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Korea and the World Economy –Economic Development Experience of Korea and Its Future Policy Agenda*

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Korea has drawn worldwide attention for its unprecedented economic growth and recent financial crisis. A unique Korean style 'developmental state model' approach has been often cited as a root cause for both success and failure of the Korean economy. This paper shares similar views with it in principle. It has been analyzed that the government-led economic operations functioned efficiently in the early stages of economic development but created low-efficiency and high-cost economic structure at later stages. For this reason, even before the outbreak of the crisis, the neoclassical principle has been suggested to replace the traditional development model approach. The IMF policy recommendations were also based on the neoclassical doctrine. The main argument of this paper is, however, that extreme neoclassical strategies can not be a successful substitute for the statist model approach in Korea. The so-called 'advanced state model' approach is suggested instead as an alternative.

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1. INTRODUCTION

Korea is a small country located in the far eastern part of Asia, but has drawn worldwide attention from policy makers as well as scholars for its unprecedented economic growth.

Korea has taken a firm position as one of the most successful developing countries, even though its glory may have been tarnished somewhat by the 1997 financial crisis. As of the end of 1995, Korea was the 12th largest economy in the world and the 12th largest trading nation at the same time. Since the end of the Korean War, per capita GNP had risen annually over 7% until the nation was hit by the crisis in 1997. Korea even became a member of OECD in 1996, which was a testament to the advancement of its economy.

It is thus quite interesting to investigate how the Korean economy has been transformed from an underdeveloped economy to one of the most rapidly growing economies in the world over the last fifty years, and then suddenly came to experience a dramatic financial crisis.

Doubt has been cast on the Asian development model since major East Asian countries (including Korea) were caught by the so-called East Asian economic crisis. Dispute on the East Asian economic miracles has become a hot issue. Whether the recent economic crisis is a sign of the limits of growth in Asian countries or just transitional phenomena in the development process that requires structural change remains to be seen. A study on the Korean economy becomes all the more important in this regard.

2. HOW TO APPROACH DEVELOPMENT PROBLEMS OF LDC'S

Economic development can be seen in many different ways. Some (the neoclassical tradition) recognize economic development simply as the increase in real income per head, and see that GNP rises as the result of the long-term effects of capital formation, labor expansion and technological change. Others like Amartya Kumar Sen (2001) define development as a process of enhancement of various forms of human freedom. In any case, we often say that human history has accomplished continuous development. Development can thus safely be seen in this respect as the improvement of human welfare, i.e. betterment of mankind's standard of living in both materialistic and mental aspects. Economics is then, a systematic logic on how to improve human (materialistic) living conditions.

LDC's have studied economic development processes of advanced countries in order to learn about their economic development and the establishment of capitalistic civil society as well. However, most of these studies and economic development theories have concentrated on the economic growth aspects of already established capitalist countries. They have neglected the development process of capitalism, especially in the transition from the pre-capitalistic or feudal society. It is obvious that the simple plantation of advanced economic systems cannot successfully settle down in LDC's, whose economic conditions are not yet fully matured enough to absorb Western style full-fledged capitalism. Many traditional approaches are misleading in this respect. Thus we need a model that can complement the drawbacks of such analyses, and interpret LDCs development problems more properly.[1)] With this notion in mind, let us briefly review leading development models such as the economic development stage model, neoclassical model, structural model, neo-Marxian model, etc.

[1)] Traditionally the economic history of the English economy has been a standard model to study since it created capitalism for the first time in the history of mankind. It served as a good reference for the second generation industrial countries such as Germany, France and so on. Development experiences of the advanced countries have not worked successfully, however, for most LDC's where the capitalistic system was introduced through colonization. In other words, their economies had been incorporated into the capitalistic world and were dependent on the economies of the advanced countries. In addition, non-economic factors have often played a more important role in their economy. Consequently a new development model has been sought which can serve as a proper reference for these LDC's. Recent tendency has been to find a successful economic development experience among LDC's to this end. The Korean development process has drawn great attention in this endeavor.

2.1. Economic Development Stage Model

The traditional development stage model of the 19th century connected societies of different development stages in historical order by differentiating them according to their characteristics. In fact, they did not offer any explanation on the cause of transition between neighboring societies. In addition, their version of societal characteristics was in general oversimplified and thus could not provide proper explanation for diverse areas and societies.

In the 20th century, modern stage models were presented by W. Rostow, P. Kuznets and C. Clark, which have been evaluated as an improvement over old development stage models. For example, Meier (1995) saw Rostow's work in particular as provocative application of a stage approach to the course of development, by pointing out that his model was a dynamic theory of production which emphasized the composition of investment and the growth of particular sectors in the economy. In fact, Rostow argued that the growth of certain leading sectors would be instrumental in propelling the economy forward.

Nevertheless, the basic feature of any stage theory of long-term economic change still assumes that the sequence of stages succeeds in such a way that first, distinct time segments of a historical order are characterized by different sources and patterns of economic changes; second, these segments succeed specifically so that 'b' cannot occur before 'a,' etc; third, succession of these segments is the process of development and growth rather than of devaluation and shrinkage and the process of a uni-directional rather than cyclic view of history.

In short, stage models implicitly assume that all economies pass through the same individual stages in order as they develop. In addition, since they prescribe a sequence of stages as an inescapable law of economic development, even in the process of decline, the return to a previously experienced stage level or recurrence of an earlier stage can not be viewed. It is highly improbable that such a simple design can be a sufficient summary description or a plausible analytic classification of the vast and diverse field of historical change.[2)]

To recapitulate, stage models in general do not provide any logic of causal relation to explain the succession of stages. Furthermore, they cannot provide any description of a society which could succeed in the future, no matter how they define a modern society. On the other hand, although W. Rowtow and A. Gerschenkron may avoid some of the general criticisms of traditional stage models, their models simply concentrate on the transition toward industrialized society from traditional and underdeveloped ones. They simply described the degree of economic backwardness based on the characteristics of stages and presented prerequisites of industrial development. Further, their models can hardly avoid the criticism that they neglect the details of pre-modern societies unlike the old traditional stage approach. From all the considerations made above, we can conclude that the stage model approach in general cannot provide sufficient and specific guidance for successful economic development of LDC's.

2.2. Neo-Classical Approach

The neoclassical tradition recognizes economic development as the increase in real income per capita, and sees that GNP rises as the result of the long-term effects of capital formation, labor expansion, and technological change, which are assumed to take place under conditions of competitive equilibrium.

Coupled with the influence of Keynesian economics, the formation of capital began to be considered as the single most important factor for

[2)] A critique of the stage model approach is well summarized in Meier's text (1995) as follows. "Stage making" approaches are misleading when they succumb to a linear conception of history and imply that all economies tend to pass through the same series of stage. No single sequence can fit the history of all countries. In fact, the notion that every economy always follows the same course of development with a common past and same future is to over-schematize the complex forces of development. The truth is that a country may attain a later stage of development without first having passed through an earlier stage. On the other hand stages need not be understood as mutually exclusive, since characteristics of earlier stages often become mixed with characteristics of later stages.

economic growth. In consequence, in the Harrod-Domar model, which occupied center stage in the late 1940s and early 1950s, a strict link between the growth of the capital stock and the consequent growth of potential output was assumed, which was its dominant characteristic as well as its ultimate flaw. It was an assumption that was imaginable only when a market price system could work smoothly; this was definitely unrealistic in LDC's.

Nevertheless, this extreme vision that physical capital accumulation was the only ultimate source of economic growth under the assumption of right market conditions, was able to gain worldwide acceptance for some periods of time, due to the notion that the marginal product of labor was almost zero due to extreme labor surpluses in the LDC's.

It was, however, discovered that the above logic could not be backed up by sufficient empirical support. When factor earnings were used as measures of the contributions of productive factors to the process of economic growth, a substantial amount of growth remained unexplained. And, efforts were made to find out contributing factors to the unexplained part of the output growth. The most reasonable initial guess was that technological progress might be responsible for that part. It was, however, quickly recognized to be a composite of effects of many different factors such as (1) improvement in the quality of labor through education, experience and OJT, (2) reallocation of resources from low-productivity to higher-productivity uses, and (3) realization of economies of scale, etc.

Consequently the development economists went beyond their (neo)classical predecessors and suggested central planning for efficient capital formation with a distrust of markets and a belief of pervasiveness of market failure. Further, coupled with pessimism regarding the external conditions of development of primary-product exporting LDC's, unbalanced growth strategy, suggested by A. O. Hirschman, began to be in full swing in development literature, putting the neoclassical tradition aside. Such a tendency brought about a structuralist approach to development problems later on.

2.3. Structural Analysis

The structural approach has not been successful in presenting the same rigorous formulation as the traditional general equilibrium theory, although it has provided a basis for empirical analysis. The essence of this line of structural analysis can be summarized as follows:

(1) Structural analysis may be more suitable for the development of LDC's, since disequilibrium phenomena are more significant in LDC's than in DCs.
(2) Thus it can establish the importance of moving resources from less productive sectors to more productive ones, for example, from agriculture to industry. These shifts are considered as more important sources of growth in LDC's than the mere increments to input factors.
(3) In addition to neoclassical sources of growth and resource reallocation to higher-productivity sectors, the structural approach also suggests reduction of internal and external supply bottlenecks, and exploitation of economies of scale, as efficient ways to provide a potential for accelerating growth.
(4) Learning by doing or importation of more productive technology available from advanced countries is also considered as another channel of productivity improvement and consequent economic growth.

On the basis of such analysis, many empirical studies have been done, with their emphasis on the effects of disequilibrium on economic growth, i.e., the economic consequences of reallocation of labor and capital, growth of exports, and capital inflows, etc. In short, while neoclassical models emphasize increments to production inputs, investment in human capital and technological progress, structural approaches concentrate more on supply bottleneck problems (to cure market failure), infrastructure build-ups (to generate a spill-over effect), export-oriented industrialization, and a shift of resources to more productive sectors. Active government intervention in the economy has been suggested, not only to correct market failures but also to restore the role of market prices.

2.4. Neo-Marxian Approach

Based on the fact that LDC's were inserted into the international capitalist system through colonization, and that exterior economic conditions for them were disadvantageous, making it difficult to achieve economic development, critical views on neoclassical approaches to development such as dependency theories of underdevelopment have risen in Latin America. The dependency school argues that there exist asymmetrical power relationships between the center (the U. S., Western Europe, etc.), previously the imperial powers, and the periphery, previously the colonies, and that the major source of underdevelopment is dependency of the periphery on the center. Thus underdevelopment of the periphery has been considered as the Siamese twin of development of the center. Further, dependency economists argue that even though LDC's can achieve some level of industrialization, they are still dependent on the superior power of the advanced countries, and thus they (the periphery) are still exploited by the world's real power (the center) — by biasing production structure toward the supplying of raw materials, by aggravating terms of trade and balance-of-payments, and by thwarting autonomous national development. By characterizing center-periphery trade as "unequal exchange," dependency theorists even contended that capitalistic development of presently advanced countries has been achieved at the expense of others, i.e., the underdevelopment of the dependent periphery.

Whether policy inferences of Marxist approaches are extreme or not, they are lacking in specifics and thus cannot serve as a substitute for the traditional approaches. In addition, most of their policy suggestions could not bring about favorable consequences in reality either. Furthermore, they came to lose their ideological ground as the socialist economies had collapsed by the turn of 1990. Historical experiment of socialism turned out to be a failure, although it contributed to human history in many ways especially in terms of the discussions on equity problems.

2.5. A New Analytic Model of Economic Development for National Economies

By reviewing neoclassical, structural and alternative approaches to economic development, we have found that even an extended version of those perspectives still have some limitations in one way or another to serve as a proper reference for LDC's. For example, stage-making approaches are misleading due to their linear conception of history, which is postulated based on distinctive segments of succeeding societies in a specific order. They cannot avoid criticism at the same time that no logical interpretation for causal relationship is provided to explain succession between neighboring societies. Neoclassical approaches turn out to be much more systematic and logical than stage models, but depend on unrealistic assumptions, especially for LDC's, such as perfect market, flexible prices, etc. Shortcomings of neoclassical models have thus often been overcome by considering structuralist perspectives as a complement. On the other hand, neo-Marxist perspectives, suggested as an alternative approach in the form of dependency models in areas like Latin America, failed to provide successful policy inferences for LDC's due to their inherent drawbacks in logic.

More sophisticated development models have been suggested recently to make up for some of the shortcomings of previous models. Some improvements have been made in this endeavor; i.e., Rostow's model over traditional stage models, a new endogenous growth model over neoclassical perspectives, etc. On the other hand, much literature has built up on issues such as modernization strategies, late-comers effect, flying-geese pattern of growth (or catch-up theory) and limits to growth in LDC's at the same time. In spite of these efforts, we still need to establish a new analytic model in order to properly analyze developing national economies.

It may not be easy to build a model, which is based on proper causality-oriented logic to explain the development of human history, but we may be able to minimize the shortcomings of existing models and properly consider socio-economic characteristics of LDC's, and still provide a systematic and realistic analysis as well as policy implications. Elsewhere I developed a new model by incorporating the Marxist perspectives and Max Weber's methodology in part, in addition to staging model logic. In other words, the model, though based on the stage model approach in principle, was built in such a way to provide causality-oriented logic based on the Marxist and Weberian views.

Since the main argument of this paper is not for the debate on development models, details of a new approach will not be introduced here. I will thus briefly summarize the main features and conclusive ideas of the model as follows:[3)]

First, evaluations on economic development should be made on the basis of the degree of welfare improvement rather than the contents of environmental or institutional change,[4)] since development can be seen as the improvement of human welfare, i.e., betterment of the living standard of mankind both in materialistic and mental aspect.

Second, the root cause or motive of the development of human history originates from the ownership and control structure of key production means, and the consequently resulting mode of production, which will determine the level of economic efficiency and equity attainable. In other words, economic development basically depends on who owns key production inputs and how to produce with them.

Third, the decentralization process of ownership has contributed to the enhancement of both economic efficiency and equity, since a greater number of owners will have more incentives to exploit and to share consequent

3) See Lee (1993, 2002) for details.

4) As mentioned at the outset of this chapter, human history has achieved continuous development and thereby improved human welfare. Again, here, development means improvement of living conditions, human rights and so on. Consequently we need to approach economic development problems from the human welfare aspects.

benefits.

Fourth, key production means that have played a major role in transforming societies have appeared in the order of 'natural resources', 'land' and 'physical capital' and is now moving toward 'human capital'.

Fifth, it is difficult to provide proper explanations for development patterns of different times and areas, since economic development is to be realized in diverse forms and orders, depending on the characteristics of cultural values that are formed based on some economic environments, institutional habitats and customs, etc.

Sixth, a new system emerges with leading production modes that can lead a new period with improved efficiency, where the basis of existing systems is relatively poor.[5)]

Seventh, once any successfully established economic system emerges, it will influence other remaining systems and areas with pressure for change. In spite of the pressure for change from the leading economic system, there are many areas that are not capable of incorporating a new paradigm into their systems. Some areas may skip some of the usual development stages or may experience others totally different from the leading ones. In any case, those areas which cannot adopt a leading economic system have to remain as relatively underdeveloped areas.

With all the ideas developed in the new model, which is a revised version of the development stage model, we can provide logical interpretation for casual relationships to explain the succession between neighbouring societies. In addition, it can provide proper explanations not only for the development processes foregone, but also those to be realized in the future.

On the other hand, the new model recognized capitalistic society as the one that contributed to the enhancement of human welfare and freedom (compared to the preceding feudal society), and the establishment of modern

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5) Note that a new economic system emerged at side areas of the existing one, not at the center of it. For example, the feudal system was initiated at the edges of the fallen ancient slavery society, capitalism, outside of the feudal strongholds, and socialism, as the way out of the capitalistic countries. Also we need to know that the western economic system could settle down easily in Japan, which was side areas of the main Oriental civilization.

civil society. Further, capitalistic society was a physical capital-oriented society, but capital ownership has been decentralized as more people and organizations have become shareholders in its development process.

3. HOW TO INTERPRET THE KOREAN ECONOMIC DEVELOPMENT PROCESS: CME SYSTEM

What was left following the devastating exploitation by the Japanese and their sudden departure, the division of the nation and the subsequent Korean War was total despair and hopelessness. Korea had neither capital nor an institutional basis needed for industrialization. It was an impending task for Korea to initiate capital formation and to establish a market economy system. The active role of the government was badly needed to accomplish this job.

From the 1960s, Korea embarked on an ambitious economic development plan with the hope of cutting off the prolonged vicious circle of poverty and to pave the way for the nation's industrialization. In order to accomplish this objective, Korea prioritized first of all the building of social infrastructure and key industries to solve the so-called supply-bottle-neck problem. In addition, Korea adopted an export-oriented industrialization strategy, but with borrowed capital from abroad due to the lack of domestic capital formation. To make the best use and efficient mobilization of limited resources, Korea pursued a sort of unbalanced growth strategy through government-led economic management.

With higher rates of economic growth than planned in the 1960s, Korea began to place major policy effort on upgrading the industrial structure from light industries to heavy and chemical industries (HCI hereafter) for sustainable export and economic growth. Strong incentives were provided to a wide range of HCI through the so-called policy financing. By the end of the 1970s, however, Korea began to realize that extensive and excessive government intervention in resource allocation could be counter-productive due to its inefficient nature and consequent economic complications. Thus, major policy priorities were given to anti-inflationary economic stabilization, economic liberalization and partly to decentralization in the 1980s. Industrial incentives were reformed, while regulations on the financialsector were relaxed. In addition, the competitive market was emphasized and promoted with reduced restrictions and regulations, and with decreased international trade barriers.

The Korean economy began to face new challenges in the late 1980s. In the course of rapid economic growth, there was a growing perception among people that distributive equity had been aggravated and the basic needs of people were not adequately met. In addition, investment in social infrastructure also turned out to be inadequate to support continuous economic growth, since production costs, especially the cost of logistics began to soar up in consequence. Furthermore, as the competitiveness of Korean exports began to lose its ground to a substantial degree due to rapid increases in wages and the appreciation of the won, industrial restructuring became an urgent task.

In the 1990s, the rapid development of information and communications technology and the birth of the WTO brought about unlimited global competition and deepening integration of the world economy. In order to survive and prosper in this environment, Korea had to step up its self-motivated globalization efforts with deregulation geared to promoting competition and harmonizing domestic institutions with international rules and regulations as well as the acceleration of industrial restructuring.

The government, however, is understood to have failed to introduce appropriate measures in time in spite of the emerging symptoms and evidence of the crisis.

Now, the problem is how to interpret such a development process in Korea. I would like to interpret it as the establishment, development and waning process of the Centralized Management Economy (CME) system, which represents the Korean style government-led economic operating system.

The terminology, Centralized Management Economic System, is employed in this paper to describe characteristics of the Korean economic development process. With this term, I try to emphasize the role of the government (or political power group) and its bureaucrats who played a leading role in establishing economic development plans and executing policy implementation. I also try to emphasize the fact that managerial control power of the government and bureaucrats played a larger role in the Korean economy than the artificial or legal ownership. In other words, business firms were privately owned, but were managed by both government and private owners. Some people (Kim and Kim, 1995) even say that the government had a superior position over private owners, since the government controlled all the financing channels.

Since the 1960's, the economic development plans have been carried out with a strong leadership of the government. It led the process for creating, managing and accumulating capital and then achieved economic development based on that.

At any rate, due to the above feature, from the very start the development plan became a sort of enforcement plan, unlike the indicative plan which was adopted by most other LDC's. Since the success of the enforcement plan depends on whether the major objectives or goals of the plan are successfully fulfilled or not, it necessitates strong control of the government. In fact, the military government specifically defines the system they want to build up as "guided capitalism." This means that all the important decisions on economic planning and policy implementation are made by the superstructure, the central government. It also implies that government will actively intervene in private sector economy whenever necessary.

Economic development policies and strategies are, in general, implemented, depending both on international and external conditions. The degree of modern institutional establishments, the degree of the current stage of development, and international economic environment are the major items to be considered. The model that Korea and many other LDC's chose was the so-called 'development state model' approach, in which a strong state is essential for economic growth. And the model that Korea built assumed one of the strongest governments by establishing the CME system.

Rodrick (1995) emphasized the fact that the government played the crucial coordinating role in Korea to encourage private (and public) investment in sectors where market allocation of resources would have failed. He also pointed out that this government-led model of development was rather successful in mobilizing and allocating resources until the 1970s. Over the years the effectiveness of this structure waned progressively, however, in the rapidly changing market and environments of the 1980s and 1990s.

In fact, the shift towards a more market oriented economic system has been under discussion in Korea during the last decade. Some reforms were implemented and Korea was also forced from the outside world to begin opening its domestic market to international competition. However, the implementation of reforms was slow and its impact on the economic system was marginal. When the 1997 financial crisis hit the country, it gave a tremendous ordeal to Korean people, but at the same time an opportunity for real change in the Korean economy and society as well.

4. STATIST VS. NEO-CLASSICAL MODEL

Since the early 20th century, the government is believed to have played a proper role as a corrector of the market failure such as inequality, great depression, etc. The importance of the government role was, however, emphasized more strongly in LDC's, which came to adopt the market economy system through the colonization process by the world powers. Since the market economy system was established when its natural development was not foreseen, and yet an escape from the absolute poverty, and an engagement of the economic development through industrialization were on urgent agenda, the leading role of government was seen as indispensible.

The elimination of supply bottlenecks was needed in the initial stage of development to break through the vicious circle of poverty. Only the government could accomplish this by expanding public expenditures extensively on SOC's (roads, ports, railroads, etc.) and key industries (electric power, fertilizer, cement and construction industries). It was also improbable for private sectors to raise enough funds needed for industrialization from domestic sources, and thus government intervention appeared inevitable.

Under these circumstances, Korea aimed at economic development through export-oriented industrialization, with borrowed foreign capital to be invested in specific sectors (a disequilibrium growth approach) and under strong-government directed economic development plans, i.e., the so-called CME system. It was natural for the government to take a leading role in establishing consistent and systematic economic development plans, when an autonomous establishment of the market economy system was improbable and yet the need for modern industrialization was imminent. The situation was similar in most of the LDC's. NICs were the most successful countries to accomplish fast economic growth with this line of policy principle. For this reason, aggressive intervention of the government in the market has been singled out as a leading contributing factor to economic success in this region. Following the financial crisis, however, doubts were cast on the government-led economic development strategies. Consequently, Korea began to move away from the old principle in its pursuit of economic reforms. The question is whether the government-led economic policy doctrine has become an old norm to be sublated.

A strong supporter of the strong developmental state model approach, Johnson (1994) emphasized the existence of a small group of elite decision makers, especially elite economic bureaucrats to play the role of pilot agency. As a matter of fact, they functioned as a think tank to initiate economic development in Korea. In this process, they constantly made decisions on which industries to maintain or to relieve in order to maintain international competitiveness. Johnson termed this as "soft authoritarian societal cooperatism."

Wade (1990) was one of the strong supporters for the government-led economic development doctrines. He proposed a governed market theory and provided both theoretical and empirical evidence and in doing so advocated the governed market theory over the free market theory.

Amsden (1989) was another major supporter of the strong interventionist state. In her book, *Asia's Next Giant-South Korea and Late Industrialization*, she proposed a successful development model of strong government intervention, by taking Korea as an example. To be specific, she pointed out three major contributing factors such as: ① successful breakthrough of the vicious circle of poverty through concentrated public investments in SOC's and key industries in the early stage of economic development, ② efficient allocation of resources with priority given to growth-led sectors, and ③ upgrading industrial structure to build up a high value-added oriented industrial restructuring process. The World Bank report, *The Asian Miracle* (1993), basically stood for similar logic. Their views had to face, however, a big challenge following a recent financial crisis in Korea and South Eastern Asia. Flynn (1999) and Henke and Boxill (2000) have drawn attention in this regard.

Both parties, I believe, however, provided convincing logics regarding the consequences of development policies at different time and areas. We can condone Johnson and Wade's argument in the sense that the developmental state model can contribute to the early stage development plans when internal and external conditions are able to work favorably. Flynn, Henke and Boxill provided evidence on what government intervention could bring about when the principle was held too long in spite of the advancement of development. Besides, it seems that LDC's can no longer imitate the old Korean development strategies, since neither government subsidies nor import restrictions are allowed in the new international economic order under the WTO system.

Faced with the realization of limitation and problems involved in the developmental state model in the late 1970's, the neo-classical doctrine began to resurge. It began to draw attention as the excessive government-led economic operation fostered bureaucratic corruptions, and deteriorated resource allocation. Reduction of the government role together with activation of the market began to gain popular support. Such movement was strengthened, while the setbacks of Keynesian economics were experienced through oil shocks and consequent stagflation. The logic was built in such a way that market oriented economic operations and trade liberalization can create more competitive economic structure.

In fact, following the financial crisis, or even before the crisis, economic reform policies have been based largely on neo-classical doctrines in Korea. Competition instead of government intervention and regulation, and trade and capital liberalization instead of import restrictions and protection have been suggested and pursued to promote economic efficiency through elevated competition. The liberalized and competition-based market economic system has been advised to replace the traditional development strategies of the developmental state model approach.

The argument that unconditional liberalization is more beneficial to economic development, however, can hardly be supported empirically either. Supporting evidence has seldom been found even in newly industrialized countries which accomplished economic development to some degree. The time has come to establish a new paradigm to replace the old with regard to the government's role. The successful one still remains to be seen.

5. WAS THE NEO-CLASSICAL REMEDY BY THE IMF APPROPRIATE?

The sudden collapse of Asian economies raised two important issues. One is whether the system of 'strong state' can no longer serve for the economic development of the LCD's. The other is whether the neoclassical orthodoxy, manifested in forms of liberalization and deregulation, is appropriate for Asian economies.

Based on the critiques that the authoritarian regimes could deliver rapid growth with insufficient diversity and ineffective management, a more accountable, responsive and transparent form of governance was suggested as policy measures for Asian countries in crisis. Market principles were emphasized, while the government was advised only to play a complementary role in the private sector by providing an environment conducive to the development of the private sector.

Chowdhury and Islam (2001), however, argued that the 'Washington consensus' could satisfactorily explain neither growth in pre-crisis Asia, nor the outbreak of the crisis. After all, Asian economies were paragons of the neo-classical principles in recent years. The 'Washington consensus' which reflected the intellectual influence of Washington-based institutions such as the U.S. Treasury, the IMF and the World Bank, advocated free markets, free flow of trade and capital across the globe. Stiglitz has led the way in criticizing conventional liberalism as development policy, and also pointed out that it misguided the East Asian Crisis.

Chowdhury and Islam even argued that the follies of the 'Washington consensus,' a significant departure from the conventional Asian development model, partially contributed to the Asian crisis, and aggravated the crisis by severely constraining the macroeconomic policy mix.[6)] They saw that the progressive withdrawal of governments from regulating both the real and financial sector of the economy since the mid 1980s in line with the

[6)] To be specific, Chowdhury and Islam put forward the following arguments: In the wake of the East Asian crisis , governments by the IMF were forced to give up policy independence to depart the fixed exchange rate regime and open capital accounts. In other words, governments forfeited the ability to fight an incipient recession through expansionary demand management policies. On the basis of the Washington-led international community, Asian governments were directed to win the 'confidence game' at all cost. Thus interest rates were raised and budgets were tightened. The Keynesian compact was broken, albeit temporarily, but its inexorable logic prevailed. A prospective recession became an unescapable reality. They said; 'Thus the answer to the puzzles pertaining to the sudden demise of the miracle economies of Asia now seems to lie in an undue faith in the virtues of globalization that made macroeconomic policy subservient to the interests of international money markets. In fact, prominent economists (for example, Corden, 1999; Krugman, 1998a, 1999; Sachs, 1998; Stiglitz, 1998b) have conclude that the very IMF adjustment package aggravated the crisis.'

'Washington consensus,' drove Asian nations into a status of hostages to international financial markets. The only thing that the government could do was simply to keep foreign capital inflows to maintain economic growth.

On the other hand, the government had to give up its investments in SOC's, education, etc, which in turn damaged the economic efficiency and productivity. Capital began to be utilized inefficiently and people began to direct their savings to speculative investment in consequence.

Others like Hutson and Kearney (2001) pointed out the fact that there is a growing consensus that the international financial market and the world financial system have exhibited an increasing degree of fragility. As a matter of fact, during the last two decades, we have witnessed four financial crises of varying degrees of seriousness. The Asian crisis has been the most serious one among them. The amount of capital that has fled out of the region is estimated to be as high as 11 percent of the affected countries' combined GDP. What is worse, the crisis even threatened the stability of the international financial system, notwithstanding catastrophic damages on the affected countries.

What scared the countries directly involved in the crisis was that, the IMF forced them in a way to adopt its policy advice against interests of the troubled economies. There has been a growing concern that the IMF operation has been moving away from the international community, in favor of the USA. It is believed by many that international financial market failures such as information asymmetries and moral hazard, aggravated the crisis, albeit basically it may have resulted from a fundamental weakness in the Asian economies, such as often-cited crony capitalism, poor corporate governance, inadequate financial supervision and inappropriate exchange rate policies, etc.

In any case, at least the IMF cannot avoid criticism that it has forced infected countries to accept its loan conditions which are in fact against the traditional line of macroeconomic requirements. Somehow, the IMF should have made an effort to reduce the size of its bail-outs. Furthermore, it should have assisted the rescheduling of debt repayment, instead of bailing out lenders alone. Unfortunately, the final decision was to ask Asian nations in crisis to adopt high interest rates and tightened government budget principles, which contributed to aggravation of the depression.

It is obvious that neo-classical principles may contribute to enhancing efficiency of the international market system, but we should remember that it will also widen the gap between the rich and the poor countries, since they will bring about an unfavorable atmosphere to LDC's in world trading most of the time.

In a nation, poor people can be protected by national policies such as the social safety net, health care, a pension system, etc. There are no comparable policies or systems that can work for the poor countries. It is quite predictable that the world economy will turn toward a more unstable position than now, unless some countervailing measures are prepared.

One more important note to make is that extreme liberalization and deregulation on the national and international level, will make weak and poor small nations helpless in implementing proper stabilization policies domestically.

6. FUTURE POLICY SUGGESTION : THE ADVANCED STATE MODEL APPROACH

By establishing the CME system, Korea was able to achieve unprecedented economic growth, but came to experience the economic crisis as well just before the turn of the 20th century due to its inherent structural shortcomings. The government-led economic operations that functioned efficiently in the early stages of economic development, created low-efficiency and high-cost economic structure at later stages.

Excessive government intervention, for example, deteriorated creative and responsive power of the market system. Even decisions on R&D investments were made by the government, making private sectors more dependent on government decisions. This in turn brought about bureaucratic corruption.

The government-led economic operations are in nature, inappropriate, as industrialization reaches a certain level. Excessive and overlapping investments, which stemmed from preferential government support, bought about not only business firms' but also national bankruptcy. The cause of the crisis is believed to have stemmed from the government's failure institutional operations.

Disaster from the crisis was able to work as an opportunity for Korea to make a real change in its economic structure. In fact, Korea executed four major reform programs that were otherwise improbable to be realized in the past, and made its economy bounce back quite strongly.

As witnessed, however, in the mishap of neoclassical policy recommendations before and after the crisis, the role of the government in developing countries should not be given up, although some modification may be needed.

If the neoclassical principle cannot successfully substitute for the conventional development state model, what then can replace the traditional approach? An alternative to be presented here is the termed 'advanced state model' approach.

The capitalistic system or the market economy is basically an efficiency-oriented system. Survival of the fittest is the name of the game. Inequality is a natural consequence. The weak or handicapped must devise their own protective measures such as the infant-industry protection doctrine. Government intervention is another way of making up their structural weakness and backwardness. The developmental state model or the statist model has played a leading role in this regard, especially in East Asian countries during the latter half of the 20th century.

Korea, and other neighboring East Asian countries still have a lot of structural and institutional backwardness and are thirsting for sustainable economic growth to catch up with advanced countries. Only compressed growth can make developing countries achieve further advancement in their economies. For faster growth under a less favorable economic structure East Asian nations still need appropriate government intervention in the years to come.

With all the foregoing discussions, I would like to suggest a new development model, which we may call 'the advanced state development model'. It will emphasize the role of government but in different aspects. The paradigm will simply be shifted from the old to the new, in such a way that it will suffice the new role of government for further advancement of the

Table 1 Economic Development Paradigms

Issues \ Models	Developmental State Model (for Early Stage Economic Development)	Advanced State Model (for Later Stage Economic Development)
Internal and External Surroundings	·Pursuit of Free Trade ·Favorable Attitudes toward Economic Support for the LDC's	·Globalization and Unlimiting Competition ·Developed Countries Interest -oriented International Economic Order
Development Strategies	·Government-led Economic Development Planning ·CME System ·Physical Capital-oriented Quantitative Growth ·Growth-First Principle ·Unbalanced Growth through Export-led Industrialization	·Decentralization and Privatization ·Decentralized and Liberal Economic Operations ·Human Capital-oriented Qualitative Growth ·Stable Growth with Equity and Welfare Improvement ·Upgrading of Industrial Structure and Correction of Industrial Disequilibrium
Role of Government	·Removal of Supply Bottle-neck Problems ·Minor Interest in Correcting Market Failures ·Neglect of Equity and Welfare Improvement	·SOC Expansion and Productivity Improvement ·Major Interest in Correcting Market Failures ·Equity and Welfare Improvement
Miscellaneous	·Capitalism is an efficiency-oriented system. ·Proper role of government is needed to alleviate inherent drawbacks of the system and to pursue economic development. ·Active and appropriate role of government is necessary for LDC's to advance their economies	

economy in Korea and (Asian) NIC's. The basic idea behind this model can be summarized as follows.

First of all, the new paradigm will concentrate on sustainable and qualitative growth to reach an advanced state of economic development, replacing the early-stage economic development strategies for fast and quantitative growth.

Second, the economic operating mechanism of the government should move from the centralized management system to a decentralized one through democratization, privatization and liberalization in such a way as to improve both economic efficiency and equity.

Third, equity and welfare-oriented development principles should replace the growth-first principle. Various unhealthy consequences and disequilibrium caused by past development strategies need be corrected now.

Fourth, future development should be directed toward the establishment of a human capital-oriented, and knowledge / information-oriented society, which will definitely improve both economic efficiency and equity at the same time.[7)]

Fifth, in order to accomplish the above objectives, the government should return private sector businesses to business firms and financial institutions, and concentrate on its original role for the supply of public goods (investment in SOC's and education, for example), correction of market failure and an embodiment of the welfare state, etc.

Finally, the role of the government needs adjustment depending on the development stages of a nation, but should not be given up. An active role of the government is indispensable for developing countries to move toward an advanced state.

A knowledge and information society is the one in which the status of human capital owners is elevated, and capital ownership is dispersed to many small owners. Human capital owners have an improved position over physical capital owners. Subordinate capital-labor relationships and extreme conflicts between them will fade away gradually, since cooperation

[7)] For details, see Lee (1999).

between them is essential to promote efficient production in the human capital-oriented society. Capital and labor will pursue a positive sum game through cooperation.

The essence of the knowledge and information society lies at the development of human capital through investments in education, training and R&D. In particular, expansion and improvement of public education will increase the portion distributed to laborers, and thus improve social equity. In the end, a knowledge and information society will create a win-win society and thereby enhance equity and efficiency through improving the laborer's position. This society can be the leading paradigm for the future and thus serve as a target for the future development policy agenda of the government.

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