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THE DEVELOPMENT
EXPERIENCES OF KOREA
& EGYPT A
COMPARATIVE ANALYSIS

NERMINE GAMAL EL-SHIMY

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THE AMERICAN UNIVERSITY IN CAIRO

SCHOOL OF HUMANITIES AND SOCIAL SCIENCES

POLITICAL SCIENCE DEPARTMENT

THE DEVELOPMENT EXPERIENCES OF KOREA AND EGYPT: A COMPARATIVE ANALYSIS

NERMINE GAMAL EL SHIMY

A THESIS SUBMITTED
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR
THE DEGREE OF MASTERS OF ARTS
IN POLITICAL SCIENCE

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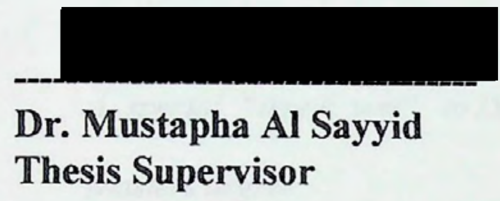

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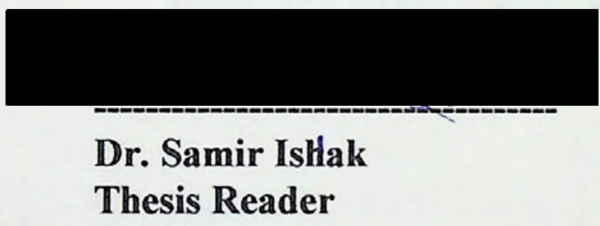

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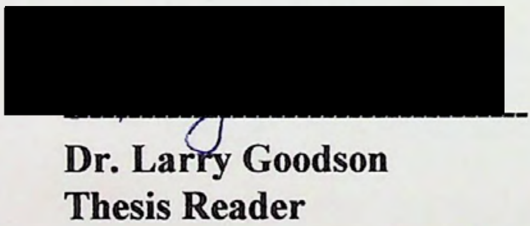

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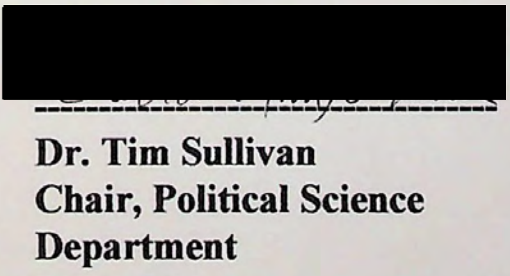

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Chapter One
Introduction

Egypt and South Korea were considered underdeveloped countries by the early 1950s. There was a certain similarity assumed between the two countries. Both were suffering harsh political and economic conditions. However, after four decades, this similarity is no longer a valid assumption. These two countries can no longer be classified under the same category. South Korea became one of the Asian four tigers, the Newly Industrialized Countries; while Egypt is still struggling to catch up. Based on the World Bank statistics, their basic economic and social indicators were very similar: South Korea's population amounted to 20,357 thousands in 1950, while the population of Egypt represented 20,461 thousands in the same year. Both countries suffered from colonization which increased the dependency on cash crops, cotton in Egypt and rice in Korea. By the early 1990s there is a very wide gap between these two countries. According to World Bank statistics, Egypt's population amounted to 57.6 million people with an average annual rate of growth of 2% in 1994, while the Korean population was 44.5 million with an annual rate of population growth of 1% in the same year. Real GDP growth in Egypt is 1.5% annually compared to 8.1% in Korea. The current account deficit in Egypt was $1.3 billion compared to a surplus of $4.5 billion in Korea. Total external debts in 1990 in Korea amounted to $34.9 billion compared to $38.45 billion in Egypt (EIU 1995, World Outlook, 210 and 269). The illiteracy rate in Egypt amounts to 55% of the overall population, while in Korea it is less than 5% according to the 1980-85 World Bank statistics. GNP per capita in Egypt equals $660 while in Korea it amounts at $7,660. Life expectancy, which is an indicator of health and social conditions, averages 63 years in Egypt to be compared to 71 years in Korea. Moreover, the maternal mortality rate per 100,000 live births in

Egypt is 500 while in Korea it is only 34 according to 1980-85 World Bank figures. Infant mortality per thousand live births is 10.6 in Korea to be compared to 64.4 in Egypt. These statistics show the existing gap between Egypt and South Korea and are summarized in **table 1**. It should be noted that the two countries still share certain characteristics. First, Egypt and Korea are characterized by an abundance of man power. Second, urbanization is a problem facing both countries resulting from the continuous migration from the villages to the cities. With respect to the international environment, both countries are very sensitive to changes that might hit international trade due to the high degree of dependence on exports in the case of Korea, and the high degree of imports in the case of Egypt. Also both countries are indebted due to the conditions that prevailed in the 1970s and 1980s (Handoussa, 6). Total external debts in 1990 in Korea amounted to $34.9 billion compared to $38.45 billion in Egypt (EIU 1995, World Outlook, 210 and 269).

This study ***compares*** the development experiences of the two countries, South Korea and Egypt. ***Development***, as it is referred to in this study, means "*the process of improving the quality of all human lives*" by increasing the living standards of people through providing a better education, and a higher level of income. Development is formed of three aspects: economic growth which is a process of increasing "*the productive capacity of an economy*"; the establishment of an economic system and an institutional basis that increase "*self esteem and respect*"; and to increase personal "*freedom*" by widening the range of choice available to the consumer (Todaro, 670-2). The main question this study is trying to answer is why did South Korea succeed in its development experience and reach the status of a NIC, while Egypt is still considered a developing nation; noting that both countries were standing at the same starting point

in the early 1950s, and that Korea started a decade after Egypt -1961 vs. 1952- its development process?

The choice of these two countries in particular is based on the following criteria. South Korea is an example of a successful development experience. It is a country that achieved a fast economic growth compared to other NICs. Second, its experience appears to be relevant to the Third World since industrialization was achieved despite the presence of large debts and a large rural sector. Third, Korea's geographical position is significant politically since it is located between socialist and capitalist forces. Finally, it provides an example for successful state planning. South Korea is a mixed economy based on capitalism and private enterprise at the same time having the government playing an important role in planning and regulation. In other words, it has been a market economy subject to government intervention. Concerning the choice of Egypt, it is a strategic Third World country whose development is of interest to the West. Egypt controls one of the shortest routes connecting the East and the West: the Suez Canal. It is also a key player and a stabilizer in one of the most unstable regions of the world: the Middle East. Moreover, it is important to study the political economy of the country in order to be able to conceive the optimum economic reform that should be applied to the country where I am living.

Table 1
Comparison of Egypt & Korea

Item	Egypt	Korea
Similarities in the 1950s		
Population in 1950	20,461	20,357
Colonization	British	Japanese
Dependency on cash crop	Cotton	Rice
Differences in the 1990s		
Population	57,600	44,500
Population growth rate	2%	1%
Real GDP growth rate	1.5%	8.1%
Current Account	$-1.3 billion (deficit)	$4.5 billion (surplus)
External debts	$38.45 billion	$34.9 billion
Illiteracy rate	55%	5%
Per Capita GNP	$660	$7,660
Life expectancy	63 years	71 years
Maternal mortality rate/1000	500	34
Infant mortality rate/1000	64.4	10.6
Similarities in the 1990s		
Abundance of man power	Present	Present
Foreign debts	Present	Present
Sensitivity to foreign trade	High reliance on imports	high reliance on exports

The ***methodology*** used is the comparative analysis since facts are presented about both countries, then analyzed, and finally, conclusions are drawn. In my opinion, the comparative approach is the most suitable for this study due to the existence of some common features between the two countries, in addition to some differences related to the topic discussed. The validity of any ***comparison*** depends on the presence of similarities between the units examined, in addition to some differences related to the phenomenon of comparison.

The study will focus on a number of variables where the two countries will be compared and contrasted. The ***economic variables*** include foreign capital accumulation, and the investment in human capital. The ***political variables*** will focus on state autonomy, planning and the institutional basis. The comparison of the two countries -Egypt and Korea- will take two dimensions. *First*, the role of the state in development will be analyzed in chapter two. The theoretical framework within which the analysis is made includes of the notion of the state according to Nordlinger's statist approach and typology of states. The hypothesis that will be tested in this chapter is : "***Under a firm authoritarian regime characterized by a degree of autonomy and a well established institutional basis to achieve objective planning, the pace of development in faster than in the absence of objective development planning and the institutional basis***". The third chapter is an analysis of the role of the state in Egypt. Chapter four addresses the role of the state in Korea. The fifth chapter is dealing with the *second* dimension of analysis which is the impact of the international factors on development. In this analysis, the opponents to, and the advocates of, the role played by foreign capital at early stages of development are presented through the Modernization theory versus the Dependency approach. The tested hypothesis is: "***at the early stages of development, if foreign capital is available, and under the***

control of the host country, economic growth will be faster". Then the role of international organizations such as the World Bank and the International Monetary Fund -IMF- through the implementation of the Structural Adjustment Program is presented. The conclusions of the analysis between Egypt and Korea will be drawn in chapter six.

Chapter Two
The Role of the State in Development

I. Introduction:

The role of the state has varied throughout this century. In the 1950's and 1960's, the predominant approach to economic policy gave the state a "*substantial*" or strong role to repair market failures which resulted from the Great Depression. Developing countries, also referred to as the periphery, required even a bigger role to be played by the state due to the prevailing circumstances: low private savings, dependency on primary exports, unemployment, and the lack of the entrepreneurial spirit. By the 1960s, the state became responsible for private capital accumulation. Yaffe pointed out that:

> *State expenditure, by postponing the immediate consequences of the fall in the rate of profit, by allowing capital accumulation to expand, necessitates an increase of credit and therefore the money supply to finance its own expenditure. In such a way the state maintains the general conditions of capital accumulation, and supports the attempts of capital to stave off in the rate of profit (13).*

Capital formation undertaken by the developing states was the engine of development. In the 1970s, the role of the state declined mainly because to the inefficiencies resulting from the state intervention. For example, states promoted import substitution strategies during the 1950s, which gave rise to inefficient industries requiring permanent subsidization as it was the case in Egypt (Wade, 8-9).

Looking from a ***neo classical perspective***, the engine of development is rather the efficient allocation of resources allowing effective investment. Institutional arrangements are needed to perform this task. The government should interfere to supply certain public goods, but at the same time the private sector should be left to the market mechanism. Hence, the role of the government is limited to the provision of

goods where it has a comparative advantage, such as electricity, and which cannot be supplied by the private agents. The government may also interfere in ensuring the functioning of the market. The neo classical view also set a list of the ***essential functions for the state***. The government is supposed to maintain macro economic stability. It is the role of the state to provide physical infrastructure such as railroads, irrigation of canals, harbors, and sewers. The state is also responsible for the supply of public goods or social infrastructure, such as defense and national security, education, health care, market information, and the legal system. Moreover, the government is supposed to establish the institutional basis needed to coordinate the various sectors of the economy. Such a task is crucial to development, as it will be seen when analyzing the role of the state in Korea. In the case of market failure, the state is responsible for the elimination of price distortions. Finally, increase social equality is a task that has to be undertaken by the government where it has to redistribute income from the richer in favor of the poorer (Wade, 10-1). This is usually achieved through the nationalization movement following a revolution or a coup d'etat.

The term state led, or government led, means the government intervention in resource allocation and investment activities. The direct intervention of the government in investment may take place through public enterprises. In market economies, the government influences private investment by providing incentives to the private sector. State intervention can take the form of policy formulation where the government uses certain instruments, or tools, to directly manipulate and influence target variables. For example, monetary policies use money supply or the rate of interest to achieve the required results. Another set of tools is known as fiscal policies where there is a manipulation of government expenditures and tax rates (Gordon, 23). In this chapter, it will be examined to which extent the state play an interventionist role in the

development experience of the countries under study, Korea and Egypt, as well as highlighting the degree of state autonomy from private actors. The tentative hypothesis is "*Under a firm authoritarian regime characterized by a degree of autonomy and a well established institutional basis to achieve objective planning, the pace of development in faster than in the absence of objective development planning and the institutional basis*".

I. Theoretical Framework:

Nordlinger attempted to treat the state as an independent variable whose autonomy is a function of ***four factors***: "*malleability, resilience, insulation and vulnerability*". The ***autonomy*** of the state means that the state is able to implement its own preferences even if those preferences are incompatible with societal needs. However, the state is aiming at gaining societal support to reduce the risks of any executed action. ***Malleability*** means the degree to which the state is responding to the preferences of societal actors. The second determinant is ***insulation*** which means the importance of societal support, and the dependence on private actors. In more democratic states, there is less insulation implying less state autonomy. Then there is ***resilience***, which means the ability of the state to counteract opposition. The last determinant is ***vulnerability*** which means the choice of acting more, or less, autonomously depending on more or less expecting success (373-83).

Nordlinger, explaining the state society relationship, developed the ***typology of states***. He classifies states as being either strong, responsive, independent, or weak. This classification is based on the level of autonomy -being high or low- and the dimension of social support. A ***strong state*** is characterized by a high level of autonomy translated into public policy, as well as a high level of social support. An

independent state is characterized by a high degree of autonomy, but lacks social support. ***Responsive states*** are acting according to the interests and demands of society which reflects a low degree of autonomy. Finally, ***weak states***, trying to have a high degree of autonomy by acting in a different way than societal demands but failing o do so, end up by having a low degree of autonomy accompanied by low societal support (369).

II. The State and Planning:

Planning from a ***historical perspective,*** started in the 1920s in the Soviet Union followed by other developed countries. Planning was a means to prevent disequilibrium from arising in the economy. After 1945, planning was aiming at transforming a war economy into a peace economy. In the 1950s, the objective of planning changed to become an emphasis on "*development*". At the beginning, planning faced a problem of ideology. Now the issue is no longer whether to plan but how to plan. In other words, the problem became procedural. Planning can be defined as "*a way of thinking, of approaching economic and social problems with the instrument of reason, so that a society may be guided at any point of time to the maximum social welfare*" (Jalaal Al Diin, 5-8). Economic planning is a "*deliberate governmental attempt to coordinate economic decision making over the long run, and to influence, direct, and...control the level of growth of a nation's principal economic variables in order to develop a predetermined set of development objectives*" (Todaro, 504).

Planning is an important concept for both developed and underdeveloped regions. Myrdal argues that underdeveloped regions are poor because they are poor, they are turning in a ***viscious circle***. Underdevelopment leads to low productivity which leads to low real income resulting in low savings and low investment, as well as

capital deficiency ending up in underdevelopment. Development is the tool to find a way out of this viscious circle. The solution to this dilemma is given through capital formation (Todaro, 93). Investments, in order to increase, require the availability of more savings either domestic or foreign. In order to project the growth rate in terms of national output, the state as a planner should estimate the current rate of savings and the capital output ratio. This type of planning is known as ***planning for growth*** (Botros, 60-1). It should be noted that at early stages of planning, problems should be resolved in a pragmatic manner especially that the constraints are unknown quantities. Throughout the process of planning, economic variables start to be quantifiable. Hence, planning is one of the processes that cannot be achieved overnight (Jalaal Al Diin, 58).

There are other categories of planning. In order to affect the growth of the whole economy, the planner is supposed to divide the economy into inter-related sectors which is known as ***sectoral planning***. Planning in ***man power*** is also required since the labor force in any economy is highly differentiated. Farm workers earn less than industrial workers for example. Moreover, among the latter, skilled labor earn more than the unskilled labor. This difference comes from the amount of human investment whether in the form of on job training, or in the form of direct expenditures on education and training. Man power planning is required in underdeveloped areas which suffer of low productivity. The objectives that man power planning should achieve are as follows. First, social and economic development programs should be coordinated with education. On the job training should be enhanced. Labor surpluses should be transferred into more productive areas. Finally, coordination among sectors and regions should be emphasized to achieve the best allocation of man power (Botros, 76-9).

In order to accelerate development in any country, development planning may be necessary. One of the rationale behind planning is that most LDCs are characterized by market failures. There is a price distortion since the selling prices do not reflect the real price of the commodities leading to the misallocation of resources for the future. In this case, planning is needed to allow the best allocation of resources in the future (Todaro, 506). The second rationale is resource allocation and mobilization, that will avoid the waste of the limited skilled labor and financial resources, taking into account the national development program and the long term objectives (Todaro, 507). Finally, the development of detailed plans with specific sectoral targets facilitates the approach of LDCs to donor countries to get access to financial assistance (Todaro, 508). The ***role of the government*** in planning is a "*priori accepted*". In general, the government has two tasks to accomplish. First, the state is responsible for developing economic institutions conducive to economic development. It is also responsible to build an efficient administrative machinery. It has to ensure the flow of comprehensive statistical information and to be knowledgeable of natural resources. Second, the government has to determine the extent of its control and ownership of the means of production. On the level of decision making, it should determine the degree of centralization or decentralization (Jalaal Al Diin, 20).

The degree of ***government intervention*** varies with the complexity of problems, and depends on the present level of a country's economic development. The lower the rate of capital formation, the more government control is required in order to achieve high rates of growth through establishing a set of saving and investment incentives. ***Centralization*** in decision making may be required till the break even point determined by the degree of efficiency of the planning techniques and machinery responsible for the formulation and implementation of the plan (Jalaal Al Diin, 22).

III. The state and Human Capital Development:

The interest of the state in getting involved in education has two aspects. It can be looked at as a strategy for providing skilled labor required for the capitalist industrial expansion; and at the same time, education can be an ideological instrument required for socializing the working manpower, or getting the proletariat educated. In the 1960s, ***educational programs*** in the Third World had expansion as a goal rather than changing the character of education, despite the fact that the newly independent nations replaced the foreign content in their educational curriculum with contents related to national traditions and culture. Educational reform took place in the following areas: equality of educational opportunities which were once discriminated based on sex, socioeconomic status, and regional and ethnic backgrounds; development of science teaching, increased efficiency of internal school administrative systems, and the enhancement of school programs to the perceived national needs. Although statistics show that public expenditures on education as a percentage of GNP and national budget in the developing nations increased, expenditure per student is less than in the developed nations. There is also a high degree of waste represented by the high dropping rate and repetition rate among students. Finally, administrative development, and research capabilities are incompatible with the growth in size of the educational sector (Atlas of the Third World, xii).

Many economists argue that the human resources of a nation are the real determinant of the "*pace*" of development:

> *"Human Resource ... constitute the ultimate basis for the wealth of nations. Capital and natural resources are passive factors of production; human beings are the active agents who accumulate capital, exploit natural resources, build social, economic and political organizations, and carry forward national development" (Todaro, 363).*

The state is playing a crucial role in providing ***public goods***, which represent social infrastructure, such as education and health. This is known as human capital development which is defined by the United Nations as being the process of widening people's choices. These choices are very broad, but "*at all levels of development, the three essential ones are for people: to lead a long and healthy life, to acquire knowledge, and to have access to resources needed for a decent standard of living*" (HDR, 4). Economic growth is needed to increase government spending on social infrastructure such as health and education. Human development will affect the economy both on the demand and supply sides. On the supply side, human development leads to a better education and healthier labor force which will increase productivity, which in turn will lead to economic growth. On the demand side, a productive labor force implies a higher wage, which increases effective demand which is favorable for development (HDR, 74).

The UN Universal Declaration Of Human Rights, in 1948, declares: "*Everyone has the right to education. Education shall be free at least in the elementary and fundamental stages*" (Atlas of the Third World, xi). Looking at ***education***, we find that the state is playing an increasing interventionist role. At the beginning of the nineteenth century, and with the prohibition of children exploitation and work, schools were provided. Schools for the proletariats were organized like factories, which means that values such as order, subordination, punctuality, respect for authority, and hierarchy were emphasized. With the development of Capitalism, schooling became more important since they represented the linking institutions between home and work (Sarup, 44-5).

Having looked at the origins of state intervention in education, and its development with the development of capitalism; as well as the Marxist and Liberal

view explaining the role of the state in education, we will try to understand the increasing role of the state in education during the last two decades. The functioning of the capitalist system has to be understood. Capitalists' goal is to maximize profit. To increase the profit gained, producers have to sell commodities at lower prices than their competitors. Production cost has to be decreased through the increase of the quantity produced. To cut the production cost, capitalists substitute machines for workers. In order to maximize profit, capitalists use more machinery through the use of the ***constant capital***, and in the same time they increase labor productivity through providing the basic skills acquired in education. Manpower represents the ***variable capital*** which cost wages. This is because labor and machinery are the two variables that can be combined differently in order to get different results, having as ***constraint***, a limited number of working days and hours (Sarup, 55).

Health problems is another issue. The nature of problems in the developing areas is very different that in the developed world. In the former, more than 40% of the deaths are from infectious, parasitic, and respiratory diseases. Statistics show that most developing countries spend less than 1% of their GNP on health compared to an average of 6-12% in the developed areas. There is also a geographic discrimination, since health care in the urban cities has shown to be more effective than in the rural areas. As a result, the quality of health in the developing world is suffering from many defects: availability, orientation, and cost (Atlas of the Third World, xii). And since health is the determinant of the quality and quantity of the labor force, the state intervenes to deal with the above mentioned defects, by spending a greater percentage of the GNP on health care, improving the quality of health in rural areas by providing clinics and subsidizing medicines if necessary, and orient health care to the major

decease available in the country such as Ineffective Hepatitis as a example of epidemic decease, and bilharsiozis as an example of endemic decease.

IV. Agriculture and State Intervention:

Agricultural problems facing the periphery are directly linked to international factors over which these developing countries have no control. Problems have been aggravated by the protectionist tools undertaken by developed nations, artificially determined commodity prices through price control, the international debt crisis, and the increased intervention of the IMF and the World Bank in policy decisions in order to be able to cover debt servicing. Third world countries are asked to finance their debts at the same time that they are undertaking strategic investment required for development. This could be only achieved through increasing export earning which seem to be declining. Countries which rely mainly on primary products exports - agricultural products- were the most hit. Agricultural development in the developing countries is facing two major problems: laissez faire policies are not existing, as well as market determination of primary commodities prices. As long as these two problems remain, development of agriculture will be one of the most difficult tasks that the state should meet (Yesilda, 232-3).

Policies regarding agriculture expansion is a controversial issue where governments have "*one foot on the accelerator and one foot on the brake*" since they encourage and discourage farm production simultaneously. Agriculture could be the best sector to which perfect competition can be applied, since monopoly cannot take place. However, in many countries, governments are dominating agriculture. It could be argued that this is because, farmers are politically organized into lobbies (Knudsen, 1-3).

Hunger is not caused by the lack of food but rather by poverty. Many developing countries are using their land to produce coffee, cocoa, sugar, and bananas as a source of exports earnings after their selling to wealthy customers. It is argued that: "*if land used to grow these products were given over to cereal production, then all Africa and Latin America would become truly self sufficient in food*" (Atlas of the Third World, xi). Such an argument shows the importance of development planning to establish clear targets to be achieved. The government in the periphery has to chose between using the agricultural land to produce products used for foreign earnings. However, the reliance on primary and agricultural products is not the optimum path to development.

V. Industrialization & the Role of the state:

Development is a process of major structural transformation where industry plays a crucial role. During this process, government intervention may be required for the efficient allocation of resources required for structural shifts necessary for development. Some argue that during the early stages, the reliance on primary exports should be replaced by manufactured commodities and new industries should be protected (Weiss, 83). An *active state* shows a shift from a situation of "*classic dependence*" to one of "*dependent development*" within which industrialization is promoted (Evans, 211). Dependent development is a "*pattern of growth*" resulting from having a country from the periphery included in the World capitalist system through its ties with the center or the developed nations (Todaro, 102). From a ***radical*** point of view, industrialization should be implemented through a high degree of state intervention, a protection from foreign competition, and a control over direct foreign investment (Weiss, 164). The industrial policy can cover a wide range of issues. With

respect to ***foreign trade*** policies, inward looking vs. outward looking strategies are the most vital. Inward looking strategies directly imply ***import substitution*** industrialization, where incentives are given to industries that satisfy domestic demands which were previously served by imports. To ensure this strategy, the government has access to tools such as imposing restrictions in the form of tariff barriers and quotas on imports; as well as limiting and restricting the accessibility to foreign exchange. On the other hand, an outward looking oriented economy adopts an ***export promotion strategy***. Here, bias against exports are removed, the reliance on imports is minimal, and import tariff rates are lower than under an import substitution strategy. However, it has to be noted that an export promotion strategy does not necessarily imply free trade because a divergence between domestic prices and international prices can still exist. The most successful example of outward oriented economies is the Asian gang of four. By the 1970s, the economies that have adopted an outward looking trade strategy have shown to be more successful than the inward looking economies (Weiss, 26-8).

The second set of policies is related to ***price distortions*** in the major markets of the economy includes distortionary vs. non distortionary policies. Some economists would link market price distortion to the adoption of inward looking strategies. But this is not always the case. For example, the Philippines in the 1970's adopted an inward oriented policies and was considered among the low distortion group. However, a negative relationship can be drawn between the level of distortion and the economic performance; since the more distorted economies grow more slowly in terms of GNP and industrial output (Weiss, 40-1). The third set of policies is related to the ***prevailing economic system*** in the economy as being whether capitalist or socialist. However, in my opinion, this is a difficult line to draw between the two systems. This

is because the two systems are rather hypothetical and do not exist in real life. For example, the United States is considered the major capitalist country, but in fact it violates one of the basic norms of capitalism -the price of factors of production is to be determined by market forces: supply and demand- by setting a minimum wage for the labor force, for example. The US is also subsidizing the companies owning the railways, which violates another aspect of capitalism.

VI. Typology of State Intervention:

With respect to the interventionist role of the state in the periphery, the relationship between state and development can be categorized into the following regimes. In a ***neo colonial regime***, despite the fact that the state got its independence from the colonial power, it undertakes policies that serve the interest of Multi National Corporations -MNCs- and the bourgeoisie allied with foreign capital (Weiss, 161). In this case, the state loses autonomy in favor of the transnational bourgeoisie. At the same time, it lacks social support since it ignored the interests of "*independent national capitalists*", as well as the mass formed of peasants and workers.

In an ***intermediate regime***, the state is neither totally capitalist nor socialist. The dominant social division is formed of an alliance between the lower and middle classes. This group is formed of rich peasants, small capitalists, and functionaries. This regime is characterized by nationalist orientation. The bourgeoisie -the upper middle class- is weak. This situation ends up by having what is known by state capitalism where nationalization of assets takes place; accompanied by strategic investments pursued by the state. The presence of a lower-middle class alliance prevents such a regime from becoming socialist. The intermediate regime is seen as transitory reflecting the weakness of the existing social classes. If growth is pursued and the private sector

develops, this will end up by having capitalism. On the other hand, if growth does not take place, and low political participation persists, the state capitalism will end up in a socialist regime (Weiss, 162).

In a ***developmental capitalist regime***, the state plays a more positive interventionist role with respect to capital formation. The state promotes the accumulation of capital in the same time of being independent from domestic and foreign capital. In other words, this model discusses the *triple alliance* between the state, domestic, and foreign capital. Dependent development requires the alliance of the state with local and multinationals capital in order to achieve considerable capital accumulation (Evans, 211). But in the same time, whenever, MNCs' policies contradict the greater goal pursued by the state, the government intervenes and adjust the policies implemented (Weiss, 162). Studying the role of the state in Korea, this model is the most applicable to Korea as it will be shown in the analysis.

Finally, in a ***national popular regime***, an alliance, between functionaries who have achieved their positions through revolution on the one hand, and the group formed of peasants and lower middle class on the other hand, is achieved. There is a nationalist orientation and strict redistributive measures in favor of the popular class (Weiss, 163). This model describes the status of Egypt in the post 1952 Revolution.

Chapter Three
The Role of the State in Egypt

The role of the state in Egypt has changed with the change of the existing political regime. There was a highly autonomous state during the era of Mohammed Ali where the state monopolized agriculture, manufacturing and trade. The Egyptian labor force worked in the factories, in the army, or were organized into corvees for work on the irrigation system. This was transformed into a ***national popular regime*** under Nasser. Under Sadat, it could be argued that the prevailing system can be looked at as a neo colonial regime where foreign investment was encouraged and the interest of the bourgeoisie allied with foreign capital was served. With the rule of President Mubarak, a developmental capitalist regime exists where there is a triple alliance between the state, domestic and foreign capital, coordinating to achieve capital accumulation, noting a positive interventionist role of the government. A more analytical explanation of the role of the state in development is discussed since the 1952 Revolution till Mubarak. The major events of each regime since the 1952 Revolution are shown in **table 2**.

Table 2
Political Regimes and Major Events

The Period	Major Events
The Era of Nasser 1952-1970	*State Controlled Economy.* *Redistribution of land.* *Nationalization movement.* *The Suez Crisis in 1956.* *The 1967 War.* *High reliance on Soviets.* *Public sector = the engine of investment.* *Import Substitution strategy.* *Investment was directed to the productive*

	sector.
	Centralization in decision making.
The Era of Sadat 1970-1981	*The 1973 War.* *Oil Boom.* *Consumption Boom.* *Import substitution strategy.* *Flow of Foreign Capital into Egypt.* *Investment was not directed to the productive sector.* *Camp David Accord.* *High reliance on Americans.* *Heavy debts and reliance on foreign loans.*
The Era of Mubarak 1981-present	*Rebuilding the Infrastructure.* *Implementation of regular Five Year Plans.* *Implementation of Structural Adjustment Program and economic reform.* *Export promotion.* *Trade Liberalization.* *Financial Liberalization.* *The Gulf War and reduction of debts.*

Egypt, a British Colony:

During the ***colonial era 1882-1952***, the industrial sector was neglected. The Egyptian government had no choice but to adopt an open door policy dictated by the colonizers. This worsened industrialization efforts since such a policy implied the absence of protectionism which was needed by the infant industries in the economy. In the 1930s, a tariff reform was imposed aiming at protecting industries. It has to be noted that the international depression of the 1930s helped in the establishment of an Egyptian industrial basis in order to serve the interests of the colonizers (Abdalla, 91-2). Statistics show that sugar production changed from 79,000 tons in 1917 to become 159,000 tons in 1939 marking an increase in quantity of 101% to meet the demand of the colonizer. The labor force shifted from the agricultural sector to the industrial sector as indicated in **table 3.**

Table 3
Percentage Distribution of Labor Force by Economic Activity in Egypt

	1897	1960	1970
Agriculture	68	58	51.3
Industry	11.5	12.6	18.6
Transportation & Commerce	8	11.7	13.5
Services	12.5	17.7	16.6
Total	100	100	100

Source: CAPMAS. ***Population & development***. Cairo. June 1973. p.174.

The growth of the economy during the period between 1882 and 1952 could be characterized as Mead put it "*by proportional expansion all around*" with the predominance of agriculture. Industry contained mainly of the primary processes done on agricultural products such as cotton ginning. The agricultural sector was marked by a limited supply of cultivable land accompanied by an expansion in labor, irrigation facilities and fertilizers. This caused an increase in agricultural output by 30%. However, average food consumption per head declined by 10 to 15% due to the rapid expansion of population (Mead, 247-8).

The transformation that occurred in the Egyptian economy under the British colonization was made in accordance to British needs. The economic activity between the two nations became tightly integrated: Britain was extracting the raw material from Egypt, transferring it to Britain where it was manufactured then brought back to the

Egyptian market to be sold. The integration was achieved through British investments in railroads, ports, communications and heavy industries. Britain improved transportation and communications in order to serve its own benefit. With the outbreak of the first World War, Egypt can be looked at as a typical case of the Liberalism's laissez faire where free trade was advocated; in addition to the following manifestations, the absence of restrictions on the movement of capital and the absence of a central bank to control the money supply, as well as the non interference of the state in production. Under the British rule, the state's role was limited to promote infrastructure and "*slightly protect*" small entrepreneurs. The task of economic development was left to the custody of private enterprises (O'Brien, 43-6).

The period between the two World Wars and the revolution of 1952 was marked by the going back of the state to central control. This shift was due to the following reasons: the two World Wars which required central control over production, the international depression which occurred during the third decade of this century, the transmission of power from the hands of colonizers back to the hand of Egyptians, and finally the realization that effective economic development had to be accomplished through the state control (O'Brien, 46).

Egypt and the 1952 Revolution:

In the post 1952 revolution period, and after Egypt got its independence, a common characteristic to agriculture and industry under ***Nasser*** was the high involvement of the state in making decisions concerning output and investment. Nationalization undertaken by the state by the early 1960s, gave rise to a diversification of production and the creation of new enterprises. During this period, the state monopolized investment in infrastructure. Due to large investment in

housing, health and education; in addition to the public enterprises, the rate of employment in the government non ***agricultural*** sector almost doubled. It increased from 13% in 1947 to 27% in 1960. Nasser's regime could be best described as being "*the extent of the involvement of the government in the direction of the economy*". From 1952 to the early 1960s, the major goal of the state with respect to agriculture was the redistribution of land and social power in rural areas. In July 1961, the second land reform law was issued lowering the maximum amount of land that a person can hold to 100 feddans. The sequestered land was sold at half of its market value. In 1964, a new law readjusted the selling price at one fourth its market value (Abdel Fadil, 9).

With respect to ***industry***, nationalization and the diversification of the industrial output, in addition to an import substitution strategy, constituted the guidelines of the state. From 1960 to 1967, heavy nationalization movement of banking, enterprises and foreign trade took place. Also quotas were imposed on imports. The economy became highly centralized, and was subject to planned resource allocation causing a growth in public ownership. The policies caused a decrease in the level of productivity, high level of domestic investment, a restricted foreign trade accompanied by an annual GDP growth of 5%. Domestic rate of savings was low causing a certain degree of reliance on external borrowings. The 1967 disastrous war with Israel, causing the allocation of resources in non productive sectors such as the military, caused a major internal recession (Commander, 7-12). Egypt, under Nasser, was transformed into a "***state controlled economy***". Infrastructure, large scale production, finance, and foreign trade were incorporated in the public sector, and were run by public enterprises through the direct administration of the government. Agriculture was not totally free from state intervention. Agricultural cooperatives which administered crop rotation and delivered

certain inputs represented central control with cropping patterns (Hansen, 243-4). In other words, a predominantly private enterprises economy was converged into a mixed, state controlled economy through nationalization under the presidency of Nasser.

<u>Egypt under President Sadat</u>:

By 1973, and under the rule of President ***Sadat***, the regime had structural factors that shaped the nature of decisions to be made. The first structural factor constitutes the socialization of the economy which took place between 1961 and 1964. The goal of Nasser was rapid economic development. By forced savings in the form of nationalization undertaken by Nasser, the regime succeeded in directing savings and investments to productive development plans formulated by the state. The second factor was the impact of the 1967 war. Beside military defeat, the war harmed the country in the following ways. It deprived Egypt from major sources of hard currency. The loss of the closing of the Suez canal amounted at LE 4 billion; the loss of Abu Rudeis Sinai oil field reached LE 2 billion; another loss was the drop in tourism revenue due to the unstable political environment (Waterbury, 1-3).

This period was characterized by a reliance on Soviets which was disadvantageous since the technology sent to Egypt was of inferior quality. In addition, Egypt was losing foreign exchange by exporting its products to the communist block having bartering as the basis for exchange at lower than market prices. Sadat saw a number of solutions: to allow the re introduction of market forces instead of central planning, to reinforce the competition among the public sector in order to reach a better quality at lower prices, and finally to welcome foreign private investment in order to revitalize the Egyptian economy, technology and managerial skills. The

Egyptian bourgeoisie -the class of investors and capitalists- was threatened by such measures either because of the ending of the monopoly status, or by the invasion of foreign investment which imply "*the survival of the fittest*" as Darwin would put it (Waterbury 429-30).

After the 1973 war, Egypt adopted an open door policy aiming at revitalizing the Egyptian economy by bringing foreign capital, Western technology and experts, as well as horizons to new markets (Waterbury, 6). The ***opening policy*** included various measures: the float of the Egyptian pound so that the currency would be purchased at its true value which would promote exports; to free foreign trade provide the easy involvement of investors into international markets; to free the domestic trade between the public and private sectors and enterprises, to have progressive tax rate meaning that the amount of tax to be paid should increase with the increase in the personal income; to increase the ceiling limit of landowners; to allow foreign banks to operate in Egypt dealing in both hard and domestic currencies; and to promote foreign direct investment as long as they are in harmony with the state planned goals. The goal of the regime can be simply put in the following equation format:

> *"Arab capital plus Western technology plus Egyptian labor and markets minus population growth would release economic growth"* (Waterbury, 9).

<u>Egypt under President Mubarak</u>:

When president ***Mubarak*** came to power in 1981, he inherited a country influenced by the legacies of the two contradictory systems of Nasser and Sadat. The legacy of Nasser was that the bureaucracy increased considerably in size, the public sector was "*the engine of investment*", and import substitution with respect to industrialization constituting the central development policy. The country was highly

centralized, and etatism was the major ideology. The legacy of Sadat's opening, or infitah, was that the engine of investment became foreign, Arab and private domestic capital. This engine was refrained by the old Nasserist engine resulting in not creating the investment climate required for development. A consumption boom took place. Import substitution remained the main strategy. No investment was made in the productive sector. All that led to marking heavy debts and deficits in the Balance Of Payments (Hinnebusch, 159-60).

Planning in Egypt:

Development ***planning*** in Egypt was generally non existent prior to 1952. The economy was run with a system of laissez faire, with certain restrictions on the production of cotton, and some regulations on the exchange rates. Following the coup d'etat of 1952, the system did not change radically because the new government did not have a clear and determined economic philosophy. Policies were determined yearly depending on the prevailing circumstances (Jalaal Al Diin, 52-3; 58). The turning point was in 1957 following the Suez crisis when basic commodities became unavailable. There was a shortage in the supply of wheat, petroleum products, and medical goods. That period also experienced the nationalization of the British and French properties. Due to these conditions, and in order to ensure the best allocation of public investments, the Economic Development Organization -EDO- was established. Despite the goal elaborated by the Chairman of the EDO as being "*not the transfer of investment from the private to the public sector, but to have paralleled private investment*"; private capital did not expand as planned (Jalaal Al Diin, 60). There was a fear of nationalization, as well as of the rapidly growing public sector. Also industry was considered a new field beyond the reach of the private sector. In addition, the late

1950s was also marked by a lack of coordination among the National Planning Commission, the EDO, the Ministry of Industry, and the remaining public authorities (Jalaal Al Diin, 60-3).

The ***Planning Commission*** did not have the necessary power required for research needed to develop a national plan. When it saw the need to establish a national account in order to be able to develop an accurate national plan in 1956, the Planning Commission was pressured to formulate a short term national plan due to the then prevailing economic conditions. This ended up in the form of a transitional plan for a two years period aiming at preparing the economy to sustained growth at a higher rate than the rate of population increase. The five year plan that followed aimed at implementing 90% of the investment projects through public authorities and the remaining 10% was to be executed automatically through the private sector as a response to monetary and fiscal incentives (Jalaal Al Diin, 63; 76). To conclude the status of planning in Egypt can be summarized as follows:

> *The Supreme Council for National Planning consists of the President of the Republic and all Ministers...It gives general directives and approves the plan in its final form. The Plan is prepared by the Planning Commission of the Ministry of Planning...which receives proposals and programs of development from all ministries and agencies...Each Ministry has its Planning Commission which prepares the plan of development...The Planning Commission has no executive responsibility...Ministries...are responsible, each in his field of work, for executing the projects and realizing the targets of the plan" (Jalaal Al Diin, 81).*

After the war of 1973 with Israel, the government paid attention to economic ***planning***. The first five year plan -FYP- of 1982/3-1986/7 focused on improving the infrastructure which was neglected during the years of wars. According to the Ministry of Planning -MOP- statistics, actual investment in transportation and communication amounted to LE11.3 billion in the period of the first FYP representing 20.1% of the

national economy. In the second five year plan covering the period of 1987/8-1991/2, investment reached LE20.6 billion compared to LE17.2 billion in 1992/3-1994/95. The second FYP focused on economic reform and the increased role of the private sector (EIU, 14). According to the MOP, the third FYP of 1992/3-1996/7 is focusing on maximizing the society's potential. Production is to reach its full capacity in order to have the Egyptian products able to compete internationally in terms of cost and quality. The third FYP is taking into consideration the global economic changes making of quality improvement one of the major strategic goals of the plan in order to allow Egyptian products to compete internationally in the markets. A general remark is that the GNP of the world is having an increasing trend since the GNP of the developed countries is reaching an average of 3.1% during 1995 compared to only 2.4% during the previous year. With respect to Egypt, GDP during the three years 1992-95 reached a total of LE145.8 billion compared to LE 131.1 billion at 1991-92 prices. This indicates an average rate of growth of 3.6% annually. The basic goal of the plan became to reach a GDP growth rate representing three times the population growth rate. Also in order to invade the international markets, updating the technology was required, as well as quality control in order to reach international standards (MOP, The Third FYP).

<u>Physical Infrastructure in Egypt</u>:

The development of basic ***physical infrastructure*** in Egypt was as follows. Prior to World War I, Egypt had a fully adequate and modern physical infrastructure in transportation, communication, and urban public utilities. In 1852, the first railroad was opened and in 1914 railroads covered Egypt from Alexandria to Aswan, and from Cairo to Port Said and Suez. Cities have been modernized before the first World War,

and major roads were constructed in the interwars period. Telegraph and telephone were established by the end of the 19th century. In 1869, the Suez Canal was inaugurated and by the time of its nationalization in 1956, it became a source of foreign exchange (Hansen, 40-1).

<u>Social Infrastructure in Egypt</u>:

Looking at the development of the ***educational system*** in Egypt, it is obvious that during the colonial era, education was neglected, since it was assumed that investment in human capital would create an educated elite able to undergo potential economic development (Moussa, 25-6). The 1923 Constitution guaranteed free compulsory education for children from seven to twelve years old. At that time, the existing educational institutions -public university and private schools- were serving the residing foreign community and to a certain extent the high income class of native population. After the 1952 revolution, progress in the secondary system has been fast marking in 1964 an enrollment rate of 70% for males and 46% for females especially after the charter of 1962 which abolished tuition and admission was made free(Hansen, 229). This rapid growth in higher education created an unemployment problem after 1964 when all graduates were given a right to employment. However, the literacy rate amounts to only 51% of the population for 1986 despite that public expenditure on education amounting to 4.1% of GNP in 1960 and 6% in 1990 (HDR, 69). It has to be noted that such figures are quite high compared to other expenditures even in South Korea which amounted to 2% of GNP in 1960, and 3.7% in 1990. The quality of education has been declining at all levels. Hence educational efforts cannot be considered as a successful experience for Egypt (Hansen, 245). This may be explained by the high dropping rates, the harsh economic conditions under which the mass in

Egypt is living. Others would argue that high dropping rate is related to high rate of failures due to the difficulty of the Arabic language.

<u>The State, Price Control, and Public Enterprises</u>:

The state also intervened in the ***price system***. With President Nasser price control increased, then decreased under Sadat's infitah. Intervention of the state distorted prices which led to major deficiencies in the economy and decelerated growth. With respect to ***agriculture***, products were subject to direct price control. Seed cotton, wheat, sugarcane, lentils, sesame, and rice were subject to low and fixed prices (Hansen, 169). Official control over wheat and rice forced farmers to turn to fruits, vegetables, and livestock which were free of price control. The result is that Egypt is today importing annually six million tons of grain (Atlas of the Third World, xi). Hence the problem does not consist of the presence of inefficient farmers, but rather of the implementation of ineffective policies.

From the early 1960s, the Egyptian government used ***public enterprises*** as a tool either by expanding the existing enterprises or by simply creating new ones A characteristic of Egypt is that the state intervention still is largely present. The high level of public enterprises shows the pragmatic approach to economic development of the government. The role of the state is not only restricted to the provision of a suitable environment for the entrepreneurs to perform their functions, but also in the provision of the basic goods subsidized. Some would argue that such a function can be looked at as a tool to maintain domestic stability and social order. The most important factor enabling the state to direct its economy was its control of the country's financial system.

The state autonomy in Egypt:

Analyzing in more depth the state ***autonomy*** and the Egyptian class structure, the following can be concluded. The state was characterized by a high degree of autonomy especially under Nasser. The state autonomy was seen by having Nasser going against the preferences of the then dominant social classes in 1952, 1961, and 1966. Surprisingly, he was faced by little resistance. This situation could be explained by the model presented by Hinnebusch labeled as "*strong state- weak society*". According to this model, economic reform results from having the state getting stronger after a long period where it was weak. Reform represents the state's own interest and is imposed even if it is against dominant societal interests (159-71). State autonomy at that period in Egypt was deeply rooted due to several factors. First, Egypt experienced for a long time non Egyptian rulers. Nasser was the first "*native son as the head of the state since the pharaohs*" (Waterbury, 234). For a long time, Egypt was dominated by foreign powers where various class structures dominated. Under the Ottoman Empire, no one class dominated. The then existing class structure had no obvious links to the forces controlling the state. At the dawn of the twentieth century, a class emerged as being controlling the state in favor of its own interests. This was the middle and large landowners' class, especially the producers of cotton for exports (Waterbury, 234). State autonomy under the British rule was directed into financial regulation and irrigation. The state founded the Caisse de la Dette Publique in order to direct revenues to pay off debts. The state also expanded in the cultivation of the cotton crop. It was only under Nasser that the state expanded and diverged to other areas of the economy. By the 1960's, the state autonomy decreased due to the emergence of a large managerial class interested not in owning but in controlling the means of production (Waterbury, 234). Under the era of Mubarak, the dominant class

became the entrepreneurial bourgeoisie. However, it was argued that the bourgeoisie is far from seizing the state's power. The bourgeoisie can influence decision making by the threat of retrieving investment from Egypt and sending it abroad (Hinnebusch, 159-71). Throughout history, the role of the state in Egypt covered the major areas of the economy. The reason behind having chosen the era of Mohammed Ali as a starting point is that Egypt's industrialization started during this period. Then it was interrupted and re-started under the presidency of Nasser. The first half of this chapter presented the role of the state in Egypt.

Chapter Four
The Role of the State in South Korea

Moving now to the role of the state in South Korea, the analysis will be drawn starting the colonial era in order to trace the legacy of colonialism, until the 1980s. A special emphasis will be given to the presidency of Park Chung Hee since the Korean industrial revolution took place during this period, the 1960s and the 1970s.

The Colonial period 1905-1943:

This section will describe the role of the state under the colonial era in South Korea. The situation of ***agriculture*** under the Japanese colonization -1905 to 1943- was as follows: the colonial goal was to increase rice exports using tools to ensure this goal such as high rents, land taxes and the extension of Japanese ownership (Hwang, 14-5). With respect to ***manufacturing***, the colonialists prevented the development of Korean enterprises. The tool used to pursue this goal was the corporation law which restricted investment in the agricultural sector. The share of manufacturing in total output was less than 7% at the beginning of the colonial era which increased to become 14.3% in 1920 after the abolition of the corporation law. ***Trade*** during the colonial period was concentrated into Japan: 85% of Korean exports went to Japan and 73% of Korean imports came from Japan. Rice represented 37% of the total Korean exports by the late 1930's (Hwang, 16-9).

Korea's first great ***industrialization*** started at the end of world war I and expanded during the 1930s especially after Japan seized Manchuria. This process was suddenly interrupted by the Japanese defeat in the second World War. Up to that point, colonialism can be described as being "*both the catalyst and the cradle of industrial development in Korea*" (Eckert, 254). This means that during the colonial period, the

industrial basis was established in the following way. Colonial industrialization gave rise to a ***new social class***, a modern labor force , a native capitalist class. The colonial government showed the predominance of the state in economic affairs. Moreover, the colonial era created a ***high degree of dependency*** (Eckert, 253-7). The Korean industrial revolution took place between 1935 and 1945. Korea inherited the ***state directed development*** from the Japanese colonial state. Although Japan developed Korea to meet the short term needs of the colonial economy, Japan did not limit its efforts to agriculture and industry. It also covered investment in infrastructure, education, and health. In 1900, very few railroads were available. By 1920, more than 600 kilometers of public railways; 3,553 kilometers of roads; and harbor facilities were developed. The death rate in Korea fell from 35 to 23 death per thousand from 1910 to 1935. With respect to education, primary school enrollment increased from 20,000 in 1910 to 901,100 in 1937 (Chowdhury, 37).

The Post Independence era:

By the end of World War II, Korea obtained independence from the Japanese occupation which lasted for three decades. In 1953, after the Korean war -1950 to 1953- ended, the ***revival*** of the Korean economy was pursued. The economic condition prevailing during that period was the promotion of import substitution of non durable consumer and intermediate goods , in addition to protective high tariffs and quotas. Hence, the annual average growth of GNP between 1954 and 1962 amounted to 3.7% . Commodity exports were less than 1% of GNP. This was due to the overvaluation of the domestic currency and the extreme anti import policy. ***Foreign aid*** were the main source of funding projects since national savings were

almost non-existent and industrial income was kept at subsistence levels. The major projects' funder was the United States.

Development of Human Capital:

In the post independence period human capital was subject to special attention. ***Education*** was considered a source of upward mobility and new job opportunities; a common goal was shared by all citizens i.e. the reconstruction of the nation. All these factors encouraged education. Data show that elementary education increased between 1945 and 1960 by 265%. College students increased from 8,000 in 1945 to 100,000 in 1960. Consequently, illiteracy rate dropped from 78% to 28%. However, this drastic improvement in education caused a major problem: unemployment among university graduates reached 20% in the 1950s. Therefore, investment in the industry was needed to create new job opportunities (Corbo, 9). ***Land reform*** constituted another major development in the 1950s. The first step undertaken by the government was the land reform act of 1949 limiting the possession of farm land as a measure of more equity in the distribution of income. The social benefit of such an action was considerable, the wealth of the minority upper class landowners decreased and the income of small farmers increased. This caused an improvement in rural living standards. Thus, during the post war period between 1953 and 1962 the Korean economy was subject to ***slow growth rate*** in addition to a ***trade protectionism regime*** and an import substitution policy. Moreover, the ***great expansion in education*** and the ***equitable distribution of income*** and wealth "*paved the way for future development*" (Corbo, 10).

Planning in Korea:

Looking at ***state planning*** in Korea in 1958, the Economic Development Council -EDC- was created by the Ministry of Reconstruction -MOR- and was given the responsibility of developing a long term economic plan. Economists were trained to plan, statistical gathering procedures were improved, and the various ministries were trained to coordinate. The Plan represented to the government in 1959 was not implemented because the Rhee's government collapsed. That period experienced a cut in US aid which slowed investment and growth which started in 1958. Chang Myon, who took over stayed in office for only ten months was reversed by a coup d'etat led by Park Chung Hee. Park established control over political events by dissolving the National Assembly and the existing political parties, taking anti communist laws which widened the degree of state power to arrest opponents. He also created new ministries as well as trading associations. In other words, he succeeded in creating, almost "*overnight*" the institutions and structures required for planning (Landsberg, 46-7). Korea's first five year plan introduced in 1962 marked the government provision of a national economic vision and program for the first time. This plan also reflected the political leadership's commitment to development. Throughout the planning process, ministries get informed about the concerns and priorities of other ministries. Planning facilitated inter ministerial cooperation and coordination in formulating and implementing economic policies. Korea's planning can be summarized as follows:

> *"Korean planning has been only partially successful in charting a detailed path for the economy to follow...It has functioned as a sort of economic topographic survey which educated officials and allowed them to make the intelligent short term policy decisions that really drive the economy. It has also had a major announcement effect articulating leadership commitment and giving the general guidelines and implicit promises of support that facilitate private planning" (Sakong, 49).*

In 1961, president Park Chung Hee came into power and made Korea one of the fastest growing economies:

> *I promise...that I will be a president who will work hard. I will personally look after city construction projects as well as farmland reclamation...I will be enthusiastic in visiting construction sites...thereby encouraging speedy progress in development...I will initiate any project which is conducive to the achievement of a self sustaining economy (Mahn, 2).*

Park recognized that there was a growing dissatisfaction with the political economy of South Korea. He also realized that North Korea with state intervention was growing more rapidly. During that period, the industrial base was strengthened and major changes were implemented in the country's development policies through institutional change and policy reform. Since Korea is characterized by limited natural resources and a small domestic market, the government adopted "***an outward looking development strategy***" aiming at increasing exports. In order to mobilize savings and resources, the government decided in 1965 to raise the rate of interest on banks' deposits from 12% to 26.4%. Consequently, saving deposits in banks doubled in a period of less than three Years. In order to encourage the flow of foreign capital the country, a foreign capital promotion act was passed in 1966. Looking at institutional measures undertaken by the government during this period, an export promotion council was founded and an economic planning board was formed in 1961 (Corbo, 10-2).

The late 1970s saw a considerable increase in world oil prices. To cope with this international feature, Korea adopted "***tight financial policies***" by reducing government expenditures. Inflation continued to rise having a fixed exchange rate which caused loss of external competitiveness as well as slower market growth and greater protectionism abroad which were direct reasons for the shrinking of the volume

of Korean exports. The ***fiscal policy*** goal in 1979 was to decrease the public sector deficit which was reduced from 2.5% of GNP in 1978 to 1.4 in 1979 (Holmes, 94). In the first half of 1980, the increase in oil prices and the devaluation of the currency caused imbalances in the economy which were offset by a reduction in government expenditures. In the second half, the government accelerated its spending to offset the slow down in the economic activity (Holmes, 94).

By the beginning of 1981, the Korean economy was characterized by severe economic recession. In order to offset such conditions, the government relaxed the financial policies and improvement took place: average annual output increased by 6% while inflation rate decreased to 4% of the GNP. However, the problem still existed since the economy was not operating at its full capacity in addition to the need of external finance. The economic policies for 1981-2 were designed to "*revive*" the economy. The exports grew in 1981 as a response to improved competitiveness and a recovery of the agriculture. But due to the widespread ***global recession*** in 1982, exports decreased. Output was matching domestic demand still operating below full capacity. The weak export performance was directly related to Korea's external debt and the emerging international debt crisis. During that period of recovery, structural policies were designed to increase the productivity and efficiency of the economy through public sector investment, tax reform and ***trade liberalization*** (Holmes, 99-104). The Adjustment policies were designed by the ***IMF*** aiming at stabilizing prices and reducing the reliance on ***foreign assistance***. The financial policies during the period consisted of a sharp reduction in the public sector deficit. Also a flexible exchange rate policy was implemented in order to improve external competitiveness. Thus trade and financial systems were liberated. These policies caused a revival in the export led growth, a decrease in domestic inflation as well as an improvement in

Korea's external position. In the period 1983-84, GNP increased by 8%, inflation decreased to 2% and the growth of external debts decelerated. It is worth noting that although Korea is the fourth largest debtor among developing countries, it ranks 16th in terms of debt/export ratio and 15th in terms of debt/service ratio (Holmes, 107).. In 1986, where strong economic policies were pursued, real GNP increased by 12%, inflation remained low, and the external current account marked a surplus. The adoption of an ***export led strategy*** facilitated the promotion of Korea's comparative advantage, and it compensated for the size of the domestic market. Meanwhile, efforts were made to liberalize imports (Holmes, 105-10).

In market economies, the government influences private investment by providing incentives to the private sector. From the early 1960's, the Korean government used private enterprises as a tool either by expanding the existing private enterprises or by simply creating new ones. Private sector was 65% of the nation's total investment in the decade of the 1970s. The Korean government relied heavily on financial policy tools to induce investment to strategic sectors. This took place through the expansion of state owned banks, and the Bank of Korea Act issued in 1962 to facilitate the central bank cooperation with the nation's long term development efforts, consequently directing the allocation of financial resources into strategic sectors (Sakong, 24-37).

In Korea, as in most of the NICs, the government intervened to promote development. Some of the adopted policies included subsidizing credit for targeted industries such as the promotion of heavy industries by the 1950s, controlling capital outflow, subsidizing the declining industries, and developing export promoting industries. In South Korea, the state rather than being involved in the market forces on a micro level, played the central role of shaping growth and the structure of the

economy on a macro level. In this respect, after 1961, the major investment and resource allocation decisions behind the South Korean industrial transformation were made by the state. The most important factor enabling the state to direct its economy was its control of the country's financial system. The export promotion strategy did not mean the commitment of the state to free trade principles. On the contrary, many rules were issued to restrict imports, e.g. limiting the amount of luxurious goods equal only 3% of total imports in 1990. The state used export promotion and import substitution simultaneously. Chaebols were encouraged to substitute for imports. In 1988, the largest four Chaebols: Samsung, Goldstar, Daewoo, Hyundai, contributed 47% of total GNP. But were such selective interventionist measures good for growth? In fact, such interventionist policies promoted high growth rate despite the presence of other economies such as Egypt during the era of Nasser who adopted an interventionist policy without success. The success of Korea was mainly due to the presence of prerequisites which lacked elsewhere. The government was able to build the institutional basis required for growth. When Park Chung Hee was establishing his legitimacy, and in order to win the support of the society, he promised that as the economy was growing, all groups of the society would benefit. This was known as the ***shared growth principle***. To demonstrate that the government is intending to benefit the society as a whole, land reform programs were introduced. A competent bureaucracy was recruited and detached from daily political interference. A "***business friendly environment***" was created establishing incentives for private investment. "***Deliberate councils***" were used where private groups were welcomed to share in the shaping and implementation of government policies. Such councils facilitated the transfer of information from the business sector to the government and vice versa. The role of such councils encompasses a more indicative and consensus building roles

(Page, 13-4). Export promotion strategy was one of the most important interventionist policies practiced by the state of Korea. It is true that at early stages of development, Korea, as any developing economy, started by adopting an import substitution policy, but such a protection of domestic substitutes ended earlier -after 1961- than in any other developing economy. By increasing exports, Korea aimed at earning additional foreign exchange. However, the promotion of exports co-existed with the protection of domestic markets. To judge its economic progress, Korea relied on the performance of exports. Exports also had a spillover effect, since through exports comes the contact with the outside world and higher technologies. These technologies, brought home by the exporters, benefited the whole society. This technology transfer process was one of the reasons behind the high growth level of productivity (Page, 22).

Insulation meaning the non reliance on private actors showing a high autonomy of the state in Korea can be traced back to the presence of some circumstances. First, following the military coup d'etat of 1961, no powerful social class represented by landowners existed. This was the result of land reform undertaken in 1947 and 1950. Second, the influence of international forces was very small since in 1961 no foreign investment existed in Korea. In addition, exports represented less than 1% of GNP. Third, the special political relationship between the United States and Korea prevented any sanctions from being imposed on Korea following the restrictions it imposed on foreign capital. In addition, Korea had access to the American markets. Moreover, following the 1961 coup d'etat, banks and investment decisions came directly under the control of the government. Although a high degree of state autonomy is not necessarily conducive to economic development, the case of South Korea showed that state autonomy from private actors was conducive to the implementation of a successful development experience (Mardon, 114-5).

The role of the state in Korea was crucial to development. Since the establishment of President Park Chung Hee's regime, who realized that good economic performance was the key to establish the legitimacy of his regime, the state played the role of a banker, a planner, and an entrepreneur. Looking at the state as a ***banker***, the Korean government controlled banks and access to foreign capital. The state allocated foreign loan funds and monitored the activities of MNCs and foreign investors. The state also intervened in the decision making process concerning investment, production, and pricing of most enterprises including the large ones known as Chaebols. The role of the state as a ***planner*** is seen in the formulation of development plans -six Five Year Plans covered the period from 1962 to 1991- sharing as a common objective economic self sufficiency to be achieved through a planned economy with a strong commitment to economic growth. To perform the role of the state constituting in national sovereignty, strategic industries were to expand. The establishment of the economic planning board to assure the design and the implementation of the five year plans was also crucial (Mardon, 116). The ***entrepreneurial role*** of the state is seen in having it manipulating production and marketing by holding important industries in the form of public enterprises (Suk Joon Kim, 74-77).

The Reasons behind the high growth rate in Korea:

On the ***macroeconomics level***, policies were formulated to achieve the required level of private investment. The Korean government was very keen to use every possible ***financial instrument*** to encourage and accumulate investment. Looking at the ***tax system***, we find that it went through three stages: from 1961 to 1972 where exports were encouraged through tax rebates thus diminishing the tax rate

on export industries in order to reduce commodity prices. From 1973 to 1979, the state aiming at promoting heavy and chemical industries, adopted tax holidays for these industries. Finally, from 1980 to 1989, supporting adjustment and liberalization dictated by the IMF, Korea adopted the value added tax -VAT- which provided the revenue to support incentives for industrial investors. The period from 1961 to 1982 was accompanied by a growth in GDP, showing how the tax programs were a facilitator for growth (Page, 231).

With respect to the ***banking system***, the government aimed at securing savings and keeping them at high rates in order to protect savers' confidence in the financial institutions. In order to avoid financial instability, the government provided financial and management assistance by mergers with stronger banks. Banks, in order to avoid failure, adopted the BIS- Bank of International Settlements -capital requirements which dictated a minimum amount of capital required when establishing a new bank. The central bank supervised commercial banks. The government also protected banks from competition by creating rigid entry restrictions. These rigid restrictions allowed the government to decide which bank should expand and when. Obviously, such restrictions on competition contributed positively to financial savings. Larger banks were those allowed to expand, so it was in the bank's interest to maintain its reputation through "*prudent lending*" since it is the one which will bear heavy loss in case of a failure. Also when competition is restricted, profits of the existing banks will increase which in turn will increase the strength of the banking system making savers more confident and finally increasing savings. This shows that for underdeveloped countries it is more favorable to have a limited banking industry formed of a few large banks rather than having a banking system constituting of many small banks (Page, 215-16).

Physical capital formation in Korea succeeded in promoting the policies that attracted investment. As mentioned above, Korea adapted its ***tax program*** to various state objectives over time. By holding the ***"prices of capital goods"*** relatively low, Korea succeeded in smoothing the impact of adjustment on investment. This is because when the price of capital goods increase, more nominal investment expenditure is required in order to reach a given level of output. "***Risk sharing mechanism"*** was a third factor that encouraged investment. In such a mechanism, governments share risk with the private sector. For example, during the promotion of chemical and heavy industries in the 1980s, the government helped 78 in-trouble firms with new subsidized loans (Page, 228-229). The government also subsidized banks whose profits decreased because of non performing loans, with credit from the central bank. ***The "control over capital outflow"*** was a major policy used during early stages of development. The rationale behind such a policy was that if people were prohibited from sending capital abroad, they will invest at home. The existence of restrictions favored high rates of savings. Such a result challenges the Western assumption that free and open financial markets are the engines of growth (Page, 230-232). The final tool used by the government was the "***moderate repression of interest rates"***. This means that the government intervenes to keep the rate of interest below the market clearing level. This policy was easy to implement especially with the control imposed by the state on the movement of capital. During the global recession of the early 1980s, Korea was highly leveraged to the US market. Korean banks and firms suffered instability. The government intervened by lowering the real rate of interest on loans, which resulted in a massive transfer of wealth from savers (households) to borrowers (Firms). Interest rates on deposits reached negative 9.2% in 1980 which caused a wealth transfer of

2.1% of GNP. However, such an intervention was brief since in 1982 the rate of interest became positive and remained so (Page, 234-37).

To sum up, South Korea's rapid growth was not due to free market and free trade policies, but to government intervention in all aspects of the economy including: entry and exit with respect to the market, international trade and investment decisions, labor market conditions and allocation of capital marking a high degree of autonomy facilitated by low malleability and high insulation. This government intervention was inherited from the Japanese colonial period during which centralized state bureaucracies and administrative infrastructures were reinforced. Moreover, despite the high degree of state autonomy, there was a considerable societal support for the government mainly due to strength of the state in the form of the state's relations with the local bourgeoisie, with transnational capital, and with local agrarian elite (Evans, 212). The major engines of high growth rate in Korea were ***private domestic investment*** and the ***rapidly growing human capital***. The high level of investment resulted from the levels of domestic savings. The rate of growth of population was slowed down. The labor force became highly educated which led to effective public administration. With respect to agriculture, productivity was improved accompanied by rate of expansion . Such achievements show that the Korean development experience is far from being a miracle. On the contrary, the success is largely due to the large accumulation of physical capital and the investment in human capital.

A Comparison between Egypt & South Korea:

In the post independence era, Korea experienced its ***industrial revolution*** marked by high level of sustained economic growth under the presidency of Park Chung Hee after the military coup d'etat of 1961, accompanied by a high degree of state autonomy, while Egypt went through various and almost incompatible autocratic regimes. In both states, the basic physical ***infrastructures*** were undertaken by the colonial power. With respect to ***agriculture***, reform was undertaken in the post independence decade in both countries through state interventionist policies aiming at increasing social equality. It has to be noted that if the reforms undertaken by Mohammed Ali were not disrupted, Egypt's modernization would have completely changed, and "*take off*" would have taken place by the end of Ali's rule. Comparing human development with a special emphasis on ***education***, it was considered a source of upward mobility to which the state gave special attention. Also both states faced an employment problem resulting from drastic improvement in education. Korea solved this problem by pursuing investment in industry to create new job opportunities. But in Egypt, available resources were directed to the army which worsened unemployment, and created a phenomenon in the Egyptian bureaucracy: disguised unemployment. On the quality level, the result was different in both countries. The illiteracy rate in Egypt in 1990 (World Bank Statistics) amounts to 49% of the total population while in Korea it amounts to 5%. Also government expenditure on education in Egypt amounted in 1960 to 4.1% and in 1990 to 6% of the GNP which is more than the Korean allocation in 1960 which amounted to 2% of GNP, and in 1990 to 3.7% of GNP (according to the figures of the 1994 Human Development Report). Despite the higher figures in Egypt, the education system in Korea is much more successful than the Egyptian experience. The reasons behind that could be the absence of training programs, the

high dropping rates from schools resulting in child labor, and the low quality of professors in Egypt.

The tested hypothesis under this chapter was: "*Under a firm authoritarian regime characterized by a degree of autonomy and a well established institutional basis to achieve objective planning, the pace of development in faster than in the absence of objective development planning and the institutional basis*" .The comparison between the two countries has shown that an authoritarian regime characterized by a high degree of autonomy is not always more conducive to high rate of growth. My argument here is based on the fact that an authoritarian regime was present under Nasser in Egypt, but it was not conducive to high rates of economic growth. This was because the country's resources were not allocated into productive investment projects, due to the Arab Israeli conflict forcing the allocation of available resources into the army. In addition, Nasser relied heavily on foreign sources -especially the Soviets- to finance projects, as it will be discussed in chapter four. Hence, the successful intervention of the state depends on the prevailing domestic and international circumstances. However, I think that state intervention at the early stages of development is required in order to achieve the effective allocation of the scarce available resources through the formulation of effective policies. Democracy at the early stages of development in the Third world countries is not really favorable. This is because at the early stages, inequality increases which might raise opposition. This is why an authoritarian regime in the periphery is a pre-requisite to development, but it is not the only affecting variable, as it will be discussed in the following two chapters. The successful experience of Korea was enhanced by successful planning, not only in terms of formulating objective five year development plans, but also by establishing an institutional framework able to closely supervise the implementation of the designed

plans. The fact of having a well defined state's objective since the establishment of Park's regime constituting ensuring national sovereignty through achieving economic development facilitated the task undertaken by the state. Unfortunately, this was not the case in Egypt which led to the existing conditions where international elements such as the World Bank and the IMF affect heavily the decision making process in Egypt making it lose some autonomy. The economic reform program dictated by these international organizations is discussed in more depth in the following chapter.

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Chapter Five
Development and the external factors

Introduction:

Because the basic needs of the Less Developed Countries -LDCs- are capital resources and technical skills, since World War II, developed countries provided capital to LDCs. This was one of the main reasons behind the establishment of the World Bank formed of 155 members each contributing an amount related to its wealth. The United States, for example, contributes 21% of the total, Japan's contribution is 15%, while Germany contributes 11% of the total (Baumol, 973). This chapter is testing the relationship between the presence of foreign capital and the rate at which economic growth is accomplished through the following hypothesis: "***at the early stages of development, if foreign capital is available, and under the control of the host country, economic growth will take place at higher rates than in the absence of such a contributing capital***". This chapter also shows the degree of intervention of the international organizations, such as the World Bank and the International Monetary Fund, into the domestic economies through the dictated economic reform program which followed the years of imbalances in both Egypt and Korea.

When countries fail to accumulate capital domestically, they try to seek help from outside. Such a low propensity to save is the result of a high propensity to consume. Foreign capital sources can take one of three major forms: Official Development Assistance (ODA), Foreign Direct Investment (FDI), and external borrowings or debts. Statistics for the period between 1975-84 show that ODA accounted for 35.8% of the total flow of foreign capital. FDI reached 13.6% while foreign debts represented 24.8% of the total flow of foreign capital from the core to

the periphery (Billet, 5). The Modernization theory considers such an inflow of foreign capital necessary especially when domestic capital lacks or the saving propensity is not high enough to attain sustainable development. The next section presents the theoretical framework where the advocates and the opponents of foreign capital present their arguments with respect to each source or type of foreign capital.

I. The Role Played by FDI in the Development of the LDCs:

The ***Modernization*** theory assumes a positive effect of the foreign direct investment on the development of the less developed nations. FDI is evaluated in terms of job creation in the host countries which reduces the unemployment problem. Also FDI in the form of MNCs increases economic efficiency in production by providing capital and technology. Some modernizationists would even argue that trade between the developed and the less developed nations would benefit the LDCs through the trickle down effect. The presence of multinationals leads to prosperity of both the center and the periphery. As a result of this prosperity, economic ties would be strengthened among countries, hence preventing the probability of going into war against each other.

On the other hand, the ***dependency*** school views FDI differently. FDI is directed towards LDCs because of the probability of the higher rates of profit. The negative effect of the FDI lies in the extraction of the surplus in the form of profit from the periphery to the core. Another fact is that the MNCs do not bring considerable amount of capital to the periphery. Instead, either local sources are used to finance projects or the earned profit is reinvested. MNCs, according to the dependency point of view, restrain economic development and growth in the periphery, threaten the sovereignty of the LDCs and reinforce the conditions of dependency (Billet, 19-21).

Marxists would view the presence of multinationals as an aggravation of the problem of the balance of payment in developing countries. Royalties, licensing, over pricing and under pricing contribute to the problem of the balance of payments. As a result, multinationals achieve a lot of profit but offer little in return. The activities of these organizations in the third world distort the structure of the economy. They establish industries allowing them to compete with cheaper prices in international markets with disregard to the needs of the developing countries. Moreover, the host countries have no control over the multinationals corporations because they can decide to relocate their plants laying off workers, and causing embarrassment in host countries. In general, there is a tendency by the multinationals to move the polluting industries such as petro-chemicals, oil refineries, and iron and steel to the developing countries causing pollution, and creating a new division of labor. A counter argument presented by Bill Warren, a Marxist, says that although the flow of capital in the developing world might be small, the presence of multinationals would create and increase other economic activities, thus it would be helpful to preserve multinationals (Billet, 23-7).

II. The Role of MNCs:

The existence of the Multi National Corporations -MNCs- can be traced back to the seventeenth century in the form of trading companies, such as the British East India Company. However, after 1945, the role and influence of the MNCs increased drastically. Also a considerable growth in number can be easily depicted: 1,000 corporations with less than 1,500 subsidiaries in 1945 to 10,000 MNCs with subsidiaries exceeding 90,000 worldwide (Billet, 5). A question may be posed: are

MNCs a new form of imperialism that emerged in the post colonial era? To answer this question, three explanations will be discussed.

First, according to a "*neo imperialist thesis*" of ***peripheral capitalism***, international capital is concentrated in the core which allows the exercise of control over the periphery and its exploitation. The periphery becomes dependent upon foreign suppliers, financial institutions, and MNCs resulting from the necessity of importing capital and technology. The imported technology may not be appropriate to the LDCs since it has been formulated according to capital intensive techniques existing in the developed nations while the LDCs may require labor intensive techniques due to the abundance of cheap labor (Becker, 3).

The Second neo imperialist thesis is ***historical dependency*** associated with ***Cordoso***. It focuses on the case of Latin America. This thesis advocates that capitalist development had many positive impacts: the increase of the industrial output, GNP and aggregate national income in many of the periphery. But these economies are structurally incomplete because they do not develop their own capital goods and technology which ends up by maintaining a "*dependent articulation*" with the world economy and the MNCs (Becker, 4).

The third thesis is ***post-imperialism***. MNCs aim at integrating various national interests into a transnational basis. MNCs offer the LDCs access to world markets, latest technology, and capital resources. FDI is a controversial issue for LDCs' leaders who worry about losing their sovereignty. Development loans reinforce state capitalism accompanied by the strengthening of the private industrial bourgeoisie (Becker, 5).

III. The Role of ODA in the LDCs:

The importance of the Official Development Assistance, which can take one of many forms -technical assistance, projects development, human needs- decreased relative to FDI and debts flow. The effectiveness of ODA depends on three factors: the purpose of foreign aid, the net dollar amount involved, and the manner of distribution whether bilateral or multilateral channels. Multilateral channels are more popular since they reduce the direct effect of one donor country on a given host country, in other words, the sovereignty of the state is more conserved (Billet, 21-3).

The opponents of ODA argue that such an assistance has a negative impact on economic growth. This is because bilaterally distributed ODA is based on political criteria rather than economic objectives. This political criteria can involve geostrategic interests for the donor country as it is partly the case of the American assistance given to Egypt. Also ODA programs are criticized for being unable to meet the desired economic goals: food aid can reduce the productivity of local farms; ODA can be directed to the purchase of military equipment; or towards unnecessary projects such as shrines of national leaders. ODA goes to the hands of the local elite which may not have the best choice where aid can be allocated (Billet, 21-3). This last observation is actually cured by the new trend followed by the donor countries consisting of diverging aid from local governments to the Non Governmental Organizations (NGOs). However, the reliance on ODA is not really favorable since the cause of the problem is not treated. I mean that ODA is used to treat the superficial symptoms such as poverty and starvation.

***IV. The Role of External Debts and Borrowings on the LDCs*:**

The reliance of the periphery on external borrowings for achieving development objectives has shown to be a double edge weapon. This can be seen in the debate between modernization and dependency where the former supports the role of foreign capital while the latter condemns such a role. External borrowing is seen as a tool to augment capital resources within a country, since domestic savings are falling behind the required rates necessary for the generation of productive investment.

The reliance on external borrowings to generate productive investment is how the modernization school sees the positive impact of foreign capital. The best example supporting such a positive role is South Korea, as it will be discussed later.

When the reliance on foreign borrowings leads to increasing domestic consumption as it is to a large extent in Egypt, the dependency argument of the negative impact of foreign capital is shown to be true. It has to be shown that external debts have been affected by the international environment. By this I mean that looking back in history, precisely prior to the 1973-4 oil crisis, external borrowings were generated by public officials in modest amounts. In the post oil crisis period, external debts increased but not to finance development projects but to cure the current account deficits resulting from the consumption boom which accompanied the oil crisis. Also foreign borrowing has a long term negative effect since it represents a net outflow of capital from the periphery to the core in order to service debts (Billet, 24-6).

To sum up, when a developing country decides to have access to foreign capital in order to compensate for the lack of the domestically generated capital or the low propensity to save, the focus of allocation of this foreign capital should be productive investment projects. In other words, the key point for the success of the

role played by foreign capital in the development of the less developed nations is the choice of allocation of this capital.

V. The International Forces in Egypt:

Like many other LDCs, Egypt suffers from a shortage in domestic capital formation due to the fact of the prevailing high propensity to consume. As a result, Egypt turned to foreign capital in order to fuel economic development.

The reason behind Egypt being colonized by Britain can be traced back to Mohammed Ali's family. Said who ruled from 1854-63, heavily encouraged foreign private investments and relied greatly on foreign loans. In 1863, when Ismail took over the custody of Egypt, the country owed an amount of LE 12 million to France and England. During this time, the Suez Canal project was undertaken and the reliance on capital inflow increased. The Khedive had to make a choice: either to cut government expenditures, or to increase the reliance and dependence on ***foreign capital***. It is reported that these foreign loans were spent on personal luxury goods, in addition to the building of the basic infrastructure. By the end of Ismail's rule, Egypt's debt increased from LE 68.497 million to over LE 98.4 million owed to foreign sources (Abdalla, 79-80). In order to finance the debt, the government increased tax revenue by 425% from 1861 to 1875 moving from an amount of LE 2 million to LE 10.5 million. However, these efforts to finance foreign debts were insignificant since Egypt was given the loans at unfavorable interest rates. In order to secure its citizens' capital and investments, England occupied Egypt in 1882. Under the colonial rule, Egypt was subject by the beginning of the 1890s to large foreign private direct investment. During the years of the first World War, the price of cotton increased from LE 3.402 per

quantar in 1914 to reach LE 17.562 by the end of the war. This inflow represented government revenue allowing the repayment of Egypt's debts (Abdalla, 83-6).

Looking at the role of ***foreign capital*** before the 1952 revolution, we notice that: during the first twenty years of this century, foreign capital was of great importance since it heavily contributed to the urbanization process, transportation and financial institutions. It also made easier the incorporation of the Egyptian economy to become an integral of the world economy. It has to be noted that this capital inflow did not change the status of the country from being an "*agrarian colonized country*". Starting with the 1930s, capital inflow declined due to the international depression, in addition to political events that hit the country. Another cause behind the decline in capital inflow can be traced to the ending of Egypt capitulation by the 1936 representing less incentives to foreigners to invest in Egypt since they became subject to the Egyptian law (Abdalla, 87-9). During the Second World War, due to the presence of allied powers, Egypt accumulated foreign currency and paid back 38% of its foreign debts. The war contributed to the promotion of the industrial sector due to several reasons. The presence of foreign troops constituted a new market for the Egyptian products. Imported goods from industrialized nations were no longer available since most of these countries' productive capacity was directed to the production of war materials. Moreover, due to the interruption of the world transportation, cotton exports were limited causing a huge decrease in land owners' revenue making them invest in the industrial sector. By the end of World War II, the market which was created by the war shrank, imported goods increased heavy competitive pressures on local industries. Large firms who were protected by tariffs were able to survive and compete. Unexpectedly, foreign capital inflow did not expand

in the post war period, and this was due to the damaged nations which needed capital to rebuild their countries and economies (Abdalla, 92).

Turbulent political conditions in Egypt represented an obstacle against the inflow of foreign capital into the country. By the mid 1950s, the IMF refused to give Egypt a loan to finance the Aswan High Dam project. As a retaliatory measure, Egypt nationalized the Suez canal. **Table 4** shows the Egyptian share in the Suez canal income which increased drastically after its nationalization.

Table 4
Suez Canal Income and Egypt's Share
1952-1964
LE millions

Year	Gross income	Income to foreigners	income to Egypt
1952	26.6	13.3	13.3
1953	29.1	14.5	14.6
1954	30.6	15.3	15.3
1955	31.8	15.9	15.9
1956	29.3	14.6	14.7
1957	24.3	0	24.3
1958	43	0	43
1959	44.4	4	40.4
1960	50.1	4	46.1
1961	51.2	4	47.2
1962	53.7	4	49.7
1963	71.1	3	68.1
1964	77	0	77

Source: National Bank of Egypt. ***Economic Bulletin***.

Egypt found itself in a situation where it had no choice but to turn to the communist bloc in order to get access to markets for its agricultural products and for foreign exchange. The 1957 wave of nationalization of foreign banks and companies aimed at avoiding the pressures exercised by foreign investors (Abdalla, 97-9). The 1952 revolution leaders had industrialization as one of their major goals. Due to political reasons, Egypt failed to attract foreign direct investment which forced the government to implement what was known as "*guided capitalism*" where private enterprises were told what, how and for whom to produce (Abdalla, 106).

The role played by foreign capital since the 1960s indicates that the decade of the 1960s represented a series of obstacles to foreign investment in Egypt. Foreign investment in a given country is determined by political, legal, social and economic variables. An unfavorable investment climate prevailed during this decade having the government intervening in all phases of economic activities, and dominating business ownership claiming that this was the path to stop exploitation of the masses. The nationalization movement undertaken in 1961 worsened the climate. Compensation for the sequestered properties was based on the book value and not the market value. The compensation was also in the form of bonds payable over a period of 15 years. Such political instability and unrest made investing in Egypt a high risk task (Elsaid, 86).

With the Open Door policy of the 1970s, political and economic liberalization took place. The opening policy aimed at accelerating economic development by having a strong private sector assist the existing public sector in the development process. Law 43 of 1974 represented the basis of investment and had two basic goals. First, it aimed at encouraging the export oriented industries without neglecting the import substituting industries required to supply the basic domestic necessities. In addition, tourism was to be encouraged since it represented a source of foreign exchange. The

second goal was to assure the transfer of the updated technologies required in the modernization process (Elsaid, 88-9). This law is known as the foreign investment law and contains a set of incentives for investors including the following: a five year tax holiday, tariff reductions on raw materials and machinery, free trade zones, and guarantees against future nationalization. The government expected that such incentives would attract especially capital from Arab oil rich countries and western technology, but Arabs preferred to invest in Europe and the US (Severiens, 45).

Despite the welcoming investment climate in Egypt during the 1970s, foreign investment amounted only to $250 million from 1974 to 1978. This can be traced back to the following reasons: inadequate infrastructure and communications, policy instability which makes business planning inaccurate, bureaucratic obstacles, and the changing inflation rate which varied from 15% to 40% (Elsaid, 91). The lack of a well known established political system is the major obstacle for investors in Egypt. The first question that comes to the mind of the investor is will the next president nationalize foreign owned firms as Nasser did. Moreover, during the 1970s, the Egyptian economy was handicapped by many problems -overpopulation, centralization of decision making, and the mismanagement of the public sector- which worsened the investment climate despite the effort of the government aiming at creating a favorable environment for investors. In addition, there was a shortage of foreign exchange due to the deficit of the Balance Of Payments -BOP- which increased from $654 million in 1973 to $2 billion in 1978. The rapidly increasing population which required at least the basic necessities to survive -food- increased imports by 250% which made of the 80% increase in exports negligible (Severiens, 46-7).

All the above mentioned conditions forced Egypt to rely on foreign grants and loans to pursue economic development. The sources of foreign capital during the

decades of the 1960s and the 1970s show that the Soviet Union and the United States were the major suppliers of loans. During the period from 1960-65, the US provided Egypt with loans to purchase agricultural surpluses from the US especially wheat under Public Law 480 (PL 480). From a total of $180.2 million given as loans to Egypt from 1962 to 1965, $68 million were allocated to the modernization of infrastructure and communications. The US charged Egypt 4% on loans while the Soviet Union charged only 2.5%. However, US terms were more favorable to Egypt since repayment was due in domestic currency extending over a longer period of time. After 1965, the Soviet Union became the major supplier of loans amounting in 1966 to $96.565 million representing 44.5% of total loans compared to $8.680 million representing 4% of the total supplied by the United States. Soviet loan funds were directed to specific projects such as the Aswan High Dam, industrial projects such as steel mills, oil refineries, electric power station, cotton spinning mills, and chemical plants. International Organizations such as the World Bank provided Egypt with a loan of $137 million allocated to the improvement and widening of the Suez Canal (Abdalla, 87-90).

Prior to the Arab Israeli war of 1967, Egypt received grants amounting to $155 million averaging $22 million annually. From 1967 to 1972, grants increased to reach a total of $1,696 million averaging at $282 million yearly. Such an increase was traced back to the donations of the Arab oil rich countries to compensate for the closure of the Suez Canal. From 1960 to 1972, Foreign Direct Investment in Egypt was negative indicating a net capital outflow for the reasons explained earlier. During this period, FDI amounted to $-64.8 million (Abdalla, 90-1).

Unfortunately, the inflow of foreign capital into Egypt during that period led to the mis-performance of the Egyptian economy due to the misallocation of funds into

non productive governmental expenditures and excessive consumption which largely increased Egypt's debts to reach $2,186.4 million representing 25% of the GNP in 1972. The debt service ratio hit 34% marking the highest of the world during this period (Abdalla, 95).

The integration of Egypt into the world market under Sadat's Open Door Policy forced Egypt to adapt its economic policy to be in harmony with the globalization of capitalism. Unfortunately, Egypt is constrained by its high dependence on aid and foreign assistance. It is also subject to the fluctuations in the oil market since the oil component is one of the major sources of revenue to Egypt. The flow of aid and oil revenue in the 1970s and their non allocation into productive investment projects were a reason behind the non development of commodity production as well as the consumption boom. The Egyptian economy was highly constrained by the burden of the military debt. All these factors made Egypt lose partial ***autonomy***, since due to the must of servicing its debt, Egypt had to accept the reform program of the IMF and the World bank; despite the fact that some economists argue that the dictated reform model is not convenient to the Egyptian case (Hinnebusch, 162-3).

The ***structural adjustment*** dictated by the ***IMF*** and the ***World Bank*** aimed at reducing the imbalances of the economy. ***Economic reform*** was divided into two phases. The first stage constituted changing a centralized economy with a small private sector to a decentralized, market oriented economy where the large scope of development is assigned to the private sector. The ***stabilization process*** has succeeded although the private sector investment remained weak. The three objectives of a stabilization process were to: control inflation, maintain a fiscal balance by reducing government expenditure or by increasing taxes. Stabilization also aimed at eliminating the current account deficit either by increasing exports or by controlling the exchange

rate through the devaluation of the domestic currency (Todaro, 599). Despite the fact that economic growth has been slow due to the reform program, significant overall progress has been made. The fiscal deficit was reduced from 22% of the GDP in 1990 to 4.7% in 1993. According to the reform expectations, the fiscal deficit is expected to reach 1.5% of the GDP by 1996. The undertaken tax reform would increase revenue from domestic taxes and decrease the dependence on international trade. Financial ***liberalization*** was manifested by the absence of a ceiling on the rate of interest. The foreign exchange system was unified giving room to international capital mobility. The Egyptian pound was devalued by 35% against the US$ in order to reduce the price of Egyptian exports. The reform also dictates to Egypt to pursue a monetary policy aiming at limiting the liquidity rate to 12%. Government expenditures are also expected to be cut to 7.2% of GDP by limiting subsidies and transfers. Energy prices are expected to increase reaching the international level over a period of five years. Food subsidies would be abolished over a period of seven years. Concerning the trade sector, the government has removed all quotas and non tariff barriers; in addition, it cut the tariffs on capital goods by 5 to 10% (A.R.E., World Bank 1995, 145-7).

With respect to privatization, ***Privatization*** aims mainly at reducing or limiting the role of the public sector in the economy while expanding that of the private sector. In the early 1990s, the Egyptian Government announced its commitment to privatization by announcing a plan for the "*divestiture*" of 125 public enterprises over the following 5 years. The privatization plan of the Egyptian Government consists of offering not less than 25 public enterprise annually starting from 1992/93 to 1996/97. Privatization is considered to be the long term economic policy issue. The legal basis for privatization was established in 1991 through law 203 which removed 314 public owned enterprises with an official book value of LE85 billion and debts of LE154

billion from the control of government to 16 independent holding companies. Some of these companies are: Bisco Misr, Misr Travel, Coca Cola, Cement Companies, Pharmaceuticals, and Fertilizers companies. The pace of privatization has been very slow due to the valuation process. Unemployment caused by the economic reform and structural adjustment program was planned to be partially alleviated by the ***Social Fund for Development***. It was established in March 1991 with a total amount of $613 million provided by 17 donors to absorb the impact of prices deregulation, privatization and public sector reform. This SFD is a quasi independent Egyptian organization and funded by the European Union, the United Nations Development Program -UNDP- and 17 bilateral donors. The SFD is designed to support projects for displaced workers and semi-skilled labor. By the end of 1994 7.8 million people had benefited from the fund projects. The SFD succeeded in creating 56,000 permanent jobs in addition to 140,000 temporary jobs (EIU, 15).

In the 1990s, ***export promotion*** was supposed to become the development strategy for the coming period. Local banks would be able to compete internationally, especially after the unification of the currency exchange rate, as well as the raising of the rate of interest. ***Trade liberalization*** would enhance the ***non intervention of the government*** in the market. The unfair public industry competition which allowed it to sell its product at lower prices would end since subsidization of output would be abolished (Hinnebusch, 160). **Table 5** shows the statistical result of implementing the Structural Adjustment Program and **table 6** shows the expected positive impact of the application of the economic reform program.

Table 5: The Result of the Economic Reform Program in Egypt

The Egyptian Economy before the reform Program 1990-1991 statistics.	**The First Phase of Economic Reform.** STABILIZATION. **1992-1993 CBE statistics.**	**The Second Phase of Economic Reform. 1994-1995 CBE Statistics.**
1. GDP= **50176.6** million ‘’ Commodity Sector **44%** Production Services **34%** Social Services **18.34 %**	1. GDP= **134335** million Commodity Sector **49.8 %** Production Services **33.1%** Social Services **17.1%**	1. GDP=**155500** million** Commodity Sector **50.1 %** Production Services **32.8%** Social Services **17.1%**
2. GDP growth rate **1.7 %**	2. GDP growth rate **2.5 %**	2. GDP growth rate **4.7 %** It is expected to reach **8%** by 1997-1998**
3. Unemployment rate*** **10%**	3. Unemployment rate **10.1%** Investment in new projects & industrialization.	3. Unemployment rate **9.6%** Investment in new projects & industrialization.
4. Inflation rate*** **25 %**	4. Inflation rate **9.7%** Price adjustment.	4. Inflation rate **9.3%**
5. Fiscal Deficit/GDP* **22%**	5. Fiscal Deficit/GDP **4.7%** Gradual subsidy cut.	5. Fiscal Deficit/GDP by 1996 will reach **1.5%** Abolition of food subsidy by 2001.*
6. Liquidity rate - %	6. Liquidity rate **16.4 %**	6. Liquidity rate* **12 %**
7. Interest rate -%	7. Interest rate **19.8 %**	7. Interest rate **12.25-17%**
8. Balance of Payments Exports **LE9438.9** million Imports **LE31392** million	8. Balance of Payments **LE15158** million Exports **$3416.7** million Imports **$10728** million Removal of quotas & non tariff barriers, reduction of tariff on capital goods by 5 to 10%	8. Balance of Payments **$7.9** billion Exports **$4.9** billion Imports **$12.8** billion
9. Exchange rate LE **3.332** = 1 US $	9. Exchange rate LE **3.3525** = 1 US $	9. Exchange rate LE **3.395** = 1 US $
10. PublicCompanies: inefficiencies,disguised unemployment, mismanagement.		10. Privatization: In 1994, **LE5.1** billion of the holding company assets were sold. By the end of 1995, holding company assets of **LE37.2** billion (51% of total holding company assets) are to be brought to the point of sale and **LE 31.3** billion sold.*

* A.R.E. World Bank 1994 Statistics. Pages 145-147.
** Forecasted Figures.
*** World Development 1991.
'' National Bank of Egypt. 1994 Bulletin.

Table 6
The Expected Positive Impact of the Application of the Economic Reform Program in Egypt

Privatization and Subsidy Cut
representing the second phase of the economic reform program

Inflow of Foreign Capital and Know How
Improvement of Domestic Industry
FDI increased from LE517.8 million in 1992-93 to LE618.8 million in 1993-94

Adoption of Export Promotion Policy
Increase of Commodity Exports
Stabilization of the exchange rate to become LE3.39 = 1$
Removal of quotas & non tariff barriers
reduction of tariff on capital goods by 5 to 10% in 1992-93

Reduction of Fiscal Budget Deficit
From 22% of GDP in 1990-91 to 1.5% of GDP in 1996

Acceleration of Industrialization
through the fiscal policy objectives aiming at reducing the rate of inflation and to encourage credits to the business sector in order to forward economic growth and increase exports

Increase of available Job Opportunities
Reduction of the rate of Unemployment

Modernization of Infrastructure
From 4882 km of railways in 1981-82 to 8743 km in 1995-95
From 476000 working telephone lines in 1981-82 to 2724000 in 1994-95
Investment in transportation and communication increased from LE11.3 billion in 1981-87 to LE17.2 in 1992-95

Achievement of high growth rates
Increase in the Standard of Living
GDP growth rate increased from 2.5% in 1992-93 to 6.6% during the third FYP and it is expected to reach 8.7% during the fifth FYP

VI. International Factors in the Korean Economy:

In the case of Korea, the theory of dependent development does not really explain its growth because foreign capital did not represent the main engine of industrial growth. The high degree of state autonomy played a crucial role in implementing the required economic policies independently from social and international forces. In other words, as Evans puts it: "*it is a distinctive feature of South Korea's dependent development that the state has the upper hand over both local capital and multinationals*" (212).

Foreign investment was only welcomed when it came in accordance with national official planning. The control of the state over foreign capital was formulated under the 1961 Foreign Capital Inducement Act -FCIA- under which the government guarantees to repay all loans made to Korea. All investment projects had to submit to the Economic Planning Board -EPB- a proposal including the nature of the project, the technology required, the level and source of capital, the capital labor ratio -K/L- the estimated output, the job opportunities presented to the domestic labor force, and the ratio of output to exports in order to make sure that the project will serve the major policy of the county constituting of an export led development strategy. By requiring such a specific proposal, the state was able to control Foreign Direct Investment in accordance to the needs of the Korean economy (Mardon, 116-8).

The Korean government realized the threats of a high degree of reliance on FDI, but at the same time Korea recognized that foreign capital and updated technology were required for rapid industrial expansion. This was the reason behind limiting FDI. The government favored concessional loans as the best form of foreign capital since the loan could be channeled and be appropriately allocated to domestic producers through the existing national financial institutions. Moreover, when the loan

funds were allocated into productive channels, the burden on the economy was temporary since after being paid back, the profit can still be generated within the economy. This is not the case of FDI since it represents a permanent burden on the economy because it indicates a continuous profit drain from the host country (Mardon, 120).

FDI has always played a minor role in foreign capital formation in the case of South Korea. From 1962 to 1971, FDI represented only 4% of the total net inflow of the foreign capital. It increased to 7.9% from 1972 to 1976, then it was reduced again to less than 4% for the period between 1976 to 1984 (Mardon, 121). FDI started in Korea in 1962 in the form of a Korean-American joint venture for the production of nylon filaments. From 1962 to 1968, the US was the largest investor since its share reached 81.7% of total foreign investments, while the share of Japan amounted to only 7.9%. During the period from 1969 to 1974, the American share was reduced to only 21.2% while the Japanese share reached 72.3% (Sung Hwan Jo, 130). Joint ventures represented the main form of private FDI in Korea since this form represents 682 out of 733 foreign operating firms. FDI created job openings in 1974 which absorbed about 162,000 domestic workers (Sung Hwan Jo, 158).

With respect to ***technology***, licensing represented the most appropriate way in order to reduce dependency on FDI. But when a certain technology was not available through licensing and was required to the development of a targeted economic sector, FDI was welcomed. For example, during the 1960s, FDI was channeled to synthetic fibers which was required for the production of textiles; in addition to petroleum refining and chemical fertilizers. When these industries were developed by 1968, FDI was allocated to serve capital intensive chemical and heavy industrial sectors. During

the 1980s, 25% of FDI was allocated to chemicals, 16.7% to machinery, 12.2% to electronics, 4.8% to metal products, and 4.5% to construction (Mardon, 122).

Foreign Direct Investment played a smaller role than did foreign borrowing in the development of the Korean economy. This was due to several reasons. First, the colonial experience made Koreans suspicious o the motives of the FDI. It was believed that the FDI might be a tool or path to dominate Korea. Third, the promotion of labor intensive light industries which was implemented at early stages of development did not require sophisticated technology or managerial and marketing skills which normally accompany any FDI. Also, Korean entrepreneur would prefer a foreign debt capital rather than foreign debt equity whereby profits would be shared with foreign businessmen. Although FDI represented a source to transfer technology, Koreans preferred licensing and joint ventures. When these alternatives were not available, Korea simply bought the needed technology (Sakong, 137-9).

With respect to ***External borrowing***, the government realized that it was necessary to adopt the ***export promotion strategy*** since these external sources represented the finance of investments in export industries. This strategy was adopted in the early 1960s. However, international factors did exist earlier in the form of heavy assistance and foreign aid to cover the balance of payments -BOP- deficit of the 1950s. In the next decade, the role of foreign aid diminished to be replaced by foreign borrowing . The government, believing that export promotion and industrialization were the solution, encouraged foreign borrowing ensuring that the capital was used in productive sectors (Holmes, 105-6).

International trade in Korea today is one of the major trading nations of the world. Korea is highly integrated into the world economy since it is deeply involved with foreign trade. Although such a dependence on foreign trade had some positive

impact such as: improving Korea's credit standing in international capital markets which reduced the gaps in domestic savings and foreign exchange, and the accessibility to world markets noting that the US represented the major market for Korea's exports; it also had negative impacts. For example, when the US suffered twin deficit problems at the early 1980s, protectionism was applied against Koreans exports due to the declining performance of the American economy. Meanwhile US pressured Korea to open its markets by threatening to take retaliatory measures. All that affected the Korean export earnings which affected in its turn the repayment of the Korean debts (Evans, 211). **Table 7** shows the relationship between trade and growth. The table shows that as the volume of exports increases, the Korean GNP increases showing a positive relationship between trade and growth. This is explained by having **GNP=C+I+G+(X-M),** where c is consumption, I is investment, G is government expenditure, and (X-M) is net exports.

Korea has successfully achieved two major goals. The first was its success to reach continued and high rate of growth through industrialization and export promotion during the presidency of Park Chung Hee. The second was its success to adjust its economy during the presidency of Chun Doo Hwan following the imbalances that hit the country at the end of the 1970s. These imbalances had internal and external causes. The external reasons were mainly the second oil shock and the rise of the international rate of interest. Among the internal reasons, there was the concentration on chemical and heavy industries through policy loans formulated by the state owned banking industry, which caused inflation. By favoring such industries, social inequity rose since these sectors of the economy were monopolized by the Chaebols which produced a total value added of 43% of the Korean GDP in 1978. Inflation was also

pressured by the increase in real wages experienced from 1976 to 1979. Inflationary symptoms made Korea lose its competitiveness (Moon, 57).

Table 7
Trade & Growth in Korea

Year	Exports billion $	GNP billion $	Exports/GNP %
1960	0.03	1.9	2
1961	0.04	2.1	2
1962	0.05	2.3	3
1963	0.09	2.7	3
1964	0.12	2.9	4
1965	0.18	3	6
1966	0.25	3.7	7
1967	0.32	4.3	7
1968	0.46	5.2	9
1969	0.62	6.6	9
1970	0.84	7.8	11
1971	1.07	9.4	11
1972	1.62	10.6	15
1973	3.23	13.5	24
1974	4.46	18.6	24
1975	5.08	20.9	24
1976	7.7	28.7	27
1977	10.05	37.4	27
1978	12.71	52	24
1979	15.06	62.4	24
1980	17.51	60.3	29
1981	21.25	66.2	32
1982	21.85	69.3	32
1983	24.45	79.5	31
1984	29.25	87	34
1985	30.28	89.7	34
1986	34.72	102.7	34
1987	47.28	128.4	37
1988	60.7	169.2	36
1989	62.38	211.2	30
1990	65.02	237.9	27
1991	71.87	272.7	26

Source: Economic Planning Board.

As a result, the economy was affected after a period of continued high growth. Growth rate reached 2.2% in 1979-1981 after an average of 9.9% annually from 1962 to 1978. During the same periods, inflation increased from 16.1% to 26.4%. Real growth in exports sharply declined from 27.4% to 7.5%, while the current account deficit hit $4.4 billion in 1981 which amounted in 1978 to $1.16 billion (Moon, 56).

The first stage of the reform program included of the ***stabilization*** process and extended from 1981 to 1984. This stage covered three major areas. The first area was fiscal policies where serious fiscal cuts were made. Government expenditures dropped from 21.9% annual increase in 1981 to 0% in 1984. Subsidies cut was also a tool of fiscal restraint. Subsidies for farmers from the Grain Management Fund were reduced from an annual average increase of 20.25% during the 1970s to only 14% in 1981. It has to be noted that the Korean budget was constrained by international forces. By this I mean that a bilateral agreement between the United States and Korea stated that 6% of Korea's GNP should be allocated to defense. This portion represented 30% of the Korean budget. Moreover, another 40% of the budget was allocated to debt servicing. This implied that 70% of the budget was committed, and that Korea was able to manage only 30% of its budget to cure the imbalances that hit the economy. The second area was real wages which enjoyed an increase from 1976 to 1979 dropped by 1% in 1981 although labor productivity increased by 18.1%. The third area the government managed successfully was monetary policies. Money supply which grew at more than 35% in 1977-78 dropped to 7.7% in 1984 (Moon, 58-9).

After the successful achievement of the stabilization stage, the second stage of the economic reform program -***Structural Adjustment***- came into being. Structural adjustment covered three major areas: industrial restructuring, financial reforms, and market liberalization. First, ***industrial restructuring*** was important due to the fact that

one of the reasons why Korea experienced imbalances was the concentration on heavy industries. The government had to reorganize some sectors such as automobiles which suffered from poor planning and "*duplicated investment*". Special attention was given to high technology industries such as computers and telecommunication. The government presented incentives for intensive R&D, and man training. Lending policies were readjusted to serve medium and small size enterprises reducing the existing preference given before to the Chaebols. Second, ***financial reform*** included liberalization of the banking industry by providing banks more autonomy with respect to fund allocation. Rationalization aimed at increasing competition among the various financial institutions extending not only to banks but also to investment and insurance companies. In addition, a joint venture between the Bank of Korea and the Bank of America was established as a step in the process of financial liberalization. The third area of structural adjustment constituted of ***market liberalization***. The Korean government was forced to liberalize due to domestic and external pressures. Internally, the market experienced monopoly and oligopoly which was against price stability. Externally, protectionism was increasing among the developed nations especially the United States which represented the major market to Korean exports, which forced Korea to adopt an import liberalization policy. Foreign Investment was also liberalized through presenting a set of incentives to investors. A negative list system substituted the positive list system, whereby foreign investment was automatically approved unless otherwise specified (Moon, 60-2). There was also the tax incentive by exempting and reducing corporate and income taxes to foreign firms involved in strategic high technology. In addition, the Korean government developed three major industrial sites -Kwangju, Chonan, Kuro- where land was sold at internationally competitive prices. The government also provided financial assistance through commercial loans with a

maturity of over five years. Finally, with respect to labor, the government developed a "*wage according to productivity*" system where the increase in wages should not exceed the productivity gains (Doing Business With Korea, 65-8). Statistical results of the SAP is shown in **table 8** and the process of the economic reform program is summarized in **table 9**.

Table 8
The Result of the Economic Reform Program in Korea

Basic Economic Indicator	1962-78 Years of Sustained Growth	1978-1980 Years of Crisis	1981-84 Years of Adjustment
Growth rate	9.9%	2.2%	9.5%
inflation rate	16.1%	26.4%	2.3%
Real growth in exports	27.4%	7.5%	
current account deficit	$1.1 billion	$4.4 billion	$1.37 billion
Money supply (M2) growth rate		35%	7.7%
Unemployment rate		4.4%	3.9%

______: The Politics of Structural Adjustment in South Korea. Korea Journal. Autumn 1991.

Table 9
The Application of the Economic Reform Program in Korea

Fiscal Control: Government Expenditures were reduced to 0% in 1984.
Subsidies were heavily cut especially farmers subsidies

Wage Control: real wage rate lagged behind the rate of increase of labor productivity

Monetary Control: money supply was reduced to 7.7% in 1984 accompanied by tight credit policies

Industrial Restructuring was divided into two stages.
Rationalization: new industries were selected instead of the emphasis on heavy industries.
Deconcentration: small and medium size enterprises had access to financial assistance from the state.

Financial reform was divided into three stages.
Liberalization under which the banking industry enjoyed greater autonomy.
Rationalization which allowed other financial institutions to compete with banks.
Internationalization where new ventures were created between foreign banks and Korean banks.

Liberalization of the Domestic market .
Import liberalization and the reduction of restrictions on imports.
Liberalization of FDI by presenting new set of incentives and the negative list system.

It is noted that the implementation of the economic reform program had negatively targeted some social segments. Farmers, for example, were highly harmed by the subsidy cut and the liberalization of imports stressed by the United States. Labor was also harmed by the program since although real wages started to increase again after the stabilization stage, the increase in wages did not cope with the increase in labor productivity.

The Relationship between Korea and the United States:

From a historical perspective, the Taft-Katsura agreement -1905- can be seen as the serious beginning of American interference in Korea. Japanese Prime Minister Katsura and the US secretary of war Taft agreed upon recognizing Japanese

jurisdiction in Korea in return of Japanese disinvolvement in the Philippines (The Centennial, 31). After the Japanese attack on Pearl Harbor, US policy towards Korea changed manifested by the Cairo Declaration of 1943 which showed US commitment to an independent state of Korea. Following the Korean War, US showed a strong commitment to Korea especially to counteract Russian movements there (The Centennial, 37). Looking at trade, the US is the major trading partner of Korea. Korea is the 8th largest exporter to the US and the 7th largest importer from the US (Choi, 117). The US is Korea's largest export market absorbing 35% of Korean total exports and the second largest source of imports amounting at 20% of Korea's total imports. Continuing to Korea's trade surplus with the US, making US exports lagging behind imports creating a trade deficit of $700 million in 1982 and $9.6 billion in 1987, trade relationship between the two countries has been affected. **Table 10** shows the number of Hyundai cars sold in the American markets and **table 11** shows the trade balance between Korea and the US. The US is exercising pressures to have access to Korean markets. Korea in return refuses US protectionism (Choi, 117).

Table 10

Hyundai Automobile Sales in the US

Year	**Number of Cars sold**
1986	168,882
1987	263,610
1988	246,282
1989	183,261
1990	137,448
1991	57,090

Source: Henrik Hansen. "Fierce Competition and Tighter Regulations" ***Business Korea***. August 1991: 22.

Table 11

Korean Trade Balance With the United States in billion US $

Year	Trade Balance
1970	-0.2
1975	-0.3
1980	-0.3
1981	-0.4
1982	0.3
1983	2
1984	3.6
1985	4.3
1986	7.3
1987	9.6
1988	8.6
1989	4.5
1990	2.4
1991	-0.6

Source: Economic Planning Board.

Finally, looking at technological transfer, since the second World War, the US established free trade as being the basis of international business, and to promote technology through foreign trade and assistance (Choi, 303). For Korea, FDI has been the major source of technology. Also licensing was a form of technological transfer. The US represents the second source of licensed technology representing a share of 25.9% of the total licensed technology (Choi, 306),

The Korean government succeeded in achieving growth without heavy dependence on foreign capital. The state favored foreign borrowing rather than foreign investment in order to reduce dependency and keep the highest possible degree of autonomy.

VII. A Comparison between Egypt and Korea:

In the case of Egypt, growth is taking place in the form of dependent development where international capital plays an important role especially in the form of ODA . In Korea, the dependence on foreign capital was limited to foreign borrowing. The Korean choice was more rational since it prevented the profit drain that accompanies FDI. This choice also allowed Korea to enjoy a high degree of autonomy by allocating funds through state institutions in the most appropriate channels of the economy. The problem with Egypt is that fund allocation is highly controlled by the donor countries, which might not benefit the country as required since in most of the time, funds are not allocated to the most productive sectors. The hypothesis: "*If foreign capital is available at the early stages of development and under the control of the host country, economic growth will be faster*" has shown to be depending on the form of foreign capital and its allocation. Foreign capital was present in both countries, but this capital did not have the same contribution in both cases. This is because, in Egypt, foreign capital was mainly in the form of ODA and FDI which did not give the country the required freedom to allocate it effectively into the most productive projects. These funds were used to purchase military equipment and other products from the donor country such as wheat under PL480. In other words, the funds were primarily returned to the donor country. FDI was not in accordance to the needs of the Egyptian society. Private foreign capital in Egypt has been allocated to consumption. Korea, on the other hand, succeeded in managing foreign capital according to its needs. Korea preferred foreign borrowing to ODA and FDI in order to avoid the profit drain and the loss of autonomy in allocating the fund. FDI has only been welcomed when it brought a new technology in accordance to the planned state's

objective. Moreover, foreign capital has been allocated to productive projects and has not been used for direct consumption.

Finally, with respect to implementing the economic reform program, a gap of ten years is seen between the two countries, since Korea implemented the economic reform program in 1981 while Egypt implemented the program by the early 1990s. The societal factor is influencing the pace of implementing the reform program in Egypt. This is because privatization, for example, is not positively seen by the employees who are threatened of losing their jobs, or by the managers who will be losing their positions and professional prestige. Another example is subsidies, which cannot be cut immediately to the existing masses of poor in Egypt.

Chapter Six
Conclusion

South Korea, an Impressive Success, Why ?

The experience of the Pacific basin is an impressive experience that has to be studied. In order to be considered as an NIC, there are some economic parameters that should be reached by the country. First, per capita income should amount to at least $3000. Second, the share of manufacturing should amount to 25% of the GNP at least. Finally, the share of manufactured goods should be 25% of exports (Schlosstein, 1-2). The success of these countries could be traced back to a number of factors and variables. To be more precise, there are ***12 variables*** that played a crucial role in the success of the Pacific experience summarized by Steven Schlosstein in his book ***Asia's New Little Dragons***.

The first reason of success was the presence of an ***authoritarian political system*** which provided the stability required for economic growth. Korea was dominated by a single party system. President Park Chung Hee was assigned the presidency in 1961 and remained in power for 26 years until his successor Chun Doo-Hwan took over in 1987. However, it has to be clarified that authoritarianism implied by no means totalitarianism. This means that a certain degree of personal freedom was preserved and private ownership was encouraged. The difference between the Asian model and the Western model for development is very obvious at this level. The Asian model, unlike the Western model, showed that political stability would lead to economic development and not the reverse. Huntington also promotes this idea by mentioning in one of the classics that : "*authority has to exist before it can be limited*" (Schlosstein, 5).

Second, these Asian tigers have adopted new forms of "***cooperation between the government and business***". There was a common goal shared by both sectors. This goal constituted of conquering global markets, and reaching a high degree of penetration, keeping at the same time the domestic markets "*relatively immune to foreign penetration*" (Schlosstein, 6). The economic policy of the Pacific basin disregarded the Western notion of the invisible hand, and replaced it by the **visible hand of the market**, where heavy Research and Development -R&D- is required to adopt the needed strategies to invade world markets. Unlike the Western model suggesting that the market is self regulatory and that no intervention is required since it operates automatically, the East Asian model realized that a certain degree of intervention is beneficial. The relationship is rather positive between the government and the business sector since they operate in the same direction, unlike the Western world where usually governments work against business. In Korea, the relationship between the government and the business sector can be best described as being a "*senior partnership*" since the government is playing a more active role in policy determination (Schlosstein, 5-7).

The third important factor of the Korean success was the adoption of an aggressive ***outward economic policy***. The Pacific Basin realized at the early stages of development that the import promotion strategy was not the optimum policy to adopt. During the period of 1978-83, the Korean economy grew at a rate of 9.7% annually due to the adoption of an export promotion strategy. Foreign trade constituted 91% of the Korean GNP. The adoption of such a policy instead of the conventional policy of import substitution, allowed Korea's GNP to expand at a rate of 9.5% annually (Schlosstein, 8).

Fourth, the NICs realized the importance of the ***accumulation of private savings***. Korea was the only exception to the four tigers that went into heavy debts during the early stages of development. The country owed about $45 billion, which decreased by 1987 to $35 billion. But at least, the country did not have to bear the burden of interest financing since the payments were made through the surplus generated by trade which amounted to an average of $9 billion annually (Schlosstein, 9). Incentives were formulated to generate savings. The formulated tax incentives favored producers over consumers. Dividends were subject to double taxation, but on the other hand, capital gains were tax exempted. Consequently, firms rather than declaring dividends, preferred to reinvest the profit instead of dividing it among shareholders. Such policies were very successful in generating savings and accumulating capital which was shown in the Korean case by having the rate of capital formation in 1988 amounting at 30% of the GNP (Schlosstein, 9-10).

These countries also were highly committed to public ***education***. This was because this region of the globe is very poor in terms of natural resources. The only remaining tool was to invest heavily in human resources. Competitive education aimed at channeling the invested human capital into either the government or the manufacturing sector. According to the Asian model, the coming era is not a post industrial era as the West claims, but rather a new age of information, where no matter how a country's wealth is in terms of natural resources, what really matters is how developed and advanced the country's human resources are to manipulate industries such as telecommunications and computers (Schlosstein, 12).

The East Asian countries have also put strong ***emphasis on applied Research and Development***. In this region, R&D became a science known as kaizen. Neither the government nor academic institutions are funding R&D. On the contrary, this process

is undertaken by private firms. This emphasis on applied R&D allowed these countries to manufacture the high quality manufactured products in half the time needed by the American firms to move such products from paper discoveries to market goods (Schlosstein, 17).

The NICs also realized the ***importance of the value added*** with respect to production. For instance, many nations of the world rely heavily on exporting agricultural commodities. However, this was not the case with the East Asian nations, not only because of being poor with respect to natural resources, but because of the importance of the value added production represented in manufactured and semi manufactured goods. Korea relied on the availability of cheap labor and was able to reach a competitive edge in some industries such as chemicals, ships, and steel (Schlosstein, 22-3).

"*People should work in order to get life better*" is one of the facts that these countries promote (Schlosstein, 25). Due to the absence of natural resources, the East Asian nations developed as a rule of survival what could be called as "***capitalist Darwinism***" implying the survival of the industrial fittest. To implement this rule, industrialization has been promoted not through the presence of natural resources, but through investment in human capital (Schlosstein, 26).

The ninth reason of success has been the ***neutral role played by religion***. Throughout ages, history lacked any religious movements like Islamic fundamentalism in Egypt, or Protestantism in the United States. Religion in the East Asian countries has played a neutral role. It was only limited to life rituals such as birth, marriage, and death (Schlosstein, 29).

One of the norms that are highly respected there is ***the sacrifice of the individual in favor of the group***. Looking at the family for example, it would be found

that divorce rates are very low as well as the presence of a single parent family. Marriage is focused on children. Such a social stability played a crucial role in rapid economic development. In these countries, individual has been sacrificed for the group: "*child to family, student to class, and worker to company*" (Schlosstein, 31). This norm was deduced from Confucianism which stressed the importance of hierarchy, social order and discipline.

Cultural homogeneity also made the development process smoother. The NICs are characterized by cultural purity. Each and every country has its own population, its own language and its own social norms (Schlosstein, 32).

Finally, the ***favorable climate and infrastructure*** promoted development. Korea has cold winters and warm summers which did not obstruct production. Moreover, beside the capital, satellite cities play important roles. In Korea, for example, Seoul is the industrial center. In addition, cities as Inchon, Ulsan, and Pusan absorbed overpopulation. Such a decentralization avoided overdevelopment at the core and the ignorance of the periphery which could have "*paralyzed*" economic development (Schlosstein, 35-6).

Those were the twelve variables that led to the successful development experience of the Pacific Basin in general, and South Korea in particular. These variables can be grouped under three categories. The first group is ***political*** and is formed of the presence of an authoritarian regime, and the cooperation between the government and the private sector through the notion of the visible hand of the market. The second group is ***economic*** and includes the adoption of a fierce export led strategy, high incentives to accumulate private savings, the emphasis on Research and Development, in addition to the importance of the value added concept. The last group is ***socio-cultural*** and is formed of the high commitment to education, the sacrifice of

the individual for the group, cultural homogeneity, and the neutral role played by religion.

A South Korean Development Model ?

In the East Asian Countries, there are some elements that contributed positively to growth. These elements or variables can be generally compounded in a development model as the Western model of development. The general traits of this model are as follows. The first general trait which is ***economic*** is the adoption of an export led industrialization which led to an impressive performance of trade and exports. The second element which is ***political*** was a relatively autonomous and strong government. The third trait which is ***socio-cultural*** is formed of Confucian teachings such as educational achievements, work ethics, loyalty to hierarchy and authority (Berger, 16-19).

The question now is whether such a development model transferable or duplicable? The transferability of such a model is very difficult because of the presence of special conditions which facilitated the development experience such as the socio-cultural elements. It has to be clarified that Korea in particular and the East Asian countries in general entered the world market in a ***time of expansion*** in the capitalist region where the developed nations were experiencing growth. ***State dominance*** was facilitated by the overdeveloped state bureaucracy inherited in the ex colonial power. Confucian morals socialized people to respect authority. Resources were mobilized through successful land reform , as well as the favored capitalist development by local entrepreneurs. It has to be noted that Korea's success with adjustment after the recession of 1980 took place under special conditions. The world ***global economy*** flourished after 1982 facilitating the success of Korea, During this period, world

growth rate increased sharply especially in the US which represents the major market for Korean exports. This was mainly a result of ***Kemp-Roth tax cuts***, which caused local demand to increase pulling imports from everywhere, Korea included (Corbo, 82). The US demand increased from 5% to 8.7% in the period of 1983-4. Imports for the same period grew from 7.6% to 27%. Obviously, there was an unusual "*locomotive pulling Korean exports*". Moreover, due to the strong dollar, commodity prices declined. Korea's term of trade improved (Corbo, 83).

Also the ***cultural element*** can be seen as a contributor to development in this part of the globe. Confucianism can be seen as a fertile soil where authoritative and bureaucratic spirit can flourish. Moreover, the high degree of industrialization that Korea went through during the post independence period resulted from strong commitment to group loyalties, strong collectivity orientation accompanied by weak individualism (Dore, 298). As a result, the transferability of the Korean model is not easy. However, lessons can be drawn from the development experience of Korea.

<u>Conclusion:</u>

The objective of this study was to compare the development experiences of South Korea and Egypt. To answer the basic question of why did Korea succeed in marking high rate of growth and develop, while Egypt did not experience the "*take off*" stage yet, a two dimension analysis has been provided.

The study of the role of the state in development presented in chapters two, three, and four represented the ***political element*** having as the state autonomy and the existing regime the major variables. In these chapters, and through a comparative analysis of Egypt and Korea, the tested hypothesis "***Under a firm authoritarian regime characterized by a degree of autonomy and a well established institutional***

basis to achieve objective planning, the pace of development in faster than in the absence of objective development planning and the institutional basis" has shown to be inconclusive. By this I mean that during the era of Nasser, Egypt experienced an authoritarian regime with a high degree of autonomy. However, the first Five Year Plan did not meet its objective in achieving a high rate of growth. This can be traced back to the 1967 disastrous war, the lack of a strong institutional basis and a high degree of cooperation among the governmental organizations, the high degree of reliance on Soviets, and the absence of a clear economic ideology. Development planning was basically absent since plans were developed and formulated according to the yearly needs. On the other hand, in the case of Korea under the Presidency of Park Chung Hee, whose regime was also authoritarian with a high degree of autonomy, Korea experienced its industrial revolution accompanied with unprecedented high rates of growth. This was facilitated by the establishment of a strong institutional basis with high degree of cooperation.

Chapter five discussed the role of foreign factors mainly foreign capital in development constituting of the ***economic element*** of the analysis. The hypothesis "***at the early stages of development, if foreign capital is available, and under the control of the host country, growth will be faster***" has shown to be true with certain limitations. The type of this foreign capital is of crucial importance. In the case of Egypt, foreign capital took the form of ODA and FDI which resulted in the loss of partial autonomy in the allocation of funds and in the acceptance of the dictated economic reform program to be able to service its debts, in addition to the profit drain. Korea, on the contrary, favored foreign borrowings in order to allocate the fund into the most productive sectors of the economy by manipulating the decision making process, and to avoid the profit drain from taking place since after the repayment of the

debt and its interest, the profit will be generated and used domestically. FDI was only welcomed when it represented the only source to access a new technology that it not provided through technical assistance for example. FDI was very limited and subject to high degree of state's intervention, since any FDI had to be in accordance to governmental plans, and in harmony to the state's objectives. This chapter also discussed the involvement of the international organizations such as the IMF and the World Bank to cure the domestic economies which suffered from imbalances. The implementation of the economic reform program in Korea took place at the early 1980s, while Egypt started a decade later. From this chapter, hope for Egypt to grow and develop was implied. Korea is a country which was able to develop by manipulating only 30% of its budget, since 30% are directed to defense expenditures following an American-Korean agreement, and the remaining 40% are allocated to debt servicing. Egypt can do the same.

Generally, the study compared the development experiences of Egypt and Korea from a political, and economic dimension. In the post-independence period, Egypt and South Korea realized the basic goals to be achieved, but embarked on different strategies to reach such objectives.

With respect to industrialization, both countries adopted in the early 1950s an import substitution strategy emphasizing the production of basic commodities. The Egyptian industrial sector was ahead of the Korean sector since it contributed to 15% of the GNP in 1952, to be compared to only 6% in Korea in 1953 (Handoussa, 17). By 1961, the situation of Korea shifted totally after the military revolution undertaken by Park Chung Hee who adopted an export promotion strategy. The objective was to avoid foreign exchange shortages, and to reduce unemployment by creating new jobs

in these export industries based on labor intensive techniques. Economic objectives in Korea were met through a strong planning board and domestic mobilization.

Looking at Egypt today, it is clear that it is in a much better situation than the one enjoyed by Korea before it embarked on the period of unprecedented growth. Korea is an oil importing country which represents a burden on the state budget, while Egypt is an oil exporting country. Also Egypt is characterized by the existence of ***economic rents*** -tourism, the Suez Canal revenue, workers remittances, and oil revenue- which can be used as sources of income to be efficiently allocated by the government. Moreover, Egypt does not suffer a shortage of domestic savings, the problem rather lies in the proper allocation of this accumulated capital into productive investment projects. Finally, I think that one of the obstacles that Egypt has to face is the bureaucracy, which is characterized by the presence of a large amount of disguised unemployment.

To conclude, the problems Egypt is facing can be surmounted by adopting clear planning objectives and by incorporating various sectors of the economy through harmonious policies. Egypt is a country with a strategic geographical position enjoying a leading political role in one of the most unstable areas of the globe -the Middle East- so it is in the interest of the developed world to help Egypt achieve development. Here comes the role of the national leaders who are asked to adopt the option that maximizes the return to Egypt. The scale of implementing the reform program are still in the hands of the national leaders, as well as the tools required to achieve the planned objectives.

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