A.I.D. EVALUATION HIGHLIGHTS NO. 14

EXPORT PROMOTION ASSISTANCE IN KOREA:
A REVIEW OF A.I.D. EXPERIENCE

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SUMMARY

The Korean Government's export promotion agencies played only a marginal role in Korea's success as a world-class exporter. Between 1961 and 1973, Korea conducted an aggressive public sector campaign to boost exports with substantial help from the Agency for International Development (A.I.D.). Evidence suggests that government assistance made only a marginal contribution to export growth. Korea created a number of government agencies to bolster its export drive, but their impact on exports was marginal, and they all outlived their usefulness. These facts should cause A.I.D. to closely examine subsidizing public sector export institutions in other countries. These findings are reflected in a recent desk study commissioned by A.I.D.'s Center for Development Information and Evaluation. The study relies on extensive literature review and numerous interviews with key officials from Korea's public and private sectors, as well as a number of U.S. exporters to Korea.

When Korea shifted its focus in the early 1960s away from import-substitution industrialization, exporters suddenly had to adapt to an environment full of new and unfamiliar tasks. Had private markets for export services not developed quickly, public export aid might have been called for to help new exporters with these challenges. However, the private sector turned out to be a more potent force for providing the services firms needed for export expansion than either the Korean Government or A.I.D. had anticipated.

BACKGROUND

Korea's trade policy history can be roughly divided into four phases: (1) an import-substitution phase prior to 1961; (2) an export-oriented take-off phase that began in 1961 and lasted through 1973; (3) a sectoral development strategy promoting heavy and chemical industries between 1973 and 1979; and (4) a post-1979 liberalization phase. Macroeconomic stabilization, devaluation, and a unique administrative system of promoting exports were all policies fundamental to the take-off during phase 2 (see Figures 1 and 2).

The take-off phase of South Korea's export-led industrialization program began with public outrage over illicit accumulation of wealth, which swept the Rhee Government from office in 1961. The military's seizure of power was accompanied by a ban on political parties, restrictions on the press, and a disbanding of unions. The Government also increased taxes on the private sector, which led to unprecedented control over the allocation of credit. This consolidation of power gave President Park, who replaced Rhee, a unique opportunity to reform the bureaucracy and change the relationship between government and business. A firm believer in rapid economic development, Park instituted reforms that put the reins of economic power squarely in the hands of the Korean Government, which set the stage for Korea's government-directed transition to export-led industrialization.

The Korean Government had experimented with several export promotion approaches during the late 1950s and early 1960s, and by 1965 key aspects of Korea's comprehensive export system were in place. By that point, the Government had begun maintaining macroeconomic stability and a competitive exchange rate; setting quantitative export targets by firm, industry, and geographic market; and monitoring performance relative to targets, rewarding firms that met or exceeded targets with heavily subsidized credit.

At the same time, the Korean Government created a high-level Export Development Committee (EDC) to provide production and marketing assistance to exporters. It established two public-sector institutions that set industrial standards, promoted quality control, and provided inspection and testing of exports. The Korean Trade Promotion Agency (KOTRA), created in 1962 to market Korean exports, carried out market research, engaged in public relations, and searched for buyers. The Government formed the Korean Institute for Science and Technology (KIST) in 1966 to overcome its concern about private sector dependence on imported technology. KIST's job was to develop an indigenous capacity to generate new industrial technologies. The Government also created a large number of public-private commodity-specific task forces to resolve production and marketing problems.

A.I.D.'S APPROACH

A.I.D. played a powerful role in reshaping Korean macroeconomic policy during the take-off phase. Even though decision-making authority was centralized by the Park Government, centralization alone did not make for a coherent strategy. U.S. assistance to Korea was so massive that A.I.D. was able to exert great influence on Korean policymakers. During the early 1960s, A.I.D. financed nearly 50 percent of Korea's imports. A.I.D.'s primary concerns were macroeconomic stabilization and stagnating exports. When A.I.D. threatened to suspend aid disbursements over macroeconomic policy disagreements, the Government negotiated a stabilization program.

The joint Korean/American Economic Cooperation Council (ECC) created the Export Promotion Subcommittee (EPSC) to deal with production, administrative, and marketing problems facing exporters. Both the Government and A.I.D. representatives on EPSC assumed that Korea's export potential was severely handicapped in those areas and believed they must prime the pump if exporters were to succeed. They decided on a commodity-by-commodity assistance strategy. A.I.D. financed numerous, highly targeted consultants to work with individual firms and industries; for example, assistance went to producers of human hair wigs, ceramics, silk cloth, furniture, canned goods, antiques, men's garments, footwear, paper, cement, shrimp, and embroidered handkerchiefs.

A.I.D.'s strategy was also to assist Korea's newly created public sector institutions, such as KIST, the National Industrial Research Institute (NIRI), and KOTRA.

KIST's mission, to develop an indigenous capacity to generate new industrial technologies to meet the needs of private industry, was a massive task, well beyond the capacity of the Korean scientific community. The Korean Government and A.I.D. turned to the Battelle Memorial Institute for help. Battelle helped KIST develop links to the international science community, recruit trained senior staff, and identify research projects.

KOTRA's job was to provide information for Korea's new export manufacturers and to conduct market research. It identified Korea's competitors and the price and quality of their goods, explored foreign demand for Korean goods, promoted exports through public relations, and found buyers. A.I.D. provided a range of assistance to KOTRA, including a survey and assessment of the organization. It also arranged for the president of KOTRA to visit the heads of large U.S. buying chains in the United States.

The Korean Government created NIRI to carry out export inspections and testing. A.I.D. supported NIRI by providing two full-time specialists and numerous short-term experts. It also financed a review of Korea's quality inspection system for exports and brought in a full-time quality control adviser to assist in establishing a quality control association. A.I.D. organized several trips abroad for Korean technicians to study quality control methods used in Hong Kong, Japan, and Taiwan. A.I.D. support also helped to establish private sector inspection laboratories in Taegu and Pusan. At A.I.D.'s urging, NIRI built, equipped, and trained individuals for six nongovernmental inspection and testing institutes.

Government-directed export promotion combined with distrust of the private sector and misunderstanding of its capabilities led to an assistance strategy heavily reliant on public sector service providers. Although A.I.D.'s technical assistance advisers occasionally nudged services provision in a private sector direction, neither A.I.D. nor the Government gave much thought to the role Korean entrepreneurs or the international private sector might play in expanding exports. This tendency limited the effectiveness of the Government's export promotion drive.

FINDINGS

Some private sector industries already had significant indigenous marketing and production capabilities, even though the governmental export drive was meant to compensate for shortcomings in the private sector. Some Korean entrepreneurs had strong ties with private sector firms in several developed countries, most notably Japan.

For centuries Korea lived in extreme international isolation, which ended abruptly when Korea opened its ports in 1876. By 1910, Korea had been exposed to substantial modern industry. During the Japanese occupation from 1910 to 1945, Korea industrialized further. During this period, factory output grew at a compound annual rate of 10 percent and total production tripled. Exports reached 30 percent of national income. Much of this growth was in textiles, a leading export industry during the first decade of the post-1960 expansion (see Table 1).

Significantly, the period of 1910 to 1945 spawned an indigenous financial, commercial, and industrial elite. Though small, this elite evolved into the leaders of Korea’s industrial conglomerates, or post-1960 chaebol, which came to dominate the Korean economy. The period from 1910 to 1945 also saw the emergence of smaller independent entrepreneurs who became active exporters in the 1960s. In sum, the Korean entrepreneurial class possessed considerable skill and experience. Japanese language skills, education in Japanese universities and factories, and technical assistance from many European and Asian machinery suppliers combined to form a private export sector with the means to "fill the gap" in export services.

Most of Korea’s post-1961 industrial expansion resulted from an increase in firm size rather than a rise in the number of firms. Korean entrepreneurs clearly knew how to export manufactures and were in touch with customer preference in developed-country markets. Once the post-1961 incentive system removed the bias against exports, they were well-positioned to exploit new opportunities. This readiness probably explains why the supply response of Korea’s entrepreneurs was so quick and substantial, suggesting that countries without such an entrepreneurial class might experience a lower supply response.

Studies conducted in the mid-1970s, as well as interviews by the Center for Development Information and Evaluation (CDIE) with key public and private sector actors involved in early export expansion, provide insight into the role of government in assisting exporters. Korean entrepreneurs reported that they went overwhelmingly to the firm’s chief executive and/or other employees for assistance in conceiving new projects or markets, acquiring new technology, and finding relevant training. They sometimes turned to the Korean Government for financing (22.5 percent of the time), for conceptualization (6.5 percent of the time), but almost never for technology acquisition or technical training.

Korean firms ranked importers as their most important marketing source (see Table 2). When asked about their first contact with buyers in new export markets, exporters ranked KOTRA near the bottom in importance. Some Korean industries relied on KOTRA’s activities and overseas offices to find buyers, but most found that the complexity of styling and design issues for ready-made garments was beyond KOTRA’s capabilities. Also, KOTRA had a limited understanding of the complexity of marketing channels. Japanese trading companies could bring enormous marketing experience to bear, although they may have charged high margins. These companies tended to know buyers’ reputations, could easily get letters of credit, and helped settle quality complaints. KOTRA’s role of finding buyers was also limited by the fact that plenty of buyers, especially big buyers, came to Korea on their own.

This does not mean that KOTRA did not play a role in early export expansion. Virtually everyone interviewed stated that KOTRA's overseas offices were havens for Korean manufacturing visitors in the early days. They provided a "home abroad," arranging contacts and providing access to cheaper international telephones and telexes.

Korea relied heavily on foreign loans to finance the import of foreign capital goods containing new technology. Multinational corporations did not fill the technology gap because direct foreign investment in Korea was relatively small, as was their contribution of technical assistance and licensing. In a survey of 112 exporting firms, foreign sources provided 68 percent of basic process and product innovation technology. The Japanese had given production assistance to virtually every firm interviewed, demonstrating once again the crucial role of the Japanese private sector in Korea's export drive. Even now, Korea relies heavily on imported technology, as evidenced by the continued dependence on exports that use foreign-buyer specifications.

Firms turned to KIST for new technology less than 10 percent of the time. KIST's role in technology transfer and development was limited, especially in the early years of export expansion. The Government only established KIST after export expansion was well underway, and its research effort focused mainly on import substitution. Few of KIST's technology development projects were successfully commercialized.

Korea also invested heavily in education and training, and encouraged labor mobility among firms, contributing to extensive local know-how in basic production technology. The Government complemented this investment in human capital with the 1961 Foreign Capital Inducement Act (FCIA). The FCIA controlled and monitored foreign investment in Korean industry; for instance, all foreign investors had to, or were encouraged to, enter into a joint venture with a Korean firm. Under the joint-venture agreement, the foreign partner was required to train the Korean partner's personnel. After they learned the basic technology, the Government closed the sector to additional foreign investment.

Overall, these findings suggest that public sector aid to exporters had a minimal impact on export expansion in Korea. It is possible that some successful exporters interviewed were biased about their own role in export expansion, but the preponderance of evidence suggests otherwise.

IMPLICATIONS

The CDIE evaluation of Korea's export services assistance program in the early 1960s has several important implications for A.I.D.

- *Be careful in identifying the rationale for intervention in export markets. Test that rationale against reality before intervening.* The Korean Government and A.I.D. seriously underestimated the capacity of Korean entrepreneurs and their foreign associates to meet the needs of exporters of manufactures. Distrust of the private sector led the Government to assume market failure in the export services markets. This assumption proved wrong. Both the Government and A.I.D. underestimated the industrial and export experience of the Koreans during the period of Japanese colonialism. In addition, substantial technical assistance in production, especially in textiles prior to 1961, was all but ignored. The Government and A.I.D. should have undertaken a serious assessment of the private sector's capacity, including the foreign private sector, to meet the production and marketing needs of new exporters before providing public sector support.

- *Focus on helping nascent exporters develop long-term collaborative relationships with developed-country buyers, manufacturers and foreign machinery suppliers. Remember that the international private sector can provide highly valuable services to exporters.* Korean exporters relied heavily on marketing assistance from Japanese trading companies and importers/buyers; many continue to do so. They turned to foreign machinery suppliers for production innovation assistance. International sources also provided help with quality control. All these services had a significant impact on export expansion.
- *Avoid creating public sector export institutions, or subject them to sunset provisions.* None of the institutions created by the Government have found a raison d'être or a productive role to play. KOTRA has continually been forced to create new roles for itself—with only limited success—as the Korean private sector's overseas marketing experience increased. Sustainability problems have also confronted KIST, which has had difficulty funding itself through private sector contract research. The six private sector export inspection and testing institutes established by the Government have met similar fates. It is difficult to reform or close an institution after it has been created, so the decision to adopt a strategy of public provision of export services should not be taken lightly.

This Evaluation Highlights summarizes the findings of the report entitled Can Export Services Assistance Make a Difference: The Korean Experience, *by Michael T. Rock, Technical Report No. 7, April 1993 (PN-AAX-264). The report can be ordered from the DISC, 1611 North Kent Street, Suite 200, Arlington, VA 22209-2111, telephone (703) 351-4006, fax (703) 351-4039.*