean peace treaty. Pyongyang wants Korea to be unified by Koreans, but intentionally avoid talks with Seoul for an inter-Korean peace treaty while seeking a peace treaty with the United States which is not feasible. This is contradictory to the above hypothesis of "Korea by the Koreans" that KMC has been insisting on in his arguments. If the DPRK wants to be royal to its mentioned theory, peace talks between the two Koreas should be the first and main and talks with neighboring countries should be a supportive role.

94. Pyongyang had sweet experiences in negotiations, particularly for the Agreed Framework signed by Washington and Pyongyang without Seoul in late 1994, though South Korea agreed to pay two-third of total construction cost for the two Light Water Reactors currently being built in the North.⁹⁵ It was the United States to spoil the DPRK to be a bully. Washington has fed milk with mostly the Seoul's cost whenever Pyongyang cried. However, the previous errors gave us a lesson not to make the same mistake: no freer ride and let them pay reasonable prices.

(d) Human Rights and Human Values in North Korea

95. I agree with KMC that "the first consideration in human values is not material but spiritual and cultural." Of course, wealth is not the end but a means of living. However, death from famine

having experienced in the DPRK is a tragedy not a virtue. The ideal of Karl Marx was in the equality of the people. Soviet Union started to exercise the Marxism by proletariat dictatorship equipped with the theory of class struggle.⁹⁶ The system could not exercise democracy properly, and the power was monopolized by the head of communist party, which ironically destroyed the Marx's ideal of equality in politics. Equality could not stay with proletariat dictatorship.

96. The concept of political equality was applied for income distribution, which was not based on productivity but on the party position. The lack of competition in the system reduced workers' motivation, productivity, and efficiency gradually. The class struggle jeopardized cooperative team sprints. The lack of feedback interrupted self-adjustment function. So, the ideal of the system made the people equally poor. This is not much different from the reality of the DPRK. The wrong choice of sprints from socialism caused a shortage of materials. Therefore, the KMC's comment on materials and sprints cannot be generalized.

97. Meanwhile, capitalism has enjoyed the fruits of a free market economy under the democratic political system despite some costs of trial and errors. The competitiveness of goods and services in the market is essential to raise economic efficiency. Foreign trade expands the production possibility frontier and expedites the mobility of capital and labor owing to rapid technological development. Increased average per capita income creates a high quality of life despite the conflict between efficiency and equality. If the system pursues more efficiency, it may lose some equality. If the system pursues more equality, it may lose some efficiency. We might be happier if we put two-third of policy weight on the efficiency and remaining one-third of that on the equality (implying more weight on the efficiency than equality).⁹⁷ In this sense, the KMC's dichotomy theory made me uncomfortable. The optimum may remain somewhere between materials and sprints.

98. As argued in my first comments, I have been confused in humanitarian aid to a nation having lack of humanity like the DPRK. The dictatorial ruler may consider the importance of sprints in terms of royalty to maintain the regime. However, the royalty to the party dominated by one individual, have killed thousands of thousands of people through starvation from famine, public execution without fair trials (even judges are not qualified), and many labor camps.⁹⁸ KMC proudly wrote that the DPRK has no opposition force, which is not natural in the open society. We have to have opposition parties with different voices in politics, economy, and society. "No opposition force" means no freedom and liberty in the DPRK. If this is the value of KMC insisted, he must be invited to Seoul or Washington in the middle of street demonstrations organized by labor unions. Thus, Pyongyang has no value of human rights enjoying freedom and liberty, and no material prosperity, then what are the values of sprints in North Korea which KMC argued in the whole paragraph?

99. However, I am glad to hear that Confucianism revived under the rule of Kim Jung-il. The party royalty was more important than the blood linkages in the early stage of power consolidation in the DPRK. Many property owners and intellectuals were purged by the report of their followers, and the parents were jailed by their children's reporting of the lack of royalty to the party as

evidenced in the Red Guard in China. The theory of class struggle requires that a family member well equipped by the Marxist ideology should report his father's ideological corruption to the party immediately. If the family value is the first and the ideology is the second by inviting Confucianism under the new regime, it must be a fundamental change of socialist ideology in North Korea. Jiang Zemin wrote "Promote the fine ancient moral heritage and revolutionary moral heritage of China; absorb all the excellent moral achievements of mankind; strive to build an advanced spiritual civilization of mankind."⁹⁹ Was there any ideological influence on Kim Jong-Il from Jiang Zemin's thought? Is the royalty to Kim Jong-Il less important than that to the family in the DPRK?

100. One of the most important values in the world community is to respect and to follow the commonly agreeable norms and rules. The United Nations have asked North Korea to provide the transparency mechanism to the UN inspectors to see fair distribution of food aids, but Pyongyang refused the request in order to hide its violations by delivering aided foods to core party members and military units rather than to needed people around the country (which has not been confirmed, but seems to be a prevailing opinion in various discussions). Transparency is one of basic norms, rules and obligations for any country to receive external food aids, but Pyongyang did not follow the rules by making its people hostages of famine. I want to hear the justification from KMC.

VI. CONCLUSION AND RECOMMENDATIONS

101. ECONOMIC REFORM MEASURES: The financial crisis in South Korea was a situation of foreign exchange shortages, so the country was unable to repay its external debts. The problem was solved temporarily through IMF rescue and restructure of short-term debts owing to the support of U.S. leadership. The crisis was caused by a continuous trade deficit, Won appreciation, currency devaluation in neighboring countries, sudden withdrawal of foreign funds, short term loan structure, inefficient business investment, and poor government management. Since the economy has lost efficiency, the country cannot sustain the burden of debt repayments without structural reforms by fixing three monopolies in the system. The ROK government should introduce the primary election in politics to remove a political monopoly weakening checks and balances, which will prevent corruption and will recover efficiency in the system. The Chaebols should eliminate monopoly power in the market through transparency, no cross-finance, ownership-finance, and streamlining of business, which must be enforced by laws. The labor market should be flexible by removing layoff prohibitions, which will improve business efficiency and will attract foreign capital.

102. GROWTH AND DEMOCRATIZATION: As the economy grows with foreign trade, society gradually moves toward democracy. Rising education and training awaken people toward ideals of freedom and democracy. Trade expansion and technological development accelerate the flow of information despite government control. Accumulated wealth widens the middle-income class paying more taxes and demanding more political power. The internationalization of the economy becomes sensitive to external pressures from human rights groups, which expedites democracy. On the other hand, the East Asian model of economic development gives the following lessons. Democracy is essential to maximize capitalistic efficiency due to lesser intervention costs with fast

feedback adjustment. The balance between political evolution and economic growth is desirable to minimize adjustment costs caused by lagging subsystems. The economic development plans were efficient in the early stage of takeoff, but created more problems in the later years when the economy became complicated. The East Asian model pursuing the export-led growth strategy is the best choice, and the financial crisis is one step in economic development. The structural reforms are an adjustment cost South Korea has to pay in the process of modernization.

103. GROWTH AND NATIONAL SECURITY: Economic development and national security are closely interactive. Peace and stability are a necessary condition for economic growth, while the healthy economy provides necessary expenses for national defense. If the government spending exceeds the level that the economy can pay, the economic system will face bankruptcy and the political system will collapse as shown in the USSR in 1991. The North Korean economy is at near collapse, dependent on external aid. If Pyongyang diverts resources from military spending to private sector for grain purchase, its people can avoid starvation from famine. Pyongyang has faced a dilemma: openness threatens the regime's survival due to freedom waves, but the economy cannot revive without external trade. The regime's strategic choice for survival lies in the strategy of balanced soft landing which means multi-dimensional, simultaneous, and gradual transformation of the system. Now is the time for Pyongyang to engage with Seoul for economic cooperation when the new administration begins with its own economic difficulties. The constructive engagement of the two Koreas is the best strategy for both sides and all neighboring countries.

104. 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 through structural adjustment within a couple of years. The DJ leadership has been successful in facing the financial crisis but should pay attention to the following. Firstly, the leadership must have a strong reform mind with aggressive driving forces. It is hard to change old habits. DJ should keep in mind that Chaebols never want to lose previous favors because they are ruthless profit takers. Secondly, the inner circle of leadership should not be corrupt for any reason as experienced in the previous administrations. The people should closely watch the properties of DJ and related individuals. Thirdly, time is essential in structural reforms and economic development. Do expedite the reform process in government as well as in business. The invested asset values are depreciated while interests on foreign debts grow day by day. Finally, Seoul should not confuse nationalism with patriotism. Purchasing Korean stocks by foreigners is desirable and better than bank loans. Nationalism hurts the economy in the age of globalization, which is not patriotic.

105. RECOMMENDATIONS TO PYONGYANG: As discussed, the constructive engagement between the two Koreas is the best choice for Pyongyang's revival. Firstly, North Korea needs outside help for grains and crude oil. This situation will remain until the economy is restructured with intensive investment. South Korea is the first nation to supply capital and technology for the DPRK's economic revival. Secondly, South Korea has faced its own economic problems, which will be recovered within two years. The DJ administration is ready to allow businesses to invest in North Korea without political conditions. Seoul does not want Pyongyang to collapse, and to take

over the heavy burden of investment and employment. Finally, the United States has supported the constructive engagement of Seoul with Pyongyang, China has favored the conciliatory approach, and Japan and Russia have been in the same line. The year 1998 should see a peace agreement between North and South Korea guaranteed by the United States and China.

106: EFFICIENCY AND EQUALITY: The economy pursued efficiency to get more profits while politics try to accomplish equality to get more votes. Socialist countries give major importance to equality while the capitalist countries emphasize efficiency in the system. Efficiency is linked to productivity and competitiveness in the economy, but equality is linked to affirmative actions to protect minority groups, which may reduce efficiency in the system. The conflict and tradeoff between efficiency and equality must be managed. The labor unions in South Korea have forced rising wages, which reduced competitiveness and exports. This lowered employment and income, which was returned to workers as feedback. South Korean workers may lose around 20% of wages in the next two years if they do not lose jobs. The government and labor leaders should be smart enough to find the optimal point of wage negotiations. If the goal of equality damages that of efficiency, the whole industry may disappear just like the USSR which pursued equality first and efficiency second. In the age of capitalism and globalization, the survival strategy lies in efficiency first (three-quarter), and equality later (one-fourth). The theory of “more efficiency and less equality” is applied to all countries including transition economies such as China and North Korea.

ENDNOTES

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1. See the worldwide web of http://www.nautilus.com/fora/13b_peacepolicy.html published by the *Nautilus Institute*, Berkeley, California for the first debate between Kim Myong Chol and WheeGook Kim on “Kim Jong-Il’s Peace Policy.”
 2. Staff, “Yet Another Shock to South Korea’s System,” *The Economist*, May 24-30, 1997, p. 37.
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acceleration of the program, however, confidence has gradually improved.” Staff, “IMF Evidently Successful in South Korea,” *Digital Chosun Ilbo*, February 3, 1998.

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12. Stephen E. Frank, "South Korea, Creditors Agree to Restructuring of Loans," *The Wall Street Journal Interactive Edition*, January 29, 1998. Timothy L. O'Brien, "Banks in Accord to extend \$24 Billion in Korea Loans," *The New York Times on the Web*, January 29, 1998. Staff, "Major Agreement of Foreign Debt Negotiations," *Hankuk Ilbo from Korea Link*, January 29, 1998.

13. WheeGook Kim, "Alternative Growth Strategies of North Korea: Lessons from Experiences of South Korea and Taiwan," presented to the 1996 Annual Convention of *Allied Social Science Associations* in San Francisco, California on January 5-7, 1996, *EWRI Monograph*, pp. 3-6.

14. WheeGook Kim, "Openness, Coexistence, and Peaceful Unification (Series #4 of 6)," *Hankuk Ilbo (Washington)*, August 9, 1994.

15. Park Jong Sang, "Business Restructure, Lee Gun Hee's Personal Property Capitalized 1,380 billion Won," *The Internet Hankuoreh*, January 21, 1998. Samsung announced 10 billion Won

of donation for unemployment funds to be used for the groups' layoff.

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