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Development Lessons from Asia: The Role of Government in South Korea and Taiwan

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South Korea and Taiwan share common structural characteristics and export-led industrialization. Several studies have documented an active role of government, beyond correcting market failures (H. Pack and W. E. Westphal, 1986; Paul Kuznets, 1988). But the role of government differs. The Taiwan government has been supportive rather than interventionist, whereas the Korean government has been collaborative and even coercive in relations with the private sector.

Government in both countries helped launch and sustain the export-led strategy, taking into consideration the initial conditions in industrial organization and structure, capital markets and trade. Although the strategy contributed to export development, once put in place, the respective governments have been unwilling and unable to adjust their role to changing circumstances. This rigidity accounts for the inefficiency of government in Korea in the 1970s and in Taiwan in the 1980s.

I. Contrasts

Since the import substitution in the 1950s, the Korean government has intervened in the allocation of resources creating an entrenched policy bureaucracy that controls the means for plan implementation. The institutional setup provides domestic market protection, implements industrial targeting, and issues permits of entry in many industries and foreign loan guarantees. "Korea, Inc." is a more apt description of government-business relations in Korea than Japan (Kuznets).

The Taiwan government uses a medium-term economic plan that sets macroeconomic targets and formulates sectoral investment plans. Unlike Korea, however, these plans are indicative. The planners have had little authority and limited access to policy instruments such as credit allocation. There is no institutional network linking the economic bureaucracy with the private sector. Interaction has been characterized by mutual adjustment rather than collaboration. The Taiwan government has in general confined its role to providing social and physical infrastructure and other public goods. It has balanced public needs with a desire to encourage private enterprise in its intervention.

II. Leading Role in Korea

In the 1960s, Korea had to cope with a formidable array of structural and institutional problems. The low rate of savings and chronic current account deficits required a continuous inflow of foreign lending unavailable without government guarantees. It was believed that the financial system could not direct resources to export-oriented industries and that there was a shortage of entrepreneurs and managers to undertake the development of export-oriented industries. The industrialist class that had been nurtured during the import substitution period had little knowledge of foreign markets and international marketing, and hence was unprepared to take high risks in selling abroad.

In many cases efficiency required adoption of increasing returns technologies. This conflicted with Korea's limited availability of resources, and forced the government to support a few, selected large producers in the targeted industries. In the absence of a market mechanism, they assumed the task of selecting the winners. The banking system was used to channel domestic and foreign savings to these large firms and as a de facto partner, and the government was drawn to participate in their business decisions. Dur-

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ing the 1960s, these large firms became successful exporters, and with the growth of the economy also developed into industrial groups dominating the manufacturing sector.

Korea's export-oriented industries could have sustained rapid growth without government intervention, though not without government support in the 1970s. However, instead of deregulating the controlled sectors, Korean policymakers tightened their grip over manufacturing industries and financial intermediaries. The confidence they gained from the success in the 1960s encouraged a big, unsuccessful import substitution for capital and technology-intensive products in the 1970s.

Industrial concentration and government involvement created its own problems. By 1977, the 30 largest groups accounted for 25 percent of employment and 34 percent of shipment of manufacturing (Kyu-uck Lee, 1986, p. 239). Concentration of economic power in the hands of a few conglomerates was necessary for efficiency, but highly undesirable for distributive equity. This dilemma created pressure for (and justified the government control of) the industrial groups. The pricing and supply behavior of these groups had to be regulated because their market position was protected by closed trade and a closed financial regime.

Government support for industrial groups created moral hazard problems. By the early 1970s, they were highly leveraged with loan guarantees through the banks owned by the government. The government had literally become a partner responsible for their failure as well as success. This bailout certainty induced excessive risk taking.

The coordination and moral hazard problems were most serious during the 1970s when the government attempted to develop simultaneously a number of heavy and chemical industries. The development was deemed necessary to take advantage of complementarity on the demand side, and forward and backward linkages among these industries. The industrial groups lost no time in making massive investments, not to be locked out of potentially lucrative markets. The result of this competitive bidding was an excessive investment and duplication.

Except for petro chemicals and nonferrous metals, most industries were developed as future export industries. In order to export with the benefits of scale economies and minimum efficient size, the groups were encouraged to build large plants from the beginning. But because of marketing, quality, and technology problems, export earnings were low and losses heavy. The complementarity as well as forward and backward linkages made the situation much worse. This setback motivated economic liberalization at the end of the 1970s. Yet, after almost a decade of trade and financial liberalization in the 1980s, Korea's policy regime is still based on development mercantilism. The government has not been able to extricate itself from its relations with the industrial groups.

III. Supportive Role in Taiwan

The indirect role of government in Taiwan was predicated on a high rate of savings, chronic trade surpluses, conservative stance of fiscal and monetary policy, an egalitarian development philosophy, and an industrial organization characterized by a large number of small and medium-sized firms in manufacturing. As a result, Taiwanese planners have been largely deprived of two instruments of industrial policy—the control over credit and budgetary allocation for development purposes.

The political leadership was also determined to prevent the concentration of resources in private hands, as it believed that a small group of powerful businessmen who controlled a large share of private resources and the financial system had caused its downfall on the mainland. This determination was manifest in the proliferation of public enterprises that accounted for an average 50 percent of manufacturing value-added during the 1950s. Even in the export promotion strategy led primarily by the private sector, this egalitarian tradition remained a balancing force.

In Taiwan, a large number of small and medium-sized firms produce and export a large share of Taiwan's manufactured products. In 1986, for example, more than 98

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percent of Taiwan's firms had fewer than 300 employees, and 48 percent of these employed 5 or less workers. Small and medium-sized firms produced about 30 percent of manufacturing value-added, and exported most of this to foreign markets (Tyler Biggs, 1988). Taiwan embarked on export promotion of labor intensive manufactures just as Korea had, but chose different production technologies. Taiwan's planners did not select increasing return technologies as the Korean planners did, because they could draw on a large pool of experienced entrepreneurs.

The dominance of small and medium-sized firms continues in Taiwan's major export industries. For example, in the footwear industry, firms with 300 or less workers accounted for almost 60 percent of value-added in Taiwan, whereas the same share was about 7 percent in Korea in 1976 (Brian Levy, 1987). With this structure, direct intervention Korean-style was impossible. A more efficient way of supporting these small exporters was to provide uniform incentives on the basis of export performance.

The strategy of relying on small and medium-sized firms obviously raises problems related to the loss of scale economies, marketing and collection, and dissemination of information on foreign consumers' preferences and technological developments. But in Taiwan they were overcome by the presence of a large number of traders coming from the mainland (see Levy). These traders subdivided large orders among small producers and still do. They gave Taiwanese manufacturers access to orders of small volume that Korean manufacturers could not accept. They have also successfully sought out specialized products for which demand is relatively small, and many technology-intensive activities to which small firms are well adapted (Levy and Wen-Jeng Kuo, 1987). Perhaps this lack of success was fortunate in that it avoided the large-scale inefficiency associated with the Korean development effort in heavy industry.

Unlike Korea, Taiwan's efforts at import substitution of capital and intermediate goods in the 1970s were frustrated. Entrepreneurs were unable and unwilling to make large capital investments with a long gestation period. Neither did the government have an industrial policy regime capable of planning and implementing an import substitution program as ambitious as Korea's scheme. In order to bypass these difficulties, the government entrusted public enterprises with developing the automotive industry in the 1970s, but the attempt did not succeed (Yun-Han Chu, 1989).

Since the early 1980s, the Taiwan government has widened the scope and accelerated the pace of trade and financial liberalization. However, economic liberalization has not mitigated the imbalance between the traded and nontraded goods sectors. The traded goods sector is still too large, the nontraded goods sector too small. An expansion of domestic demand, in particular in the public sector, is now needed. Yet, the industrial policy regime that prevented the promotion of a large-scale import substitution plan in the 1970s has made it equally difficult to channel more resources into the nontraded goods sector. The housing and social and physical infrastructure sectors remain grossly underdeveloped. The supportive role of government has become a cause of misallocation of resources.

IV. Any Lessons?

One conclusion is that there is no ideal model for the role of government. The success or failure of export-led development strategy does not seem to correlate with policy activism. In both Korea and Taiwan, initial conditions, structural, and institutional characteristics have been more important than the strategy itself, or development ideologies in shaping the role of government. Institutional and structural characteristics explain why Korean planners have always sought to adopt increasing return technologies whereas Taiwanese policymakers have not. Technology differences in turn brought about differences in the role of government between the two countries.

Another lesson is that once government assumes a certain role in the development process, it tends to persist with the same role, often failing to adjust to changes in economic environment. This inflexibility

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could be a cause of government failure as it was in the case of Korea in the 1970s and in the 1980s in Taiwan.

Finally, have governments contributed to rapid growth and industrialization in the two countries through intervention? It is difficult to believe that the private sector alone could have launched and sustained the export drive without the direct government intervention in Korea in the 1960s. Nor would it have been more efficient if the Taiwan government had assumed a more interventionist role during the same period. But since the mid-1970s, efficiency of government intervention in the two economies has been debatable at best. Judging from the record of rapid growth with stability, however, any losses related to government intervention must have had their offsets.

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