Prospects and Perils for Small and Medium Enterprises in Outward-oriented Industrial Expansion: Lessons from Korea and Taiwan

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ABSTRACT

Many developing countries are currently involved in adjusting their policy regime from one which is inward-oriented, import substitution-based, to one which is more neutral or perhaps slightly biased towards exports. It is argued in this paper that some of the policies that are adopted to achieve this outcome may have implications for the size structure of industry.

Using the example of Korea and Taiwan, the paper develops three hypotheses which it argues should be the focus of future research.

1. Small and medium enterprises may have more difficulty in participating in export trade than larger firms insofar as the fixed informational costs of selling abroad are substantial.

2. From the perspective of small and medium firms seeking to expand exports, a laissez faire, outward-oriented policy is preferable to a policy involving protection plus tariff drawbacks, even if these drawbacks are provided automatically to exporting firms.

3. In general, given the relationships between the transactions costs to a bureaucracy of dealing directly with individual firms and the absolute magnitude of response on the part of enterprises, it seems plausible that the greater the degree to which governments use methods of direct, discretionary intervention to achieve their economic goals, the more difficult is likely to be the economic environment for small and medium firms.

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The comparative experience of less developed countries over the past two decades has revealed that outward-oriented policies which encourage the export of manufactures are more likely to yield sustained, employment-intensive industrial expansion than are policies of import-substituting industrialization.[1/] What role can small and medium firms play in the expansion of manufactures exports? To what degree does their role vary with the particular mechanisms through which policies to promote manufactures exports are implemented?

This paper explores these questions by focusing on the experiences of Korea and Taiwan, two countries that have been extraordinarily successful in promoting economic development via the expansion of manufactures exports.[2/] The paper will delineate the character of the policies adopted to promote manufactures exports, with special emphasis on some institutional features that are both less familiar than the broad countours of policy in the two countries, and are of particular importance to small and medium enterprises. In addition, as a prelude to subsequent micro field work in the two countries the paper will lay out some preliminary propositions as to the implications of these institutional features for small and medium enterprises.

The Macro Prices of Traded Goods in Korea and Taiwan

'Getting prices right' -- that is, allowing the prices of both inputs and outputs to reflect their opportunity costs -- has long been recognized as the starting point of a policy of outward-oriented industrial expansion. On the product side, 'getting prices right' has meant in large part setting -- and maintaining -- a realistic price for foreign exchange in terms of local currency, and ensuring that there is no systematic bias that induces firms to produce for the local rather than export market.

Tables 1 and 2 suggest that -- as numerous studies have attested -- both Korea and Taiwan have ensured that the macro prices of traded goods meet these criteria. Thus both countries have maintained a single, unified exchange rate ever since their outward-oriented policies first were underway. Moreover, as Table 1 shows, both countries have generally ensured that real effective exchange rates for exporters remained stable over time.[4/] In Korea in particular, where domestic inflation has consistently been more rapid than world inflation, the policy response has been to combine periodic devaluations with adjustments in export incentives so as to maintain export earnings at a rate equal or in excess of 300 real 1965 won per dollar.

Table 2 presents average data on relative effective subsidies -- average effective rates of protection adjusted for differential taxes and subsidies for foreign and local sales for the manufacturing sector as a whole for Korea and Taiwan as well as, for purposes of comparison, Colombia and Argentina. As the table shows, the balance of support in

Table 1: Real Effective Exchange Rates for Exporters in Taiwan and Korea

	Taiwan (1960 Taiwanese dollars per U.S. $)	Korea (1965 won per U.S. $)
1962	39.6	264.2
1963	37.4	276.1
1964	37.8	305.3
1965	39.9	304.6
1966	39.4	305.1
1967	38.3	298.8
1968	39.4	298.7
1969	40.4	299.4
1970	41.9	307.9
1971	43.0	328.6
1972	43.8	348.9
1973	39.0	396.5
1974	29.9	338.4
1975	34.1	320.9
1976	38.8	-

Sources: Larry E. Westphal and Kwang Suk Kim, "Korea"; and T.H. Lee and Kuo-Shin Liang, "Taiwan", in Bela Balassa and Associates, Development Strategies In Semi-Industrial Economies (Washington: Johns Hopkins University Press for World Bank, 1982), pp. 218, 314.

Table 2: Relative Incentives to Sales in Domestic and in Export Markets for Manufacturing[1/], Selected Countries

		Ratio of Effective Subsidy for Domestic Sales relative to Effective Subsidy for Export Sales
Korea	(1968)	0.93
Taiwan	(1969)	0.97
Colombia	(1969)	1.42
Argentina	(1969)	2.92

Source: Bela Balassa and Associates, Development Strategies in Semi-Industrial Economies, pp. 32-33.

Notes : 1/ Manufacturing is defined here to include intermediate products I & II, Nondurable consumer goods, consumer durables, machinery and transport equipment.

Korea and Taiwan on average marginally favored exports; by contrast, in Colombia and especially Argentina, support was skewed disproportionately towards production for local markets.

The data in Tables 1 and 2 are by now familiar to many development economists. What may be less familiar -- and what is of particular relevance to our analysis of the role of small and medium enterprises -- is that, for all that macro prices in Korea and Taiwan were 'right' on average, in neither country can trade policy be described as laissez faire. As Tables 3 and 4 reveal, underlying the average data in Table 2 are substantial variations both in effective subsidies across sectors and, within sectors, in relative subsidies for foreign and local sales.

The presence of these variations in effective subsidies has two important implications for policies that aim at the expansion of manufactures exports. First, their presence raises the possibility that the government in either country might manipulate the subsidies on a discretionary basis in order to favor -- or to achieve finely calibrated responses from -- individual firms, cross-subsidizing low profit exports, with high levels of protection for local sales; as we shall see, there is some evidence that the Korean government in particular engaged in this practice. Second, in the absence of compensating policies the prevalence of protection against imports in a wide range of sectors would place exporters from both countries at a disadvantage in world markets: as a result of protection the cost of their inputs would be above world prices faced by their competitors. Yet, as the records of the two countries reveal, exporters from these countries are anything but disadvantaged. One key reason is that both countries have mounted extensive tariff-rebate programs to ensure that

Table 3: Effective Subsidies for Manufacturing in Korea (1968) and Taiwan (1969), Disaggregated by Product-Type (percentage excess of domestic value added over world market value added)

	EXPORT SALES		DOMESTIC SALES		AVERAGE SALES	
	Korea	Taiwan	Korea	Taiwan	Korea	Taiwan
Intermediate Products I	43	29	-30	36	-22	34
Intermediate Products II	17	30	20	26	19	27
Non-durable Consumer Goods	5	10	-21	9	-15	9
Consumer Durables	2	30	38	44	31	38
Machinery	5	11	31	- 3	31	0
Transport	-23	10	159	66	159	53
Food	2	30	-25	1	-23	7
Construction	6	5	-17	-15	-16	-12
TOTAL	12	23	- 7	18	- 5	20

Source: As in Table 1

Table 4: Effective Subsidies in Manufacturing in Korea (1968) and Taiwan (1969), Disaggregated by Trade-orientation of Products (percentage)

	EXPORT SALES		DOMESTIC SALES		AVERAGE SALES	
	Korea	Taiwan	Korea	Taiwan	Korea	Taiwan
Export[1/]	16	19	-15	7	-3	11
Export-and-Import-Competing[2/]	9	23	55	27	38	25
Import-Competing[3/]	39	15	100	61	99	55
Non-Import Competing[4/]	2	3	-14	-18	-14	-17
All Manufacturing[5/]	14	21	7	17	8	18

Source: Bela Balassa, Development Strategies in Semi-Industrial Economies, pp. 34-5

Notes : 1/ Export sectors are defined to be those sectors where exports exceed 10 percent of production and imports amount to under 10 percent of consumption.

2/ Export-and-import competing sectors are defined to be those sectors where exports exceed 10 percent of production, and imports exceed 10 percent of consumption.

3/ Import-competing sectors are defined to be those sectors where exports amount to under 10 percent of production, and imports exceed 10 percent of consumption.

4/ Non-import-competing sectors are defined to be those sectors where exports amount to under 10 percent of production, and imports amount to under 10 percent of consumption.

5/ Differences in value for the "all manufacturing" category in Tables 3 and 4 are a result of differences in definition of the aggregate manufacturing sector.

the price environment faced by exporters approximates what it would be in a free trade world.

The next section of this paper explores in depth the character of the compensating and cross-incentive programs in Korea and Taiwan. As will become clear, in contrast to textbook outward-oriented policies where the task of government is to 'get prices right' and thereafter remain at arms-length from the fray of market activity, compensating and cross-incentive programs involve a more activist role for government and thereby -- in practice if not in intent -- discrimination against small and medium enterprises.

Compensating for Price Distortions

This section focuses on three mechanisms that compensate exporters for domestic price distortions and explores their implications for small and medium enterprises. Compensatory drawback schemes are examined first; then the focus turns to export processing zones; finally, some evidence is presented on the role of cross-subsidization.

Drawback schemes. Both Taiwan and Korea have made extensive use of drawback schemes that rebate to exporters (or exempt exporters from) any indirect taxes, including taxes on imports, for which they might be liable. In Taiwan, between 1963 and 1972 the value of drawbacks on import taxes ranged between 5 and 10 percent of the total value of imports; in 1972 exemptions (41.8%) or drawbacks (6.3%) of tariffs on imports procured by exporters together accounted for 48.1% of total potential customs revenues.[5/] In Korea, tariff exemptions amounted in 1968 to 14.4 percent[6/] of export value.[7/]

These drawback schemes have a two-fold purpose. One purpose that has already been noted is to ensure that exporters do not face disproportionately high input costs, and thus are able to compete on equal terms with competitors from other countries. A second purpose is to ensure that local suppliers of intermediate inputs needed by export producers can compete at least on equal terms with inputs imported from abroad. If we are to understand how the use of drawback schemes to attain these objectives affects small and medium enterprises, it is necessary to outline the mechanics of the schemes in some detail.

To begin with drawbacks for direct exporters, in both Korea and Taiwan exporters automatically are granted licenses for importing the inputs they require, and are either rebated or excused payment of any tariffs on their imports. In consequence, exporters can choose freely on the basis of price and quality between importing inputs and procuring them from local suppliers.

Exporters in both countries have been permitted 'wastage allowances' whereby the quantities of inputs imported are permitted to exceed what is required for export production; the Korean government in particular has used its discretionary control over these wastage allowances as a mechanism for penalizing and rewarding firms on the basis of their export performance.[8/] But to ensure that drawback schemes do not undercut entirely the protectionist purposes for which tariffs were imposed in the first place, both countries have devised mechanisms for ensuring that by and large drawbacks are available only for goods produced for export, not for production geared to the local market.

Rather than rely on the bureaucratically cumbersome (and

potentially vulnerable to corruption) practice of requiring case-by-case evidence of whether inputs are for domestic or foreign sales, both Korea and Taiwan have made extensive use of input-output coefficients: exporters are required to give evidence of the value of actual -- or expected -- exports of a particular product; and input-output coefficients, determined by government, serve as the basis for calculating what input tariff rebates are due on these exports. The data requirements are staggering: in 1968, the Taiwanese used over 7,000 distinct coefficients to calculate their tariff rebates.[9/] Prior to 1979 the Koreans had 17,000 input classifications for 6,000 export items; after streamlining their system in 1979, these numbers fell to 11,000 input classifications for 3,000 export commodities.[10/] Yet for all of this complexity, as export performance in the two countries attests, these drawback systems have been successful.[11/]

How do drawback schemes affect exporting by small and medium enterprises? Insofar as drawbacks are available for all firms, irrespective of size, there is no direct discrimination against small and medium enterprises. Both Taiwan and Korea have adopted the principle of automatic access to drawbacks by all firms, although their is some indication that in Korea drawbacks -- as well as other incentives for exporters -- are available only for firms above a minimum size threshold.[12/] But even in the absence of direct discrimination, when contrasted with a trade regime that involves neither protection nor drawbacks, it seems plausible to hypothesize that drawback schemes act as a disincentive to export by small and medium enterprises. The reason has to do with the differential impact by firm size of the transactions costs that firms must bear in dealing

with the government agencies that administer drawbacks.

Figures 1 and 2 illustrate diagramatically how the transactions costs of drawback schemes discriminate in practice against exporting by small and medium enterprises. As Figure 1 clarifies, insofar as the bureaucratic costs of claiming a drawback are invariant to the volume of exports, while the value of the rebate rises proportionately with the value of exports, below some level of exports -- say Q^1 -- there is no incentive to claim a rebate. Translated into the terminology of Figure 2, when contrasted to average production costs in a laissez faire free trade regime, a system of drawbacks implies higher average variable costs of production for levels of export below Q_1, and higher average fixed costs for export levels above Q_1. While it is marginal costs that determine -- given entry to a particular market -- what quantity will be produced (and, in this example, exported), average costs determine whether production will occur in the first place. Moreover, as a simple matter of arithmetic, the influence of fixed costs on average total costs will be larger the smaller is the total volume of production. Figure 2 illustrates the implication of these propositions for the present analysis: the effect of a drawback scheme is to shift the average total cost schedule upwards, with proportionate increases in average costs largest at lower export levels. Assuming an export price of P_1, in a laissez faire regime the minimum volume at which firms will begin to export will be Q_2; but in a system involving drawbacks only larger firms, capable of exporting at least Q_3 units of output, will engage in export trade.

As will shortly be clarified, an analysis of transactions costs may not only be helpful in explaining why the insertion of an added

FIGURE 1

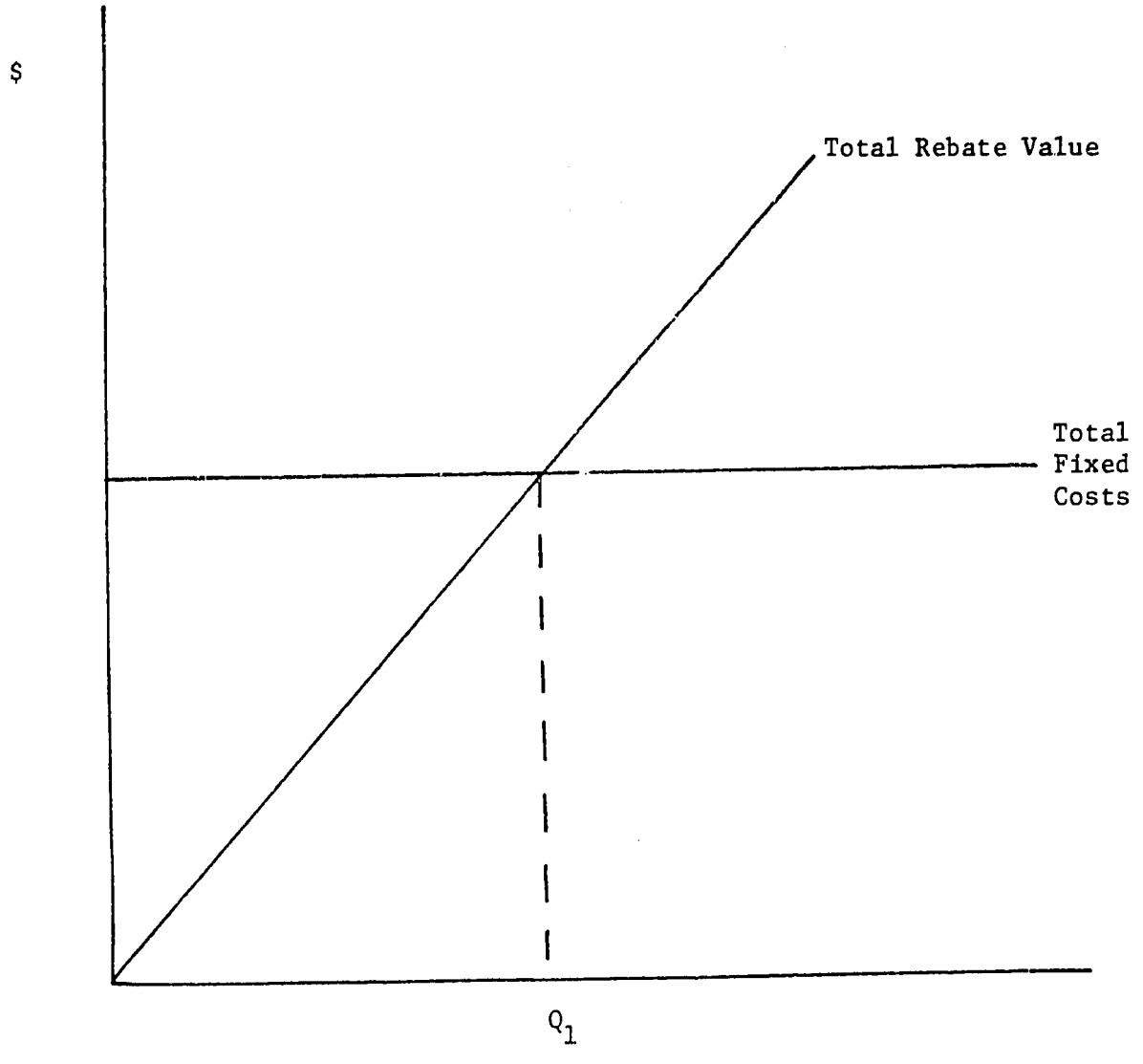
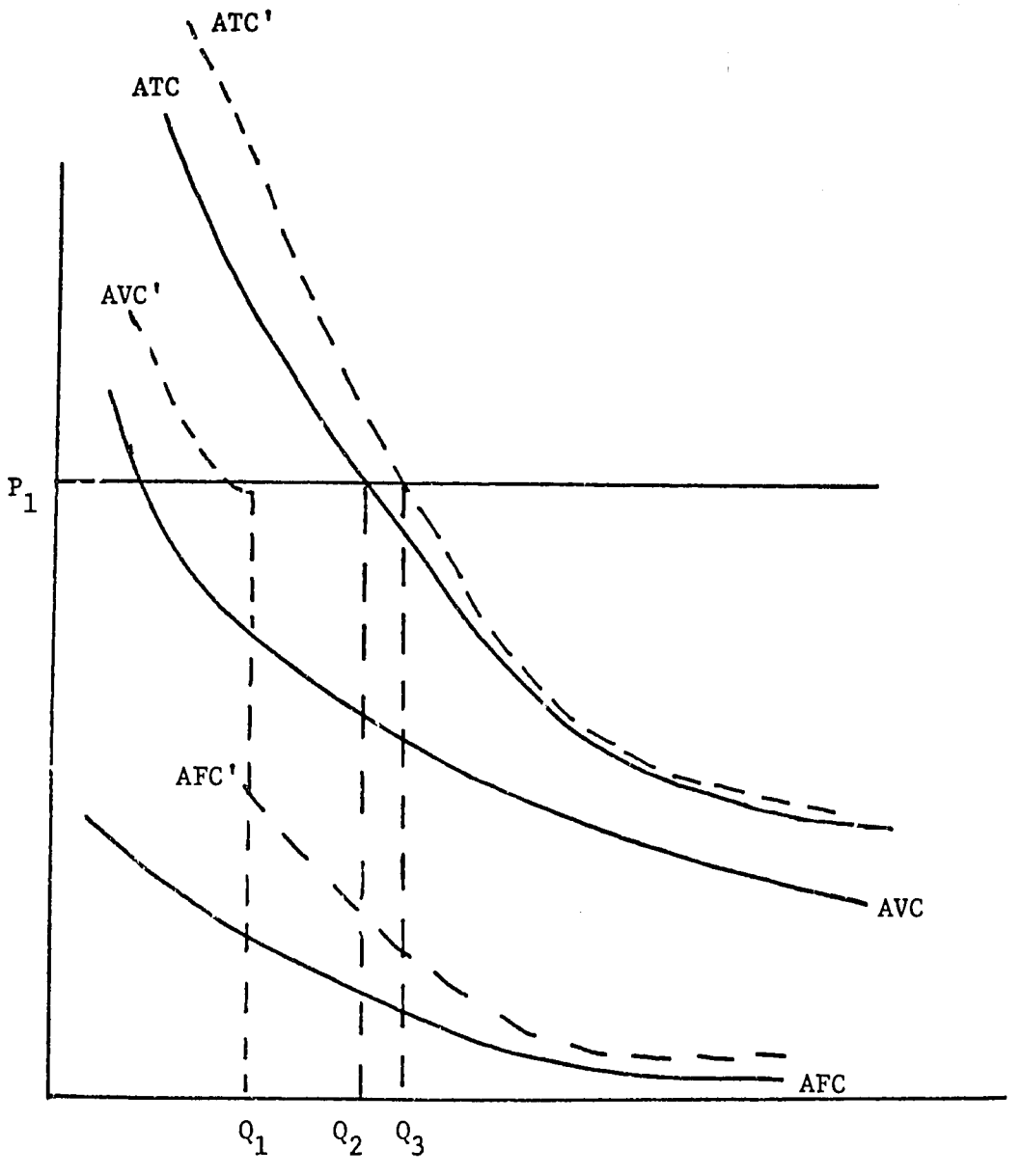


FIGURE 2



AFC (AFC') = Average fixed expott costs in a laissez faire (drawback compensated) trade regime

AVC (AVC') = Average variable export costs in a laissez faire (drawback compensated) trade regime

ATC (ATC') = Average total export costs in a laissez faire (drawback compensated) trade regime

bureaucratic requirement discriminates against small and medium-sized firms. It also is relevant in exploring the impact of the second large function of drawback schemes on these enterprises: in both Korea and Taiwan, drawback schemes ensure that local suppliers of intermediate inputs needed by export producers can compete at least on equal terms with inputs imported from abroad.

Insofar as direct exporters have access to both automatic import licenses and rebates on import tariffs, it follows that for local suppliers of intermediate inputs to secure orders from exporters they must offer goods of international quality at internationally competitive prices. Thus, in the absence of some form of relief local suppliers would face negative effective rates of protection: they would have to sell their output at world prices, but secure their own inputs at relatively high cost in domestic markets.

To overcome this problem, both Korea and Taiwan have extended their drawback schemes to indirect exporters, though in subtly different ways. In both countries, indirect exporters are responsible for providing documentary evidence of the extent to which their output has gone into the production of export goods.[13/] The two countries differ, however, in the kinds of support they offer indirect exporters.

The Taiwanese scheme is both more straightforward and provides higher levels of support to at least some indirect exporters: the government simply pays indirect exporters whatever tariff protection they would have received -- the difference between local and world prices -- had they sold their wares to producers for the local market.[14/] Indirect exporters -- and firms that supply indirect exporters (who are entirely unaffected by any drawback scheme) -- thus

enjoy equivalent levels of effective protection in domestic and foreign markets.[15/]

By contrast, the Korean scheme places greater pressure on indirect exporters to become internationally competitive themselves. The Korean input-output coefficients apply to whole chains of vertically-related activities: suppliers of intermediate goods to direct exporters can obtain rebates on tariffs for their inputs; and suppliers of inputs to intermediate producers can themselves obtain rebates.... all the way back to primary producers. The Korean scheme thus differs from its Taiwanese counterpart in two ways: in the absence of other incentives, indirect exporters in Korea enjoy zero -- rather than either positive or negative -- effective rates of protection; and the drawback paper chain -- which in Taiwan stops at the level of the immediate producer of intermediate inputs for exporters -- can sometimes unfold through layer upon layer of intermediate producer.

These drawback schemes for indirect exporters have both advantages and disadvantages for small and medium enterprises. The disadvantage is that they involve bureaucratic costs for firms, and thus -- compared with laissez faire trade policies -- the kinds of disincentives for small and medium enterprises that have already been analyzed in the context of direct exports. But, given policies of protection plus drawback, they are advantageous insofar as small and medium enterprises are more likely to participate in manufactures exporters as indirect than as direct exporters.

It is again transactions costs that explain why small and medium enterprises are more likely to be indirect than direct exporters; now, though, the relevant transactions costs are not those of dealing with

government but the informational costs associated with penetrating foreign markets. Later in this paper we will explore in some detail the mechanisms through which both Korean and Taiwanese firms overcame the barriers to sale in foreign markets. For now, it suffices to note that -- except where the marketing function is performed by specialized local intermediaries -- exporting necessarily involves communication of one kind or another between local producers and foreigners; and that successful communication requires skills that -- unlike the skills of selling locally -- are not likely to be learned in the course of the normal pursuit of everyday business activities. These transactions costs of exporting are, like the costs of dealing with a bureaucracy, fixed costs. And in ways that parallel bureaucratic costs, their existence implies that the minimum scale at which firms enter export markets is likely to be relatively large.[16/]

Indirect exporting enables small and medium-sized firms to participate in export trade, while bypassing the transactions costs of foreign marketing. And drawback schemes for indirect exporters ensure that skewed incentives do not preclude local suppliers of intermediate inputs -- including small and medium enterprises -- from sharing in the benefits of outward-oriented policies.

In all, then, the effect of drawback schemes on small and medium enterprises is mixed. From the perspective of small and medium firms that are potential exporters, a laissez-faire trade policy where prices reflect international opportunity costs is preferable to a policy of partial protection plus drawback. But, if drawback schemes are used, it is crucial that they do not discriminate against local suppliers of intermediate inputs. The worst of all possible outward-oriented

policies for small and medium enterprises is one that rebates tariffs to direct but not indirect exporters, leaving the latter saddled with negative effective rates of protection and thus -- given the high levels of protection provided if sales are to local markets -- with no incentive to participate in the export sector of the economy.

Export processing zones. Export processing zones (EPZs) -- zones which bring together within a delineated area the opportunity for tariff-free trade, an industrial estate, and all relevant government offices -- can, like drawback schemes, ensure that exporters are able to be competitive in world markets. Such zones have been established in both Taiwan and Korea. Taiwan opened the world's first modern EPZ at Kaohsiung City in 1965; subsequently two more zones were established, at Nantze and Taikiung.[16/] Korea opened its first zone in Masan in 1971, and a second in Iri in 1975.[17/]

Given the earlier start-up of EPZs in Taiwan than in Korea it is not surprising that, while only a cumulative gross value of $20 million of exports had flowed from Korea's EPZ by mid-1973, in that year the gross value of exports from the zones in Taiwan exceeded $400 million; nett of imported inputs, the 1973 export value amounted to marginally more than $100 million.[18/] In 1979, 57% of the entire output of Taiwan's EPZs was composed of goods from the electronics sector.[19/] In neither country have the zones ever accounted for more than a small fraction of total exports: exports from EPZs amounted to only 8.5% of Taiwanese exports in 1975; at no point have they accounted for more than 10 percent of Korean exports.[20/]

At first blush given our earlier analysis of transactions costs, the presence of EPZs -- and the associated easing of bureaucratic

hassles -- might appear to add to the opportunities for small and medium enterprises to participate in outward-oriented expansion. But closer consideration suggests that such a conclusion would be at the very least premature. For one thing, EPZs per se do nothing to offset the informational costs of exporting which were argued earlier to represent a difficult barrier for small and medium enterprises. Perhaps more importantly, EPZs generally are not set up to attract small and medium enterprises; indeed, it may turn out that the licensing requirements for entering an EPZ positively discriminate against these firms. Rather the focus is on providing an investment environment that is favorable to foreign investors. Thus by 1976, 82% of the cumulative value of investment by private firms in Taiwan's EPZs had been made by foreigners.[21/] Finally, insofar as EPZs delineate a region free of standard public regulations, the effect is almost to erect a trade wall between the simplified EPZ environment and the rest of the national economy. Thus between 1966 and 1974 local sources supplied less than 14 percent of the machinery, equipment and materials requirements of EPZ exporters in Taiwan.[22/] It was argued earlier that indirect exporting is likely to represent an important way in which small and medium enterprises share in the benefits of export expansion. Yet, if the Taiwanese experience is typical, EPZs would seem to add to the obstacles of indirect exporters.

Cross-subsidies for exports. The two mechanisms examined thus far both offset directly the disabilities to exporters that result from ongoing protection from import competition in Taiwan and Korea. The existence of the third mechanism -- the cross-subsidization of exports through import barriers and the associated profits for domestic

producers selling to local markets -- also depends on the persistence of protection. Unlike the other two mechanisms, however, it can function not merely to offset the burden of import tariffs but also as a means of indirectly subsidizing exports. To what degree has cross-subsidization been practiced in Taiwan and Korea? Insofar as it has been used, what implications does it have for small and medium enterprises?

Westphal and Kim (1982) have asserted (based in part on the institutional analyses of Jones and Sakong (1979) and Rhee et al (1984)) that the Korean government used cross-subsidization as a targeted mechanism to achieve finely calibrated responses from individual firms -- the government has enabled some firms to earn high profits from local sales behind protective barriers, but only on the condition that they also exported some of their output. Although evidence on the prevalence of cross-subsidization is incomplete, especially for Taiwan, the data presented in Table 4 earlier does provide some grounds for speculation.

To begin with Korea, at levels of 55 percent above value added in world prices, effective subsidies for domestic sales in export-and-import competing sectors (sectors where by definition a significant fraction of output was being exported) were way above average subsidy levels. The table shows also that subsidies in import-competing sectors were largest of all; however, in the absence of evidence that these sectors also exported -- high effective subsidies for exports could plausibly be adduced as indirect evidence -- there is no basis for asserting that subsidies for local sales were used, in part, as leverage to encourage exports.

Without institutional knowledge on the operation of subsidies in Taiwan (and no detailed studies of the business-government relationship in Taiwan have been published), there is no way of knowing whether Taiwan, too, used import protection as an indirect mechanism for targeting subsidies to exporting firms. On the basis of Table 4, the relatively lower subsidies for domestic sales in export-and-import-competing in Taiwan as compared with Korea (and indeed the absence of much differential between subsidies for export and domestic sales in export-and-import-competing sectors) does hint that the Taiwanese may have, at the very least, been less aggressive in their efforts at targeted cross-subsidization than the Koreans.

What difference does it make to small and medium enterprises whether governments attempt to promote exports by conditionally targeting protection to benefit favored firms? Insofar as protection is targeted to those firms that offer the highest private recompense to relevant public officials, small and medium enterprises are at an obvious disadvantage.[23/] But even without side payments, in practice targeted cross-subsidization is likely to discriminate against small and medium enterprises. The reason parallels the earlier discussion of fixed transactions costs, only now the relevant transactions costs are not those of the firm but of government officials. The time and effort required to negotiate a subsidy in return for a specific response is likely to vary little across firms of different sizes. But the absolute magnitude of the export response is likely to be greater the larger is the size of the targeted firm. It follows that the government official seeking to promote exports will rationally allocate scarce time to negotiating cross-subsidization arrangements only with larger firms.

Export Promotion in a Free Trade Regime

The three mechanisms explored above are ones where the governments in Taiwan and Korea provided firms with export incentives that either offset those penalties against export that resulted from the persistence of protection against import competition in both countries, or used the persistence of protection as a basis for targeting benefits to favored firms. But both countries also undertook to promote exports in ways that were entirely unrelated to their parallel policies of protection for local markets. The governments in both countries provided a range of credit and tax subsidies for exporting firms: details of these subsidies are readily available [24/] and will not be reproduced here. What will be explored are two sets of institutional innovations used to further the export drive. The first has to do with the ways in which exporting firms in both countries, with limited governmental assistance, overcame barriers to entering export markets. The second set of innovations to be explored is the process whereby the Korean government (though not its Taiwanese counterpart) planned and oversaw the entire export drive of that country in a collaborative relationship with private firms.

Marketing exports abroad. Once firms have developed the capacity to produce products that are competitive in price and quality on international markets, they still face the task of selling their wares abroad. In the initial stages of export expansion, both Korea and Taiwan relied heavily on the initiatives of those foreign buyers who responded both to the general signals that these countries had the

potential to be low-cost, stable export suppliers, and to the specific efforts to attract overseas buyers by public agencies established by the two governments specifically for that purpose.

The Korean government created and financed KOTRA (Korean Trade Promotion Corporation) in 1962 to provide information about Korean exporters and importers.[25/] In Taiwan, initially the Ministry of Economic Affairs stationed economic counsellors in many countries; then, as it became apparent that Taiwanese embassies might lose their accreditation abroad, the government helped sponsor Far East Trade Services, an export promotion operation that worked through the semi-official China External Trade Development Council.[26/] Along with these governmental agencies and the foreign buyers they attracted, important initial assistance in export marketing in both Korea and Taiwan came from Japanese trading companies; in the early 1960s, these sogo shosha marketed fully 60 percent of all textile imports from Taiwan.[27/] In addition, as was implied by the earlier discussion of EPZs, Taiwan, but not Korea, actively courted foreign investors able to provide ready access to overseas markets. Thus the cumulative value of foreign investment in Taiwan prior to 1970 -- $421 million -- was more than fourfold the equivalent value in Korea. Between 1970 and 1974 a further $867 million flowed into Taiwan; the Korean inflow over the 1970-1975 period amounted to $700 million.[28/]

As the export drive progressed, both the Korean and Taiwanese governments provided special incentives to encourage the development of national institutions with the capacity to market exports directly.[29/] Even so, as Table 5 reveals, fewer than 20 percent of new export opportunities between 1974 and 1976 for a sample of 69 firms came about

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Table 5: Mechanisms of Initial Contact with New Export Markets by Korean Firms,[1/] 1974-1976

	Number of Contacts	Percentage
Contact initiated by foreign buyers	98	45.0%
Contact initiated by exporting firm	43	19.7
Contact through Korean intermediary[2/]	38	17.4
Other[3/]	39	17.9
TOTAL	218	100.0%

Source: Y. W. Rhee, B. Ross-Larson and S. Pursell, Korea's Competitive Edge: Managing the Entry into World Markets (Baltimore: Johns Hopkins University Press for World Bank, 1984) pp. 134-5

Notes : 1/ The contacts were those of a sample of 66 firms

2/ Korean trading firms, KOTRA, sectoral trade associations, and other Korean firms doing business in the country

3/ Discussion following trade fairs, enquiry from affiliates of foreign firm to which Korean firm already exporting

as a result of initiatives of the exporting firms themselves, while over 40 percent of the new opportunities were initiated by foreign buyers. Thus in 1975 Korean trading companies accounted for only 12 percent of the value of Korean exports. Subsequently the share of exports rose rapidly to reach 48.2 percent by 1982.[30/]

To what extent do the opportunities of small and medium enterprises to export vary across these different institutional mechanisms of exporting? It follows from the earlier discussion of indirect exports that the larger are the fixed information costs associated with a particular mechanism, the greater will be the disincentive against exports by small and medium firms. Thus, small and medium firms are hardly likely to export directly themselves. They will have opportunities to sell to foreign buyers only insofar as these buyers are willing to absorb the transactions costs of dealing with large numbers of small firms in return for the security of a diversified source of supply. National trading companies also could in principle provide small and medium firms with access to foreign markets at relatively low transactions costs to the firms, although whether this access is provided in practice will depend on the opportunity costs to the trading companies of the time spent in transactions with small and medium firms.[31/]

Government-directed implementation of export promotion. Of all the mechanisms examined in this paper, it is in this final mechanism -- the degree to which government cajoled, collaborated with, and pressured firms to expand their export activities -- that the differences between Korea and Taiwan appear to be greatest.

There has been no detailed institutional analysis of the role the

Taiwanese government played in that country's export drive. Even so, a recurrent theme in research on the political economy of Taiwan is the wide status and language gap between the Kuomintang government staffed predominantly by mainlanders who crossed over to Taiwan in the late 1940s, and business which is disproportionately controlled by native Taiwanese.[32] Although not in explicit reference to this gap, one scholar has depicted the relationship between business and government as follows:

> "managers of both large and small firms feel they operate at the will of the government, which is considered at best capricious.... people in industry feel strong antipathy, mixed with awe, toward government officials. These officials are considered incapable of continuous and effective action and, like the government they compose, are frequently felt to behave arbitrarily and with a haughty manner".[33]

The Korean government, like its Taiwanese counterpart, also is the dominant partner in its relationship with business. But the way in which it has gone about asserting its power has been radically different from the Taiwanese pattern, as the following quotation from one important study of business-government relations in Korea suggests:

> "....the bureaucratic decision-making structure has been able continually and successfully to adapt to rapidly changing conditions..... government policy response is typically closer to the alacrity of a crack air-force unit scrambling to the attack than to the lethargy usually associated with bureaucracy.... The Korean policy-making style is one of diving in, getting started, observing results, adjusting policy, and repeating the process until the appropriate mix is found.... Policies are often made with low levels of generality; for example, for application to a single firm.... There is virtually unlimited freedom of economic expression with various levels of government quite receptive to the opinions of businessmen, academics and foreigners..... the level of government intervention is high and has a positive net impact."[34]

The activist orientation of the Korean government is reflected in the institutional mechanisms it established to oversee the nation's export drive. Three of these mechanisms will briefly be described here.[35/] First, since the early 1960s firms in Korea have been subject to annual export targets; initially these targets took the form of directives from government, but over time the input of firms in target setting progressively increased; data on performance in relations to the targets is transmitted on a daily basis to the head of the export promotion office of the Ministry of Commerce and Industry. Second, since 1965 the government has convened monthly export promotion meetings, chaired by the nation's president; participants at these meetings include senior cabinet ministers, the heads of some of the nation's larger firms, and the chief executives of key export associations. Third, the government declared Korea's first Export Day on 30 November 1964, when Korean exports first passed the $100 million mark; the day has been celebrated each year thereafter, highlighted by the award of prizes for the most successful exporting firms.

What has been the impact of these efforts on exports? A survey of 106 firms found that 62% of these firms felt that their export targets had led to increases in exports, while only 14% claimed the targets had made no difference to the growth of production.[36/] Over 60 percent of the firms agreed that the monthly export meetings significantly affected their export performance, in part through the effects of exhortation, and in part through accomodation by government "resolving difficulties or delays in the firm's dealings with government ministries".[37/] Underlying these positive responses appears to be the implicit threat of government sanction:[38/] almost three-fourths of the

firms that responded to the survey viewed the most important advantage of good export performance to be its implied assurance of continued government support for the firm's efforts.

Although collaborative decision-making between business and government may well have accelerated export growth in Korea, it is entirely possible that this acceleration was at the expense of small and medium enterprises: as was argued earlier in the context of cross-subsidization, government officials seeking to promote exports are more likely to allocate their scarce time to pressure -- and in return to nurture with special favors -- large firms capable of a more substantial absolute response than their smaller counterparts. Indeed, given the relatively moderate differences between the two countries in the way they used the other mechanisms examined in this paper, the centrality of collaborative business-government decision-making in Korea and its apparent paucity in Taiwan, stands out as the mechanism (of those examined here) most likely to help account for the disproportionately large role of small and medium enterprises in Taiwan, and their disproportionately small presence in Korea.

Some Hypotheses that Warrant Further Exploration

This paper has attempted to achieve two complementary purposes. It has endeavored to delineate some institutional aspects of the outward-oriented economic policies in Taiwan and Korea; and it has explored the implications for small and medium enterprises of this selected set of mechanisms of export promotion. Although more definitive conclusions must await the results of field research in the

two countries, four provocative hypotheses have emerged from the initial exercise.

The first hypothesis is that small and medium enterprises may have more difficulty in participating in export trade than large firms insofar as the fixed informational costs of selling abroad are substantial. This is not to say that small and medium enterprises will necessarily be disadvantaged in countries that have adopted outward-oriented policies. What it does imply, however, is that special governmental attention may have to be given, first to ensure that there exist intermediary trading institutions that absorb the informational costs of learning about foreign markets and thereby provide small and medium enterprises access to these markets and, second, to ensure that there is not unintended discrimination against indirect exports in the prevailing constellation of trade policies.

As for the second hypothesis, from the perspective of small and medium enterprises seeking to expand exports, a laissez faire outward-oriented policy is preferable to a policy involving protection plus tariff drawbacks, even if these drawbacks are provided automatically to exporting firms. The logic here is that any bureaucratic overlay on top of a free trade regime involves transactions costs for firms, and these transactions costs impose a disproportionate burden on small and medium enterprises.

The third hypothesis addresses not so much the relative position of small and medium enterprises as it does differences in the structure of outward-oriented policies in Korea and Taiwan. On the basis of the evidence summarized in this paper, it does not appear useful to distinguish between the two countries in terms of the degree to which

their policies are laissez faire in character. Economic policies in both countries involve a significant degree of intervention and control on the part of their respective governments. Where they differ is in the balance between the punitive and promotional functions of their mechanisms of control. The rather limited evidence currently available suggests that controls in Taiwan tend to be punitive in their function, implicit threats to firms to toe the line or suffer the wrath of government.[39/] By contrast in Korea, although the punitive element is by no means absent, the government also has fostered a relationship of 'partial mutuality'[40/] with business in order to promote its economic objectives.

It is perhaps a paradox that the relative embrace of business in Korea has had the practical, if unintended, consequence of discriminating against small and medium enterprises. Indeed in general, and this is the final hypothesis, given the relationship between the transactions costs to a bureaucracy of dealing directly with individual firms and the absolute magnitude of response on the part of enterprises, it seems plausible that the greater the degree to which governments use methods of direct, discretionary intervention to achieve their economic goals the more difficult is likely to be the economic environment for small and medium enterprises.

These four hypotheses suggests that -- as the title of this paper implies -- there are both opportunities and perils for small and medium enterprises in an outward-oriented industrial strategy. The perils lie in the possibility that even with the best will towards small and medium enterprises in the world, the mechanisms designed to implement outward-oriented policies can have the effect of excluding these firms

from export trade. But in principle, if careful attention is paid to the impact of these mechanisms on small and medium enterprises, there is no reason why they cannot share in the fruits of outward-oriented policies and the accompanying expansion of manufactures exports. If this paper has made even a modest beginning in identifying how the perils can be circumvented and the opportunities embraced, then it has accomplished its purpose.

ENDNOTES

1. For overviews of three major research efforts that yielded this result, see Balassa (1982), Krueger (1978), and Little, Scitovsky and Scott (1970).

2. For one review of the Korean experience, see Kim and Roemer (1979); for Taiwan, see Ho (1978) and the articles in Galenson (1979).

3. For example, see the articles in Balassa (1982); also Kim and Roemer (1979) and Ho (1978).

4. Although note that the Taiwanese dollar became overvalued for a brief period in 1974 and 1975, and the real won value of exports in Korea rose after 1970.

5. Westphal (1978) p. 20

6. Almost half of the total value of incentives -- 29.8% of total merchandise exports, according to Westphal and Kim (1982), p. 217.

7. The Taiwanese data are from Scott p. 334; the Korean from Westphal and Kim p. 217. Insofar as export and import values approximate one another in the two countries, the data suggest a somewhat larger role for the drawback system in Korea. The data in Tables 3 and 4 -- which point to relatively higher effective subsidies in Taiwan than in Korea and thus potentially (though not in practice) greater scope for rebates in the former country -- reinforce this conclusion. Note though that Tables 3 and 4 measure subsidies only for manufacturing. When effective subsidies for all sectors -- including non-manufacturing -- are compared, the difference in subsidy levels between the two countries all but disappears.

8. For Korea, see Westphal and Kim (1982) p. 216; for Taiwan, Lin (1973) pp. 97-99.

9. Lin (1973) p. 102

10. Rhee (1985) p. 85

11. Maurice Scott has calculated -- Scott (1979) p. 335 — that for the average manufacturing establishment engaged in producing exports in Taiwan in 1971, rebates of import duty -- as well as commodity and other indirect taxes on exports -- equalled nearly three-fourths of value added and more than double estimated trading profits net of depreciation, but gross of income tax and interest payments. Given these magnitudes, it is implausible that exports could have expanded as they did (given the protective tariffs) in the absence of rebate schemes.

12. According to Rhee, Ross-Larson and Pursell (1984) p. 11, Korean firms qualify for export licenses only once their exports exceed

$1 million annually. It is not clear whether smaller firms that export through general trading companies nonetheless have automatic access to the various incentives for export.

13. By showing evidence of final exports, and using input-output coefficients to calculate the value of their inputs in these exports.

14. Little (1979) p. 483.

15. On the basis of conversations with government officials and firm managers, Westphal (1978) p. 27 -- by contrast with Little (1979) -- concluded that indirect exporters do not enjoy such extensive protection. Rather, indirect exporters get no payment from governments, but direct exporters can apply for rebates of any import tariffs paid by their suppliers. Moreover, because of the paperwork involved, the producers interviewed by Westphal sought indirect rebates only for major input purchases. If Westphal is correct, indirect exporters in Taiwan enjoy no more -- and possibly less -- support than in Korea.

16. Scott (1979) p. 337

17. Rhee (1985) p. 67

18. The Taiwanese data is from Ranis (1979) p. 238.

19. This amounted to one-third of total electronics production in Taiwan; Hofheinz and Calder (1982) p. 189.

20. Data for Taiwan from Lee and Liang (1982) p. 317; for Korea from Rhee (1985) p. 67.

21. Ranis (1979) p. 248.

22. ibid p. 251.

23. There is no evidence that corruption has been a pervasive problem in either Korea or Taiwan.

24. For a summary of the incentives in Korea, see Jones and Sakong (1979) pp. 94-5; for Taiwan, see Lee and Liang (1982), Lin (1973) and Westphal (1978).

25. Rhee, Ross-Larson and Pursell (1984) p. 52.

26. Scott (1979) in Galenson, p. 342.

27. ibid p. 367.

28. For the Taiwanese data, see Ranis (1979) p. 247; for Korea, see Westphal and Kim (1982) p. 251.

29. For a brief description of the incentives in Taiwan, see Westphal

(1978), p. 31; for Korea, see Rhee et. al. (1984). Westphal implies that the level of marketing assistance afforded exporters by the Taiwanese government fell short of the efforts of its Korean counterpart.

30. Rhee et. al. (1984) p. 148-9. It is not clear to what degree this shift represents a change in the mechanism of exporting rather than a difference in the definition of the medium of export.

31. The Korean trading company, Korea Trade, specializes in the exports of small and medium-scale producers; the value of its exports rose from $18 million in 1975 to $75 million by 1982.

32. Gates (1981) in Ahern and Gates pp. 255-256; also Kerr (1965). Aside from scattered remnants of an earlier indigenous population, the 'native' Taiwanese themselves migrated from southern provinces of mainland China in the course of the nineteenth century.

33. Silin (1976) p. 16

34. Collated from Jones and Sakong (1979) pp. 290-292. It may be worth noting that one disgruntled Taiwanese business executive commented explicitly that "....in Korea the government helps business plan and is co-operative. Here there are more problems and government controls"; Silin p. 20.

35. For additional details, see Rhee et. al. (1984)

36. ibid, p. 91.

37. ibid p. 34

38. Jones and Sakong (1979) p. 109 argue that the key mechanism of control of the Korean government is its control over the allocation of credit.

39. For further discussion of the way in which the state controls business in Korea see Amsden (1984); for an analysis in a different context of how economic policy can be used as a mechanism of political control, see Bates.

40. The phrase is from Jones and Sakong (1979)

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