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Book Reviews

Charles Harvie and Hyun-Hoon Lee

Korea's Economic Miracle: Fading or Reviving?

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Reviewed by
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The Korean economy is doubtlessly one of the most dynamic economies in the world, which has experienced the "miracle" of high economic growth, followed by financial crisis and then a strong recovery. The Korean economy grew very rapidly from the level of per capita income of less than 100 U.S. dollars when the first Economic Development Plan was introduced in 1962 to the one of more than 10 thousand U.S. dollars when Korea joined OECD in 1996. Accordingly, the Korean economic development model drew world-wide attention, since it showed that a poor agricultural economy could have hopes of growing to become a high income industrialized one within the period of one generation.

However, the 1997 financial crisis in Korea led to some questions being raised about the Korean economic development model. Firstly, why had the seemingly successfully developed Korean economy been unable to escape the financial crisis, what kinds of problems had there been in the Korean-style economic development model, and what had made Korea, an OECD member country, vulnerable to financial crisis? In particular, the fact that the crisis occurred under the circumstances of seemingly strong macroeconomic fundamentals, such as output growth of 6 per cent, moderate inflation, a current account deficit of less than 2 per cent of GDP and a balanced

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government budget, was even more surprising.

Secondly, in response to the crisis, Korea carried out severely tight macroeconomic polices including a high interest rate policy, and pushed through numerous structural reform in the financial sector, the corporate sector, the labor market and the public sector. It then achieved a strong recovery, with high economic growth, a huge current account surplus and low inflation, which again surprised the world and stimulated other questions, such as how the Korean economy had been able to perform such a strong recovery, what kinds of challenges the Korean economy now faces, and how these challenges could be overcome.

Korea's Economic Miracle: Fading or Reviving, recently published by Charles Harvie and Hyun-Hoon Lee who have continuously studied the Korean economy since the 1997 crisis, is an excellent book which answers these questions.

The book is composed of four parts. Part I reviews the development of the Korean economic miracle from 1962 to 1989, and the fading of the miracle from 1990 to 1997. The authors are not reluctant to identify the Korean economic performance from 1962 to 1989 as an economic miracle, and then agree with the generally accepted analysis on the basis of the Korean economic miracle during the period. That is, the remarkable transformation of the Korean economy was mainly accomplished by a government-led economic strategy based on an export-oriented and *chaebol*-centered development model.

However, Harvie and Lee point out that the structural weakness of the model began to appear from the early 1990s. At the core of the problem was the close tripartite relationship between the government, banks and *chaebols,* which resulted in severe misallocations of resources and a substantial accumulation of non-performing loans in the banking sector on the one hand, and overcapacity and overleverage in the corporate sector on the other.

In fact, the Korean government mobilized scarce financial resources and allocated them to strategically selected sectors and firms in the export-oriented industries. In order to strategically allocate these financial resources, the government exerted control over the financial sector, in particular, the banking sector, and through its support of the strategically selected sectors and firms, the government-business relationship became tightened. This kind of a government-business relationship is defined as a quasi-internal organization (Lee, 1992). A unique tripartite government-banking-corporate relationship was established. The government was in all aspects a leader or principal player, while banks and business corporations were its agents or followers (Yoo, 1999). This relationship contributed to the miraculous achievement of high economic growth in an environment, where the market system was not institutionalized at the early stage of economic development.

However, the usefulness of this tripartite relationship began to diminish with time. As the Korean economy developed, financial resources should have been more efficiently allocated. The interlocking close tripartite relationship also resulted in problems of agency, moral hazard and even corruption.

Reform and liberalization were urgently needed. According to authors, however, the opening of the capital market exacerbated the situation by bringing about a rapid increase in capital inflows, overborrowing and an overvalued domestic currency. The authors conclude that these became the seeds of financial crisis for the Korean economy, which had until then been praised as a miracle.

Part II focuses on the events that took place immediately before, during and after the financial crisis from 1997 to 1998. The authors diagnose the crisis as triggered internally by an unprecedented number of business insolvencies, and externally by the South East Asian financial crisis and its contagion effects. In particular, they encapsulate the key ingredients of the crisis, its triggers and warning signs with their own unique *stroke hypothesis*.

In addition, they argue that the crisis was initially badly handled by IMF, whose policy responses in the form of tight monetary and fiscal policies turned the financial crisis into the economic and social crisis. While the structural reforms required by IMF were of considerable importance to long-term economic growth, overemphasis on them in an economy experiencing temporary liquidity shortage served to compound Korea's difficulties.

In fact, at the time there were very many controversial discussions on the issues of both the tight macroeconomic policies and the severe structural reforms. Firstly, on the issue of the tight macroeconomic policies, in particular, the high interest rate policies, to restore credibility in the foreign exchange market, it was argued that expansionary monetary policy should be adopted instead to prevent unnecessary defaults in the corporate sector (Martin Feldstein, 1998; Joseph Stiglitz, 1998; Jeffrey D. Sachs, 1998; Paul Samuelson, 1998). Empirical tests on the effects of high interest rate policies on credibility in the foreign exchange market also showed mixed results

Secondly, with regard to the severe structural reforms, it was argued that the 1997 Korean financial crisis was basically due not to fundamental insolvency but to temporary illiquidity (Martin Feldstein, 1998; Joseph Stiglitz, 1998; Jeffrey D. Sachs, 1998). In this sense, the authors' diagnosis that the structural reforms required by IMF served rather to compound Korea's difficulties may be acceptable.

In part III, Harvie and Lee consider three key measures that need to be taken if Korea is to return to long-term economic growth: revival of the traditional economy through macroeconomic policy measures and structural reform, development of the new economy, and the fostering of economic cooperation between South and North Korea.

Once stability in the foreign exchange market ha been achieved, Korean monetary policy returned to a low interest rate policy to boost the depressed economy. In particular, an inflation targeting system was adopted as a new monetary policy framework. Structural reforms were carried out in five key sectors: the financial sector, the corporate sector, the labor market, the public sector, and the capital and foreign exchange markets. As a result, the Korean economy accomplished a remarkable recovery to double-digit output growth and a huge current account surplus in 1999.

The authors review the process of post-crisis macroeconomic polices and structural reforms, identify their positive effects and discuss some remaining issues. They point out that maintaining macroeconomic stability and completing structural reforms are essential to sustaining economic growth. They argue, however, that these things still only amount to reviving the old economy, and that the new economy must be developed to achieve a return to high and sustainable economic growth. Certainly, promotion of a new economy based on information and communications technology could be an alternative industrial policy in the post-*chaebol* period.

The authors suggest that another potential strategy for the Korean economy is the strengthening of economic cooperation between South and North Korea. They argue that the South and North may be able to stimulate both of their economies by forming a combined economic territory in a climate of détente, which may also pave the way to peaceful reunification of the peninsula. However, as the authors point out, there is a very strong precondition for economic cooperation between South and North, needless to say, the ease of military tensions between the two.

Finally, part IV brings the book to a close by looking forward to the future challenges and prospects which the Korean economy will face in the twenty-first century: education, welfare reform and promoting competition issues, to promote sustainable growth and improve the Korean people's quality of life. In particular, the authors emphasize that the current education system, after having contributed to the miracle of high economic growth, need to be changed now to one which is more creative, to embrace the new economy, and that an adequate social safety net is also needed not, only for the sake of equity but also to facilitate efficient functioning of the labor market.

Finally, the question remains of whether Korea's Economic Miracle will fade or be revived as the title of the book enquires. Harvie and Lee conclude that this will depend largely upon whether the Korean economy, currently standing at a crossroad, will embrace the principle of the new economy, requiring a move away from the government-led economy and towards resource allocation by the market.

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The Economic Development of Northeast Asia

Cheltenham, UK / Northhampton, MA, USA: Edward Elgar, 2002

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1. INTRODUCTION

As the latest part of the growing literature on the Asian economic development, *The Economic Development of Northeast Asia* provides a comprehensive collection of the major studies on the subject. With four volumes and 72 articles (over 2300 pages), this series will remain for the near future as one of the most comprehensive sets on the Asian development. The book is recommended as the essential reading for both new and experienced researchers on not only Asia but also economics as a whole. The editor, Professor H. Smith of Australian National University, has done a remarkable job not only collecting these materials, but also organizing and outlining them through her overview.

Reviewing a book of this size and magnitude is indeed a difficult task, especially as it is filled with many seminal articles on economic development. Therefore this review offers a brief summary of the book, and then raises some fundamental questions about the Asian development as a whole. This is followed closely by how the book deals with such issues. Finally, some issues and studies, which would have enhanced the book with their inclusion, follow.

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2. BRIEF SUMMARY

The book begins with the introduction by the editor, which outlines the four volumes. Broadly, it is argued that the Asian development can accredit its success to the combination of low wages and neutral foreign exchange regime. When combined with its outward orientation (export oriented industrialization), the region was able to enhance its physical and human capital accumulation, further resulting in a rapid pace of technology development. The active role of the governments in allocating capital was an essential factor, in addition to shaping the economies' industrial structure. The book also questions whether this practice has led to the financial crisis of 1997 – challenging the readers to further examine the success of the Asian development.

In dealing with the above path for development, the major issues involved, ranging from government's selective intervention, fiscal and monetary policies, to human capital/labor policies, are extensively presented in detail. Economic integration of the region was also addressed – although only two articles were included. The editor concludes that although the region's development model may present little positive lessons, there are a number of factors to be fully considered by both students of economics and policy-makers. The editor then provides an overview of the future prospects, with the argument that a greater political will is required to undertake continued reforms, especially in regards to corporate governance.

3. MAJOR ISSUES IN THE ASIAN DEVELOPMENT

For the students of economic development, it seems that there are four major questions associated with the Asian development. They can be broadly outlined as following: (i) Has the development departed from the mainstream (neoclassical) theories? (ii) Can the lessons from the development be effectively transferred to other developing countries? (iii) Did the development path cause the financial crisis – or is it a separated case caused by external factors? And (iv) what is the future of the Asia development? What are the main issues and challenges, as well as strengths? The book attempts to address these questions in turn.

First, although the book does not take one side over another, it does provide detailed information on the fundamental question of whether the development has significantly departed from the neoclassical economic theories. Many neoclassicals argue that the development is consistent with theory. They tend to argue that the rapid Asian growth was based on a simple factor accumulation – and that no real increase in productivity (thus 'development') has occurred. Furthermore, they believe that the selective intervention was either (at best) irreverent or (at worst) harmful – the latter having to significantly downgrade the financial sector. In Young (1995) in Chapter 10 of Volume I, as the economies have shown limited increase in total factor productivity (TFP), the answer is negative. Yet, although many studies, including the ones by Krugman (1994) and World Bank (1993), echo the Young study, these cannot be considered as only, conclusive explanations on the Asian development. The editor also adds that there are different methods of accounting for TFP, and that there is no definitive answer. In this, the structuralists (see Lall (1996) in Chapter 3 of Volume I and Chang (1993) in Chapter 8 of Volume IV) have further argued that the TFP measurements are either inaccurate or inconclusive – and that statistical nature of the neoclassical approach cannot provide an in-depth understanding of the development paths.

For this issue, the role of the government takes a center stage. This is a fundamental issue – questioning the value of the 'invisible hand' that has directed the study of economics for centuries. Indeed, if the most successful developing economic region has departed from this principle, it is not an exaggeration to suggest that economics as a whole needs to be reconsidered. The neoclassicals have suggested that the selective intervention, overall, was not as effective, and that it had a minimal role in its development. This is contrast to Lall (1996) in Chapter 3 of Volume I, which credits the intervention as the key source for development. Here, the book would have benefited from considering the seminal studies in Stiglitz (1988) and Rodrik (1996), which argue that as developing economies suffer from market (information) failures, there exists multiple-equilibriums. Then, under such circumstances where rationality is impaired by imperfect (information) conditions, the neoclassicals' trilogy of maximization, efficiency, and rationality does not always apply to those Asian economies. Although there is a danger of 'straw-man effect' in simplifying the neoclassical theories, the book seems to show that no one set of theories can offer a clear understanding of the economic development.

Second, another important question (which is linked to the first question) when studying the remarkable growth of the Asian economies lies in whether the lessons can be effectively transferred to other developing regions. Here, the editor argues that the Japanese and Korean model does not represent positive lessons. This may be justified if one is considers the selective intervention and other related policies as the central pillar for the Asian development. However, as further argued below, the key to the development may have not been the intervention. This is not to suggest that it was not an important factor – however, as explained later, there were also more fundamental pillars of development that made the selective policies (at best) beneficial or (at worst) benign.

Indeed, the editor also notes the significance of high level of savings, education, market orientation, and integration to international economy. In many ways, these factors seem to represent the key to the economic miracle. These are fundamental components of *any* economic development, and the government intervention alone cannot effectively explain for them. A key source for these components seems to lie not only in the economies' policy framework, but also its historical background – which is addressed later. As reflected in the collection of articles in this book, the current literature seemed to have overly reflected on the issue of selective intervention – but it seems that a greater attention is warranted on the fundamental factors of Asia's development. In Korea, for example, the rural and land reforms have been very significant in preparing the groundwork for the economic modernization. This is a significant lesson for many transitional economies as well.

Third, the book (in Volume I) emphasizes the financial crisis of 1997 as a defining event in the Asian economy. To simplify, the book seems to argue that the selective credit allocation pressured the financial sector that led to the crisis. This suggests that as the neoclassicals have predicted, the declining competitiveness (as measured through TFP) and distorted financial sector have finally signaled the end of the Asian economy's caricature as the role model of economic development. The structuralists have countered that much of the crisis was caused by lack of regulations and unstable international financial system (see Chang, 1998). Although certain reforms are necessary, they argue that the fundamentals of the Asian economy are still relatively positive. Thus, whether the crisis was largely caused by the Asia's unique system is still the question that will be debated for a near future.

Furthermore, it seems that although the book argues for the more reforms – specific details still lead the readers back to the question about the nature of Asia's development. The editor argues that although Korea, for example, has shown remarkable recovery, it still needs to change its fundamental ways of doing business – in seeking more balanced growth. It is important to note that while Korea and other countries still need to change their ways, considerable progress has been made since 1997. The issue of 'balanced growth' also needs to be clarified. If the editor is suggesting that chaebols' over-bearing political power needs to be controlled – then this is a different argument suggesting that their economic dominance compared to the small and medium sized enterprise sector needs to be reduced. The specific methods to induce this would probably entail more selective intervention – not less. For Japan, the editor suggests that its economic slump is a rather 'perplexing' matter. It seems that as Japan is the largest economy in the world history to deal with this matter, its cautious approach is not surprising. One can always clear the non-performing loans, but its mid-term impact on the real sector needs to be carefully estimated – especially as the world economy is also slowing down since the Sept. 11 terrorist attack.

Finally, on the future of the Asian economy, the book largely suggests that the reform of the old ways of doing business should continue as well as placing a greater emphasis on technology development. Although the recent scandals in the United States may cast doubt on these countries on following the Anglo-Saxon models of corporate governance, the chapters (articles) seem to indicate its necessity. In Korea and Japan, where the problems may be most significant, it seems that considerable improvements have been, although more progress may be needed. In terms of technology development, although the editor has expressed some doubts, it is difficult to imagine a more effective path that can be taken compared to other countries. Although Okimoto (1989) in Chapter 13 of Volume IV may be exaggerated the role of governments, it seems clear, as Kim (1997) in Chapter 16 of Volume IV argues, that the government has clearly facilitated the learning process. Now, these Asian economies have to be considered to be in a frontier of commercial technology, not withstanding the TFP arguments that have been made earlier.

4. ISSUES FOR FURTHER DISCUSSIONS

Although the book should be fully appreciated for its depth and wide-coverage, there are two issues that may have more fully offered the readers on the insights of the Asian development. First involves the political economic approach to the issues. There are many writings by political economists which offer an in-depth understanding of how and why the policies were pursued, including the political economic implications of the industrial structure dominated by a small number of firms – in addition to Haggard and Collins (1994) in Chapter 4 of Volume II. In fact, Woo (1991) and Strange (1988) argue that the policies were often made for political efficacy, rather than economic efficiency. This yields an useful approach to understanding the cause (of policies) and outcome (of political economic implications, industrial structure, etc.) for Asian economic development. The second issue, which could have been addressed, involves the historical nature of the

Asian development. It is erroneous to think that these economies have only initiated its development post-World War II period. Japan was already an industrialized country beforehand. For other countries, the implication of the sustained colonial rule by Japan (although a controversial issue) also needs to be considered as well – in terms of developing a foundation for the industrial take-off at a later stage (in addition to Yoon and Lee (1997) in Chapter 20 of Volume IV, see Cha *et al.* for a good overview of Korea's history). These two components would yield not only lessons for other countries as well, but also provide an interesting comparison to other regions, such as Latin America.

The readers should further recognize that different countries have different systems. In other words, although the economies being discussed in the book share the success and region, much of their paths differ. Japan has a different system than Taiwan, and Korea's industrial structure contrasts to one by Hong Kong. This means that, again, it is difficult to simplify that the region's success was to due a common policy theme, such as selective intervention. Then, if their common success were not a mere coincidence, what would be the root cause? The editor notes that the common themes for these countries include: (i) limited natural resources; (ii) dense population; (iii) engagement of land reform which resulted in rise middle class; and (iv) reliance upon export oriented industrialization. Of course, in terms of economic policy, many developing countries are now attempting for export- and market-oriented policies (even though Latin America attempted for import substitution policies). It can be also inferred from this that outward looking policies (as best explained by Krueger (1995) in Chapter 1 of Volume III) in themselves cannot be accredited for the success. The book has emphasized the issue of selective intervention – but again, many developing countries have been trying this – with limited success. Even among the Asian economies – the each government's commitment for the intervention has also varied. Thus, the book still leaves the readers with the fundamental question: What is the common theme behind the varied successes of the Asian economies?

For economists, it may be humbling to note that the possible common themes go beyond the realm of economics or economic policies. First involves the historical and cultural factors, which have been briefly mentioned above. These factors have allowed for the countries become more united and uniformed in economic activities – making easier for the governments to implement policies. The second factor relates to competent economic/public bureaucracies in these countries – although they are not independent from political pressures. These bureaucracies formulated and implemented policies more effectively than other counterparts from developing countries. The fact that some of the policies were selective should not belittle this important pillar for development. Finally, these countries were also blessed with a relatively high level of human capital – despite their low wages. This factor is partly due to policies and market demands – but more importantly, they also seem to be social and historical in nature as well. Furthermore, these are also uniquely 'qualitative' factors, difficult to measure and almost impossible to emulate. Although it is not suggested here that other regions are somehow cultural unable to develop, it seems that these factors, along with the fact that these countries were also able to benefit from the generous economic environment much caused by the Cold War, have made the Asians to undertake their development at a more rapid pace than compared to others. It is only with such a foundation that made the intervention and other types of policies highlighted in the book possible, and disallow the capturing of the lessons of Asia to those with the purpose of confirming or discrediting the traditional economic principles.

5. CONCLUSIONS

Overall, this book and its four volumes represent a wealth of knowledge on the Asian development. Although some questions are left unanswered, no one book can truly answer all the questions – nor should it be the task of the book. The book has done an admirable job in providing details to some of the major economic issues surrounding the Asian region. It is worth stating again that the book should be considered as an essential reading for the students of Asian economy and development economics.

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Sung-Hee Jwa

The Evolution of Large Corporations in Korea –A New Institutional Economics Perspective of The Chaebol

Cheltenman, U.K.: Edward Elgar, 2002

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Chaebol is one of the most important and yet controversial issues in establishing economic, social and political policies in Korea. It also is the most powerful private sector in various aspects. Many large, private firms belong to business groups known as Chaebol in Korea. Chaebol is an exclusive business group of formally independent firms whose top management is centered in the hands of one person or a family. Large chaebols usually contain 40-50 member firms including financial institutions owned and controlled by the original founder or his family successor. Korean chaebol, although it consists of many legally independent firms, is operated as a single firm or a conglomerate.

Korean chaebols are unigue and different from U.S. and European conglomerates. One of the factors accounting for this uniqueness in Korean chaebols is highly centralized management with both ownership and control. In most cases, the power is concentrated on one person or a family. In other words, the original founder or his family successor wields the absolute managerial power on business. Another factor found in Korean chaebols is diversification in which relatively large numbers of firms operate various industries.

There are mixed responses on chaebol's contribution to Korean economy. Those who praise chaebol system regard it as a major locomotive of Korea's

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remarkable economic growth in modern history. Most economists overseas believe that chaebol policy has greatly contributed to getting Korea out of poverty after the Korean War. Many developing countries even try to learn Korean economic policy through chaebol system. However, not a few people are against the chaebol-centered economic policy. Some economists attribute the financial crisis in late 1997 to the extorted managerial behavior in chaebols. Since then, chaebol reform emerged as a priority in economic policy. The government has also pursued various chaebol reform policies over the past 5 years.

The pros and cons of the chaebol policy make us hesitate to determine whether it succeeded or failed. The author, Sung-Hee Jwa, attempts comprehensive analysis on the unique chaebol system of Korea in his recent book of *The Evolution of Large Corporation in Korea*. As the president of Korea Economic Research Institute established by companies belonging to chaebols, he might know chaebol better and deeper than anyone and is available to abundant data on chaebols. This will make this book one of the best among chaebol-related books written in English. Western scholars, especially for those who are interested in Korean chaebols, would have a better understanding on chaebol's role in Korean economy and at the same time its challenges lying ahead through this book. Overall, the author believes that chaebol has successfully survived by adapting to the unique political and economic environment in Korea in past several decades. In other words, he puts more weight on the positive aspects of chaebol than on the negative one. Chaebol has been the symbol of Korean economy and has grown together with Korea's dramatic economic growth.

Although most current parent firms of chaebols were founded as early as in the 1950s, chaebols generally become acknowledged when they began to record substantial success in the early 1970s. The government implemented strong export-driven economic policy, mainly focusing on heavy and chemical industries which required large-scale investment that only chaebols can afford. Korean chaebols expanded rapidly between 1973 and 1980. The six largest chaebols - Hyundai, Samsung, LG, SK, Daewoo and

SSangyong - have experienced average annual growth rates of 50.9 percent in sales over this period. The rapid chaebol growth can be explained by the aggressive and energetic entrepreneurship, strong organizational structure and management, high-quality labor forces who were willing to suffer low wages and long work hours, political stability and strong governmental support.

In this respect, the author's perspective on chaebol is quite persuasive. He, however, does not provide us with a clear answer on why Korea's major private firms all belong to chaebols. The possible answers would be as follows. First, firms wanted to avoid higher transaction costs involved with external transactions. Since Korean market was still fragile, firms could benefit through the use of more extensive intra-group transactions. Second, group affiliation with chaebol can reduce firm risks because chaebol is widely diversified in both products and markets. Third, their pursuit of growth in terms of sales, market share and profits coincided with the government strategy to promote rapid economic development. Accordingly, group-affiliated firms could enjoy a variety of favors from the government. I guess the author would agree with these answers.

The book consists of 9 chapters. Chapter 1 explains the basic concept and idea on chaebol along with the structure and the objective of the book. Chapter 2 focuses on the background of chaebol's appearance in Korea. The author considers it inevitable by-product under the political, economic, social and cultural upheaval in Korea's recent history. Chaebols have managed well to find and consolidate their roles in business sector. Chapter 3 discusses problems on chaebol, especially on economic concentration, monopoly and oligopoly. Chapter 4 presents a new model for the analysis of chaebol. The author tries to make a new interpretation on problems and policies regarding chaebol through the two-stage decision-making process. Chapter 5 analyzes chaebol in the perspective of the new institutional economics. Chapter 6 deals with the diversification of chaebol. Chapter 7 tries to figure out what we should learn from chaebol system and what the future paradigm would be. Chapter 8, accordingly, presents a new framework of chaebol policy. Chapter 9 summarizes the above discussions and draws up conclusion.

The book reviews the past and present of chaebol in Korean economic history and seeks out desirable direction for the future corporate policy. It gives us a better understanding of chaebol in general, analyzing its problems in various aspects and suggesting possible solutions as well. The author also emphasizes that rather than imposing direct and strict regulations, the government had better establish new and more elaborate economic environment, and encourage chaebols to pay attention to critics on them so that they can reform themselves. This will help chaebol not only survive but stand out in the fierce global competition. The author's assertion may be somewhat different from that of active chaebol reformists who draw wide consensus in recent years. Therefore, I strongly would like to recommend this book for anti-chaebol economists or active chaebol reformists, because it would give them a balanced view on chaebols.