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**Characteristics of the East Asian Economic System:  
Authoritarian Capitalism and  
The Developmental State**

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## Introduction<sup>1</sup>

Within the space of less than three decades the economies of East Asia have shown unprecedented growth rates, and since the late 1980s the region has become subject of increasing academic attention (see Wade, 1992 and Kang, 1995 for reviews). Debates on the causes of East Asian economic growth have indeed become one of the most competitive theoretical, sometimes ideological, battle fields including growth theory, developmental economics, state theory, international political economy, industrial organization and comparative sociology (Amsden, 1989; Wade, 1992; Henderson, 1993; Lucas, 1993; Krugman, 1994, Evans, 1995). The rise of East Asia revitalizes the old issues in political economy with fresh historical experiences; why some countries (or only four East Asian newly industrialized countries (NICs) succeeded in capitalist industrialization in the Third World? Why not the others e.g. in Africa or Latin America? This raises another pertinent question: is the East Asian Model applicable to other countries such as Southeast and South Asia or Eastern Europe? Some researchers even ask different, sometimes more fundamental, questions about the desirability or sustainability of authoritarian capitalism in East Asia.<sup>2</sup>

The answers to these questions are not easy because complex factors or variables contributed to economic growth. Some economists argue that the high level of productivity based on the on-the-job accumulation of human capital has been the most important source of economic growth in Korea (for example, see Lucas, 1993). Other economists emphasize the role of free trade in accelerating growth rates in East Asia (Krueger, 1990). By contrast, scholars in other disciplines regard the state's intervention in the economy as the key factor which contributed to economic growth (Johnson, 1987; Amsden, 1989; Wade, 1990 and Weiss and Hobson, 1995). Furthermore, some scholars consider social and cultural factors such as Confucian ethic as the key element in East Asian economic growth (Morishima, 1982 and Berger, 1988).

The answers are not easy. Also because the economic systems in East Asia are different from country to country. There are various opinions concerning the economic growth model in East Asia. Some consider the Japanese model as an East Asian model, which can be applied to

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<sup>1</sup> I would like to express my thanks to Jacques Hersh and Johannes Schmidt for giving me a chance to develop the ideas which appear in this essay. During the writing process I received helpful comments and ideas and I appreciate Schmidt's careful reading and editing of the paper.

<sup>2</sup> The most devastating critique of the literature appraising the East Asian economic growth comes not from radical scholars but from a mainstream economist, Paul Krugman (1994). Krugman argues that the rapid economic growth in East Asia is nothing but a simple reflection of large factor input. Like the rapid economic growth in the Stalinist period in Russia, he argues, it cannot sustain in the long run without improving productivity. Raising questions about the desirability of economic growth in East Asia, Bello and Rosenfeld (1990) shed light on the dark side of economic growth in East Asia such as oppression of workers, environmental pollution, dislocation of peasants, and etc..

explain the cases of Korea and Taiwan (for example, see Johnson, 1987). Others regard the Korean and Taiwan case different from the Japanese model (Hirono, 1988; Weiss and Hobson, 1995). Scholars in East Asia even identify significant differences between Korea and Taiwan with regards to the type of state intervention in the economy and economic structure (Koo, 1987; Chen, 1990; Shin, 1990; Evans, 1995).

Different explanatory models to answer the same question, emphasizing different factors and processes, mainly reflect the institutional boundaries of different disciplines. While economists focus on economic factors such as trade or market as the key factors which contributed to growth, political scientists and sociologists emphasize the role of the state. Each discipline provides only a partial view of economic processes in East Asia because there are many anomalies and important questions unanswered according to each explanation. In authoritarian capitalism the state's intervention in the economy has been much more comprehensive so that it is closer to the command economy in Eastern Europe than the market economy in Western Europe. While the state is a significant actor in the East Asian economy, it is not an economic actor generating surplus but a coordinator or planner.

The real foundations of a national economy are work organizations or industrial firms. The definition of Industrial firms is that, they produce goods and services within a political framework provided by the state. Work organization is an economic institution in which labor, technology and capital are organized in specific ways to produce profit. While research on industrial relations and organizations balanced the state-centered approach to explain Japanese economic growth, only the state-centered approach dominated the discourse on economic growth in Korea and Taiwan. Missing the link between state and market, the debates end up with economic growth without economic producers or production itself. In fact, the compartmentalized disciplines in social science are not effective to properly understand and explain East Asian economic growth because each discipline try to find answers within its own narrow and self-identified academic territory.

Participants in these debates have also tried to find the final cause of economic growth, in one way or another, neglecting the mechanisms through which multifactors are interacting at multilevels. Independent variables suggested to explain economic growth in East Asia are education, free trade, market, state intervention, Confucian culture, etc. Except market variables, other variables are chosen because they are supposed to be distinctive in East Asia. However, a single variable approach does not successfully explain the rise of the East Asian economy and its limits. What is needed is a holistic explanation of the rise of East Asian economic growth to identify the interconnection of economic and political factors and examine its limits of applicability to other developing countries.

In this paper I would like to identify some characteristics of the East Asian political economy which I call 'authoritarian capitalism', and analyze the factors which contributed to the

economic growth in East Asia. Next I will discuss the nature of the East Asian authoritarian capitalism as a distinctive political-economic system from democratic capitalism in Western Europe and authoritarian socialism in the Eastern Europe. Then I will focus on three dimensions of the operation of authoritarian capitalism in East Asia; the developmental state, the political economy of work organization, and geopolitics and the world system. The role of the developmental state in the economy and the operation of work organization are distinctive with respect to the state intervention in organizing an economy providing financial support and guidance of private production in East Asia.<sup>3</sup> The core dynamic force of economic growth in East Asia was not market demand but state command. Looking at the inside of the production organization, I argue that soft budget constrained firm and factory despotism have been the micro-foundation of the growth machine in authoritarian capitalism. Similar to firms in Eastern Europe, firms in East Asia faced soft budget constraints due to state subsidies. With the help of the state's oppressive apparatus, labor control inside firms has been despotic, denying workers' basic rights and demands. However, the growth machine has operated in the changing climate of the Cold War and the global economy. Interactions among local, national, and international economic and political power are continuously changing in the real world. As far as the economy is concerned, I argue, the interaction in East Asia has been favorable to economic growth in South Korea and Taiwan under the US hegemony since 1945. The political and military alliance between the United States and East Asian countries gave greater advantages to the East Asian countries in terms of aid and easy access to the US market (Wood, 1986; Stubbs, 1989; Hersh, 1993). Under the hegemony of the United States, East Asian countries have been incorporated into the international production and trade network, which was crucial for the initial stage of export oriented industrialization (EOI). This implies that the applicability of the East Asian model, if any, to other countries is very limited.

To explain the causes and processes of economic growth in East Asia requires a comprehensive comparative historical analysis as well as a subtle theoretical explanation. Focusing on the micro-foundations and macro-dynamics of the East Asian economy, here I discuss my own approach to the East Asian economic growth which is inevitably synthetic and holistic. In addition, I argue that the temporal dimension of the process of economic growth in East Asia is crucial to understand economic dynamism in Taiwan and South Korea.

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<sup>3</sup> To identify nuts and bolts of the growth machine is an answer to the how-question. Ignoring the how question, searching for an answer to why-question tends to emphasize the role of culture and mentality or values without providing the ways in which they are operating.

## Social Formations in the Twentieth Century

In the twentieth century, it is possible to observe three different types of social formation as political-economic system, which sustained for a long time; democratic capitalism, authoritarian socialism, and authoritarian capitalism.<sup>4</sup> These variations are geographically segmented throughout the world. Democratic capitalism mainly developed in Western and Northern Europe and North America, authoritarian socialism in Eastern Europe, and authoritarian capitalism in Latin Europe and the majority of Third World countries.

Democratic capitalism has existed since the beginning of the twentieth century, and flourish as the dominant political-economic system in the late twentieth century, with several crises of interruption such as Fascism and the great depression in the 1930s.<sup>5</sup> Democratic capitalism is characterized by the fact that the means of production is privately owned and the political power is regularly contested and transferred through electoral competition. Economic exchange among individuals is mediated by the market through which the price mechanism operates as a key factor to maintain the transaction of goods and services.

Authoritarian socialism or state socialism is a fundamentally different kind of political-economic system.<sup>6</sup> It has been characterized by two factors. The first is that the state owned the means of production and allocate resources and commodities (the state-owner-employer-manager-planner economy model). The second is that political power has not been contested and not shared by the people, but monopolized by one party, the Communist Party (the one-party-state polity model). The state's control of the economy is possible, since the Communist Party monopolize political power. Thus the mode of production and the mode of domination is not differentiated but coupled into one.<sup>7</sup>

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<sup>4</sup> Unlike Althusser's conceptualization, I use the concept of social formation as political-economic system, a coupling of mode of production and mode of governance. This typology is based on two principal modes of organizing societies; the mode of production and the mode of domination. It implies that theoretically democratic socialism can be an alternative political-economic system. For example, Bowles and Gintis(1986) and Cohen and Rogers(1980) argue that what is principally valuable about socialism is its extension of democracy into economic life.

<sup>5</sup> Equal and universal suffrage in most of the European countries was introduced in the 1910s and the 1920s. Women's right to vote were guaranteed in France after the Second World War. See Jacobs (1989).

<sup>6</sup> State socialism (Konrád and Szelényi, 1979) is a more frequently used term than authoritarian socialism. However, state socialism does not show how political power operates within the socialist system in Eastern Europe. It only shows who exercises political power in Eastern Europe. I would rather use 'authoritarian socialism' to denote socialism in East Europe to capture the ways in which political power operates.

<sup>7</sup> Thus the post 1989 transition in East Europe can be called the 'double transition' which means the transition to a market economy and the transition to democracy (Centeno, 1994).

Authoritarian capitalism is a third kind of political-economic system. Similar to the capitalist system, private ownership of the means of production is the dominant form of ownership, and ownership rights exist with decentralized forms. But political power is monopolized by particular social groups such as the military or political parties or by individual personnels. Thus the competition for political power is severely restricted and political oppositions are repressed. Civil rights are not guaranteed by the state. In fact, authoritarian capitalism is not a short-lived political-economic system. As seen by historical fact in the Third World, it has been the dominant political-economic system since the nineteenth century.

### **Regime types**

The political regime refers to a set of rules and institutions with respect to two aspects; the relationship between state and society and the goals the political regime tries to achieve.<sup>8</sup> The welfare state in the Nordic countries is one type of political regime in democratic capitalism.<sup>9</sup> Even though the political-economic system is democratic capitalism, the welfare state in the Nordic countries heavily intervened in the area of resource allocation and redistribution, through the state social and labour market policies. By contrast, the Japanese state systematically intervened in the sphere of production and less in the sphere of redistribution. Thus welfare provided by the state has been minimal. Instead of the state welfare system, the big private companies developed a 'company welfare system' which is only beneficial to their own employees (Dore, 1973).

It is also possible to identify different regime types in authoritarian capitalism with respect to mode of governance and political orientation. We may distinguish between three principal types of regime in authoritarian capitalism in the twentieth century. The first type is the populist regime which emphasized the redistribution of income and mobilized popular support against the ruling elite (Kaufman and Stallings, 1991).<sup>10</sup> The best examples are the Peronist regime in Argentine in the 1970s and Alan Garcia in Peru in the 1980s. The second type of regime is the predatory regime in which power holders tried to maximize their own welfare through plundering private as well as public resources. The Zairian regime under Mobutu is the prototype of the predatory regime (see

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<sup>8</sup> The regime here refers to the political groups which seize the state apparatus and exercise governance power. The state refers to a set of institutions and rules which possess the monopoly of violence and monopoly of tax. When there is no regime change for a long period, it is not possible to distinguish the regime from the state.

<sup>9</sup> We can identify different types of welfare state according to the comprehensiveness of welfare and the principles of welfare (for example, Esping-Andersen, 1990).

<sup>10</sup> Variety of different conceptions of populism have been suggested by researchers in Latin America. See Robert (1995).

Evans, 1989, 1995: 43-47). The third type of regime is the developmental regime which emphasizes state intervention in the economy to promote economic growth sacrificing popular sectors. Contrary to the predatory regime, the developmental regime exercises comprehensive power to mobilize finance and even control private investments to achieve rapid economic growth set by the regime (Collier, 1979, Johnson, 1982; Evans, 1995). Even though the effectiveness of the state's growth policies was different, the mobilization of economic and social resources by the state to promote economic growth has been common characteristics among the developmental states in East Asia and Latin America.

### **The developmental state in East Asia**

As Wallerstein(1994) correctly points out, economic development has been a common objective of almost all political regimes in the World. Although policies to achieve economic development were not equal, political regimes regardless of ideology pursued economic development. In this sense, any modern political regime is a kind of developmental state.

As some scholars (Polanyi, 1943; North, 1981; Mann, 1986 and 1988) already have pointed out, state intervention in the market system has been embedded in the capitalist system. Economic activities - production, distribution and consumption of necessary goods and services - have never been free from politics and state intervention. With the nation-state becoming the dominant form of polity, state intervention into the economy became more sophisticated and comprehensive than ever before(Tilly, 1979). Although the degree of state intervention in the economy was not constant across time and space, the state's role in providing basic rules and institutions for economic activities has been a prerequisite for capitalist development.

Then what are the characteristics of the developmental state in East Asia? The developmental state model was originally suggested to explain the role of the state in Japanese policy making by Johnson (1982, 1987). The model describes the role of the state in organizing economic activities of the private firms. It is possible to identify six distinctive features of this particular entity in East Asia in terms of the mode of state intervention.<sup>11</sup>

First, the developmental states in East Asia have exercised autocratic power, compulsion and oppression. The military regime in Korea and the martial law regime in Taiwan have been dictatorial regimes where power is concentrated into one man, Park Jung Hee in Korea and Chang Kai-Sek in Taiwan. They established personalized leadership through military coup (Park Jung Hee) and military occupation (Chang Kai-Sek). They repressed political opposition to monopolize

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<sup>11</sup> Johnson (1987) suggested a slightly different criteria from here. In particular, he added autonomy of the state. I think the autonomy of the state from the society is not a typical feature of the developmental state. Rather autonomy of the state is quite common among the authoritarian states in the Third World.



power, and controlled each society in similar fashion to military generals in the army. State terror by the developmental state including arrest and torture of dissidents was common phenomena.

Second, establishing centralized economic policy making organizations, the Economic Planning Board(EPB) in Korea and Council for Economic Planning and Development(CEPD) in Taiwan, they launched a series of economic planning agencies and initiatives for economic growth. Thus state intervention in the NIC economies has been more comprehensive and selective than any other capitalist country.<sup>12</sup> 'The state command' replaced 'the market demand' in core economic decision makings of private enterprises.<sup>13</sup> The series of economic plans in Korea and Taiwan have constituted the major source of industrial transformation and economic growth (Amsden, 1989: ch.4 and Wade, 1990: ch.4). The state intervention in East Asia is more similar to the Stalinist regimes in Eastern Europe than to Keynesian regimes in Western Europe, since the state also played the role as entrepreneur as well as planner, which means that state enterprises played important strategic roles in promoting exports.<sup>14</sup> The state also selected several industries as strategic sectors and exclusively gave them protection from excessive competition among domestic enterprises as well as foreign enterprises. The state provided financial subsidies, supports and scrutinized their economic performance. It controlled the number of competing enterprises in the market by restricting new entry and production capacity, and frequent state-led mergers of private firms.<sup>15</sup>

Third, the developmental state has managed investment by controlling the flow of money. Most importantly the state controlled finance through the nationalization of the banks (Jones and Sagong, 1980: 103-109; Wade, 1990: 161). The state-owned banks were strategic instruments for anti-consumption policy and pro-investment policy, controlling consumption levels and prohibiting

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<sup>12</sup> Economic planning has been a common phenomenon among the Third World countries after liberation. In Asia all the countries, except Hong Kong, initiated economic planning. China and Taiwan launched economic planning in the same year 1953. North Korea's First Five Year Plan was presented in 1954. Although the content and effect of economic planning varies significantly, it was the dominant form of state intervention in the economy in Asia. See Kirby (1967).

<sup>13</sup> Gunnar Myrdal(1968: 898) used the term 'strong state' to describe the state that could impose obedience of social groups to state policy.

<sup>14</sup> Taiwan has had one of the biggest public sector among the non-socialist countries. Public enterprises in Taiwan shared one third of gross fixed capital formation and one fourth in Korea in the 1970s and 1980s. Economists in the West described the large proportion of the public sector as a 'socialist pattern' (Jones and Sagong, 1980: xxix).

<sup>15</sup> For example, the Korean state frequently imposed mergers of the firms since 1962 to control excessive production capacity in the automobile industry in 1980 and heavy and chemical industries in the late 1970s and to promote productivity in construction and shipbuilding industries in 1984 (Jang, 1993: 148-150).

domestic and foreign luxury goods<sup>16</sup> The state initiated nationwide saving campaigns to expand capital investment in strategic industries. Consequently, there has been a thorough trend of high saving rates and high investment ratios in East Asia.<sup>17</sup>

Fourth, the developmental states initiated export-oriented industrialization as a strategy of economic growth.<sup>18</sup> The principal difference of the developmental state in East Asia from Eastern Europe is the fact that the state in East Asia adapted the outward-oriented industrialization strategy, a mercantilist strategy, stressing foreign trade. The mercantilist state made exports 'a compulsion rather than a choice' for private companies (Amsden, 1989; 69-70). In order to promote export, the dualist trade regime has been developed in East Asia: a free trade regime for export-related production and a protectionist trade regime for import-related production with a selective tariff system.

Fifth, the developmental states created economic agencies, and big capitalist companies, to carry out economic planning in the private sector in Korea and Japan and small capitalist companies in Taiwan.<sup>19</sup> They have utilized state resources and power, financial subsidies, access to foreign capital, licenses to import scarce consumer goods and so on, to make domestic capitalists become internationally competitive.<sup>20</sup> As the case of the Chaebol groups in Korea and Zaibatsu

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<sup>16</sup> The state-owned banks did not provide loans for consumers and importers of domestic and foreign luxury goods (Jang, 1993: 139). Luxury goods listed by the state included passenger cars, refrigerators, washing machines, and video camera etc.

<sup>17</sup> The investment ratio to GNP was 25.0 per cent in Korea and 25.5 per cent in Taiwan. In 1980 it was 31.7 per cent in Korea and 32.2 per cent in Taiwan, while it was 17.9 per cent in Britain and 18.9 per cent in the USA. In 1990 the investment ratio in Taiwan decreased to 22.4 per cent, while it increased up to 36.9 per cent in Korea. The investment ratios in the USA and U.K. remained below 20 per cent in 1990 (Korea Labor Institute, 1992, 24).

<sup>18</sup> It does not mean that import substitution policy was totally abandoned. The state continuously provided financial subsidies to private firms for the development of domestic technology to substitute imported intermediate goods (Green, 1989). Nevertheless, Korea and Taiwan show high levels of export dependency in their economic growth. During the 1980s the average trade dependency ratio was almost 65per cent in Korea and 83per cent in Taiwan respectively. It was 36per cent in France, 47per cent in Germany, 16per cent in America. See IMF(1992).

<sup>19</sup> The most striking contrast in the development strategy in Korea and Taiwan is that the KMT regime promoted the small employers' role in economic growth and pursued decentralized growth, while the military regime in Korea concentrated state finance into a small number of big capitalists and limited areas. See Amsden(1989: 120-125) for the Korean case and see Ho(1980) for the Taiwanese case.

<sup>20</sup> Green(1992) provides an excellent example of state protection and guidance of private enterprises in South Korea's automobile industry.

in Japan, with the help of the state, the indigenous capitalists became world-class capitalists in a short period.<sup>21</sup>

Finally, in order to maintain a 'good business climate,' the developmental states have pursued an oppressive labor policy through either exclusionary labor policy in pre-war Japan and post-war Korea or inclusionary labor policy in post-war Taiwan (Shin, 1994: ch. 10). Mobilizing the anti-communist ideology, the developmental states did not allow basic rights of workers such as freedom of association and collective actions (Deyo, 1989; Shin, 1994: ch.6). To prevent possible workers' revolts, the state tightly controlled the workplace through the oppressive apparatus, i.e., legal, political, and physical measures including state surveillance and violence.<sup>22</sup>

## Organization of Production

The individual firms are the principal organizations for the production of goods and services. Production of commodity takes places in the individual firms and they are 'the hidden but real' micro-foundations of macro-economic performance at the national level. As Krugman(1994) argues, there is no competitiveness at the national level. Competitiveness only comes from the performance of individual firms.

The private firms face four fundamental constraints in industrial capitalism, that is, financial constraints, labor constraints, and technological constraints, which are the three components of the production, and market-demand constraints. An individual firm can increase the volume of production by the increase of more than one of three factor inputs. The degree of the finance constraint of the individual firm varies according to the alternative sources of finance available to the firm. In developing countries, there has been chronic lacks of capital. Labour constraints come from labour market conditions such as the labour force available, skills, and the peculiar nature of labour power as commodity-labor force available, called the agency problem, workers' commitment to work. Various labor controls in industrial capitalism have been developed to

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<sup>21</sup> The combined sales of the three largest chaebols accounted for 9.0per cent of total gross production in 1974. It went up to 35.8per cent in 1984. The ten largest chaebols accounted for 67.4per cent of the total gross national product in 1984 (Amsden, 1989: 116). The economic concentration in Korea is much higher than in Japan. The six largest zaibatsu in Japan accounted for only 16.43per cent of gross sales in 1984 (Morioka, 1989:149).

<sup>22</sup> Arrests and torture of labor unionists have been ordinary events in South Korea and Taiwan. See Ogle(1990) for South Korean case .

secure extraction of labor power from workers.<sup>23</sup> Technical constraints are also important problems for the firms both in the developed countries and the developing countries.

### **Soft budget constrained firms**

Then what are the characteristics of the firms and work organization in East Asia? To discern the characteristics of work organizations in East Asia, it is useful to adopt Kornai's concept of soft budget constraint firm and demand constrained economy, which were originally developed to describe the characteristics of East European economies under the socialist regimes (1983 and 1992). He suggests that firms are exposed to different constraints in the socialist economy and the capitalist economy. Under the pure capitalist economy firms face pure hard budget constraints, when they are in the situation of 'exogenously determined prices,' 'hard tax,' 'no free state grants,' 'no credit,' and 'no external financial investment.' (Kornai, 1983: 36-51). The survival of the firms depends upon the costs of inputs and sales of outputs. And the growth of the firms totally depends on the internal accumulation and technological improvement. By contrast, under the socialist economy firms face pure soft budget constraints, when they are in the condition of endogenously determined prices,' 'soft tax system,' 'free state grants,' 'soft credit,' and 'external financial investment,'. Then survival and growth do not depend upon prices in the market but political decisions and negotiations with policy makers.

Strategic firms supported by the state in East Asia can be categorized as soft budget constrained firms through the soft credit, soft tax and price-makers' position in the domestic market. Firstly, Korean and Taiwanese firms are dependent more upon borrowed money than on equity capital in their operation. Strategic firms get export credit according to previous year's export performance and its planned exports for the current year. The interest rates for export credit loans are less than the normal short-term interest rates.

Second, the firms may get tax exemption or lower tax according to the state official's discretion. The paternalistic relationship between the state and private firms has maintained a low level of tax and a flexible tax burden. If firms complied to the state's policies and they were not reluctant to donate political money(quasi-taxes) to political elites, they evaded tax and could avoid

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<sup>23</sup> Marx's conceptual distinction between labor and labor power provides an excellent explanation of the labour constraints embedded in the capitalist work organization (Marx, 1967: part III). For historical explanations of the evolution of labor control in industrial capitalism, see Braverman(1974), Freedman (1977), Edwards(1979) and Burawoy(1985).

a tax investigation.<sup>24</sup> For instance, many monopoly firms keep a large number of bank accounts with pseudonyms in order to avoid tax.<sup>25</sup>

Thirdly, the monopoly firms in Korea are not price-takers but price-makers in the domestic market. Even though there has been state regulation of consumer prices, the same products in the domestic market are much more expensive than those in the international markets. The state has guaranteed compensation for the low profit in the international markets with higher profits in the domestic market through price distortions.

However, unlike a socialist economy, key factors motivating production for private firms are profits from the market. Whereas production of goods in a socialist economy was controlled and commanded by the state plan and thus the operation of production was constrained by the resources allocated by the state, those in authoritarian capitalism in East Asia have been motivated by the market mechanism through which surplus profits are legitimated and guaranteed. Even though states intervened in the economy through guidance and command, benefits from compliance to state policy lead to guaranteed profits from the market. Demand from the foreign as well as domestic market constrained the economic transaction and state intervention.

### **Factory Despotism**

Due to the state's oppression of the labor movement, manufacturing firms in Korea and Taiwan have not experienced serious disruption of production until 1987. Although there were several strikes organized by workers in the 1970s and the 1980s, their impact on the national economy was trivial. They did not pay much attention to the problems of labor relations within firms. The state managers have functionally played the role of managers in the private firms to deal with labor unrest. Thus the firms used less managerial manpower in Korea and Taiwan than in the advanced industrial countries.<sup>26</sup>

In addition, individual firms did not experience any labor shortage, because of the unlimited labor force until the mid 1980s. The large population of the rural areas has been transformed into urban workers in Korea. In 1961, 61 per cent of the economically active population in Korea was engaged in agriculture or fishing industry. It decreased to 18.3 per cent in 1991 by more than 40 per cent in three decades. Almost one third of rural family members became industrial workers,

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<sup>24</sup> Due to the paternalistic relations between state officers and private firms, there has been a chronic corruption problem of the government officers. The government used tax investigation as a threat to the private firms, when they did not show obedience to government directions (Jones and Sagong, 1980: 114-115).

<sup>25</sup> When Kim Young Sam's government declared that all the bank accounts should be with real name in 1993 to eradicate tax evasion, the most seriously damaged groups were the major chabols in Korea.

<sup>26</sup> The ratio of managers or supervisors to workers was in 1:4.41 in Korea(Cho et. al., 1992: 35), 1: 2.92 in Sweden (Wright, 1985: 195), 1:2.23 in Britain (Marshall et. al., 1988) and 1:1.76 in America (Wright, 1985: 195). These calculations was done by myself.

while the other one third became urban petty bourgeoisie (Cho, Kang and Shin, 1994). Because the military regime pursued a spatially concentrated development in major cities, social mobility accompanied a massive spatial mobility, i.e., rural-urban migration.

Taiwanese firms also enjoyed abundant labor supply from the rural areas. Because the KMT state emphasized a decentralized industrial development, the firms became scattered through the whole Taiwanese Island (Ho, 1979). The rapid growth of rural nonagricultural employment is a sharp difference between Korea and Taiwan. As in Mao's China, Chang Kai-Sek's Taiwan also emphasized development of the rural areas. Thus the Taiwanese firms could fully utilize the underemployed rural labour forces with low wages.<sup>27</sup> Taiwanese workers who stayed in rural area needed less reproduction costs than the Koreans who moved to large cities.

The first generation of the Korean workers were the proletariat, who were separated from the rural land, to survive in the urban areas. Because of their weak position, they could not escape long working hours under poor working conditions and low wages. Although big enterprises provided relatively higher wages than small enterprises to induce skilled workers, they were comparatively low to maintain the lowest possible labor costs. To give monetary incentives, the big enterprises in Korea have introduced seniority wage into a wage system which has been based on a piece rate system. However, they did not introduce the Japanese style of life-time employment and company welfare.

Under the repressive labor policy, the management complained about the lack of workers' commitment to work.<sup>28</sup> Although the working hours in Korea and Taiwan have been very long, compared to other countries, big capitalists demanded even longer working hours for workers. In the 1980s the average working hours per week in the manufacturing sector was 53.4 hours in Korea and 48.4 hours in Taiwan. The long working hours have been common in all the East Asian countries including Japan. Furthermore, due to the short paid vacation, the working hours per year show incredibly big difference between the Western European countries and the East Asian

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<sup>27</sup> Firms established in the rural areas have been more labor intensive and smaller sized than those in urban areas in Taiwan (Ho, 1979: 86). The firms in the rural areas contributed to lower the wage of the rural workers who had an alternative source of income, agriculture. Although per capita GNP in Taiwan has been higher than in Korea, the hourly wage has been lower in Taiwan than in Korea (BLS, 1990).

<sup>28</sup> Chung Ju Young, chairman of the Hyundai group, worked extremely hard, 14 hours a day, six or seven days a week, and he expected all his employees to follow his work habit. Chung's view on work is well represented in his remark: "other industrial countries have lost their advantages to Japan mainly because their workers don't have the proper attitude to work" (cited from Ogle, 1995:25).

countries.<sup>29</sup> Due to long working hours and bad working conditions, there has also been high rates of fatal injuries in the manufacturing sectors in Korea and Taiwan.

The characteristic of labor management relations at the workplace has been despotic in the sense that managerial authority has been considered as sacred and any kind of workers' disobedience was penalized by managers. Because there were no voice mechanism, a channel to express their grievance, for workers, the exit rate, the quit rate, was extremely high in Korea and Taiwan. Management reports to police concerning those who were suspected to make a voice, that is, organize unions or collective actions prompt immediate police investigations. State agents and enterprise managers in the private firms cooperated with each other to prevent workers' collective actions.<sup>30</sup> Even in cases of collective actions, which have been frequent since 1987, big enterprises organized 'enterprise rescue teams(*kusadae*)' with white collar employees to break strikes and sometimes hired gangsters to attack union leaders and kidnapped union leaders.<sup>31</sup> With the help of KCIA, police and hired gangsters, the big enterprises could repress workers' resistance and maintained managers' despotic power in the factory.

Due to the strong repression of the labour movement and lack of protection of worker's rights by the state, the despotic control of workers by managers has been a common phenomena in East Asia. It might be called 'factory despotism', which is contrasted with 'market despotism' in early capitalist Britain.<sup>32</sup> The state also provided wage guidelines to control wage increases and inflation. The low wage of workers was not a product of the market mechanism but a product of state intervention in wage determination. The control and mobilization of workers, with low wages and the long working hours, has been possible by factory despotism. The workers in Korea and Taiwan were not controlled by market dynamics or rules made by labor and capital but by despotic control of managers.

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<sup>29</sup> The paid vacation was 10.3 days in Korea (1989), 15.3 days in Japan (1988), and 10.3 days in Taiwan (1987), respectively. Working five days a week is not common in East Asia. Only 1 per cent of Korean workers and 29.5 per cent of Japanese workers regularly worked five days a week (Park et. al., 1991: 44). Thus the working hours per year was 2,590 in Korea, 2,124 in Japan, 2,522 in Singapore, 2,423 in Taiwan. They were 1,683 in France, 1,598 in Germany, and 1,948 in the US

<sup>30</sup> In Taiwan, the retired military personnel took key positions in the state controlled labour unions and cooperated with the security agencies. See Arrigo(1985). In the Korea labor department, the prosecutor' office, KCIA and the police were involved in surveillance of workers. See Ogle(1990: 53-64).

<sup>31</sup> In addition to help from the state agency, Hyundai Motor Company, for instance, hired local gangsters who stormed the meeting place of union leaders in 1990. Almost 30 union leaders were seriously injured and hospitalized. Terrors and violence against unions leaders have been common tactics adopted by Chaebols in Korea. See Lee(1994) for an excellent description of Hyundai's anti-union terror and violence as well as the state's oppression of union movements in the Hyundai groups.

<sup>32</sup> According to Buraway(1985), market despotism in early capitalist development was possible due to the real subordination of workers to capital, high unemployment, and no state protection of workers.

### **East Asian Production and Segmented American Markets**

One of the most distinctive features of the East Asian NICs is the formation of a 'asymmetric economic networks': technological dependency with Japan and trade dependency with America. The core element of the 'asymmetric economic networks' is the combination of foreign technology, cheap domestic labor and American consumption. The major source of production technology of South Korea and Taiwan came from Japan. Because of the low level of production technology, Taiwan and South Korea have tried to develop domestic technology which could promote ISI. However, it was almost impossible to catch up to the advanced technology of Japan and America in a few years. After South Korea and Taiwan switched to the export orientation industrialization, they commonly tried to overcome technological bottlenecks by importing capital goods from Japan who has been among the largest exporting countries to South Korea and Taiwan since the mid 1960s, when both countries embarked EOI. During the 1960s and 1970s the imports from Japan amounted for more than 35 per cent in both countries. More than 80 per cent of the imports were the capital goods to produce consumer goods and intermediate goods to export. The technological dependency led to a chronic trade deficit with Japan in both countries.

However, this process of technology transfer did not imply that the level of production technology was homogenized across countries in East Asia. As Bernard and Ravenhill(1995) correctly point out, South Korean and Taiwanese manufacturers lacked capacity to indigenize foreign technology because of the low level of R & D expenditure. The original equipment manufacturing (EOM) has been the dominant form of production for export in major industries such as consumer electronics, apparel, and steel, in which more than 80 per cent of total exports was the OEM products (Bernard and Ravenhill, 1995: 191; Gereffi, 1995). The hierarchy of production technology contributed to the maintenance of economic dependency based on technology and marketing.<sup>33</sup>

Another element of the above mentioned triad, the trade dependency with the United States, has been beneficial to East Asian economies until the late 1980s. The rise of the East Asian economy can not be explained without considering trade with the United States. The articulation of East Asian production and American market reveals how East Asian countries succeeded in export-oriented industrialization. The export to the US market accounted for almost 40 per cent of the total export of Taiwan and almost 34 per cent of Korean export in the 1980s (Schive, 1995: 82; Korean Bureau of Statistics, 1995: 329).<sup>34</sup>

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<sup>33</sup> Hyundai motor company which exported almost one million cars succeeded in making its own engine by reverse technology in 1990.

<sup>34</sup> The largest proportion of export to the US market to the total export was peaked in 1968 with 52 per cent in Korea and 48.1 per cent in 1985 in Taiwan. Due to the import restriction, based on the Super 301 code, the proportion of export to the US market from both countries is declining since the late 1980s.



The market, in fact, is an illusive concept because it comprises a variety of different systems of transaction from potatoes, labor power, and money itself (see Swedberg, 1994). As Amsden(1989: 11) correctly points out, the market is different from the market mechanism. While the market refers to a locus of exchange, the market mechanism refers to the dynamics of processing exchange. When we talk about the role of the market as an alternative to the state, we refer to the market as a mechanism which is supposed to allocate economic resources according to the impersonal logic of demand and supply.

With respect to this discussion, the developmental states played the role as actors conforming as well as governing the market. When they cannot govern the market, more correctly they cannot intervene in the market mechanism, they chose the market conforming strategy. For international markets, the developmental states in East Asia did not have enough power or leverage to control them, they simply tried to follow their logic and utilized their comparative advantages. However, in the domestic market they intervened in the market mechanism by price setting and import/export policies. They intervened in the market mechanism through 'getting the price wrong' in the financial market as well as in the product market (Amsden, 1989: ch.6; Wade, 1990: ch.10).

There are great variations between and among the domestic and international market conditions across countries in terms of consumer preferences and price structures. We can call the differentiation of markets, the product market segmentation.<sup>35</sup> As is the case in the segmented labor market, the product market in the world is highly segmented because of the variation of consumer preference according to class and culture and because of the differential prices of commodities according to the different tariff and tax systems. As a result, the product markets are just as heterogeneous and fragmented as the internal labor markets are. Two different types of commodity market could be distinguished according to the operating principle. The first type of market is *the price competition market* in which the preference of consumers is not sophisticated and well articulated. The price elasticity is so steep that the effective demand as an aggregated volume of individual consumption is drastically changing according to the change of the price of products. The entry cost to the price competition market is low, since there are many ways to reduce the production cost such as low wages, mass production, the use of more efficient technology, etc. Consequently, to use Vernon's term (1971), "the product life cycle" in the price competition market is very short because less developed countries can produce the same kind of product taking advantage of their low wages. As wages in South Korea and Taiwan rise, their products are gradually losing their competitiveness in the price competition market.

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<sup>35</sup> Market niches refers to the part of the segmented product market in which comparative advantages of the goods can be guaranteed.

The second type of market is *the quality competition market* in which preferences of consumers are sophisticated and the price elasticity is not so steep. The entry barrier to the quality competition market is very high since it requires high levels of production technology and quality control. Thus the economy of scale or low price based on low wages do not necessarily guarantee strong competitive advantages in the quality competition market. Advanced technology and skills are more crucial factors to increase the share in this market. The successful entry into and survival in this market require incessant innovation of products and manufacturing processes with massive R & D spending and organizational flexibility. The post-Fordist production system represents a good example of new methods of production to expand the market share in the quality competition market.

The NICs in East Asia could successfully penetrate into the price competition market in the United States, mainly relying on low wages, borrowed standardized technology and the economy of scale. As a result, compared to the industrialized countries, the level of productivity in East Asia has been very low. Good performance of the East Asian countries does not come from high productivity but only from the economy of scale (Kwon, 1986; Chen and Tang, 1990; Krugman, 1994). Nevertheless, products from East Asia could find 'market niches' in the United States because the price competition market is well developed. Because American society is a highly stratified society according to class, gender and race, the large number of poor people and underclass people mainly concerned with the price of the commodity have been major consumers in the price competition market. Japan explored the price competition market in the US in the 1960s and 1970s and then moved into the quality competition market with the help of high technology and innovation. South Korea and Taiwan rushed into the price competition market in the US with the help of transferred technology and capital goods from Japan and the US in the 1970s and 1980s. Throughout the 1980s some enterprises in Taiwan and South Korea are now moving into the quality competition market.<sup>36</sup> In the late 1980s, China and the Southeast Asian NICs try to penetrate the price competition market utilizing massive low wage labors and will probably soon replace South Korea and Taiwan.

The success of economic growth in Korea and Taiwan partly lies in taking advantage of the price competition market in the United States. In the case of poor countries whose domestic markets are small, economic growth is only possible by exporting goods to the large markets. However, the export to the large markets does not necessarily guarantee the success of export

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<sup>36</sup> One good example is the attempt by the Taiwanese bicycle industry to increase competitiveness in the US market, upgrading product quality rather than lowering prices. To solve the rising export price of Taiwanese bicycles due to the devaluation of the US dollar, Taiwanese manufacturers moved to a quality production system by developing new materials and new components. The price of one bicycle rose from \$ 47.1 in 1986 to \$ 119 in 1993 in the American market. Competitiveness in the price competition market was no longer guaranteed because products from China and other Southeast Asian countries were much cheaper than those from Taiwan.

oriented strategy. Capital accumulation based on export is possible only when the exported goods are matched with the sufficient market demand. EOI was possible in South Korea and Taiwan simply because they could exploit the US market with low wages and low price goods. As Japan did before, South Korea and Taiwan succeeded in moving up to the quality competition market in the US, replacing American goods as well as European goods. A heavy dependence of export on the American market has been maintained for more than three decades and has now become a source of trade conflict between the East Asian NICs and North America after the collapse of the Cold War.

## **Geopolitics and Dynamics of Global Economic System**

As mentioned previously, the rise of East Asia reveals the distinctive interconnection of economic dynamism and geopolitics since the Second World War. The single most important aspect was the post 1945 American intervention in South Korea and Taiwan as well as Japan to contain the socialist bloc. During the early period of industrialization in South Korea and Taiwan the US provided aid based on the mutual security alliance which was crucial to consolidate unpopular regimes and create the foundations of economic growth. The economic and military aid compensated for the low rate of private savings in Korea and Taiwan.<sup>37</sup> In addition, two wars in Asia after the Second World War - in Korea and Vietnam - contributed to boost the respective economies in the region in two ways; direct transaction of remittance and indirectly expanding exports due to the war boom. However, the most important and long lasting effect of the Cold War was the lowering of entry barriers to the US market to imports of consumer goods from South Korea and Taiwan.

### **Foreign Aid**

After the Second World War, the United States launched massive aid programs to Europe, the Marshall Plan, to revive the capitalist economy and to the Third World to support anticommunist

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<sup>37</sup> Contrary to the conventional argument that the major source of early rapid economic growth in East Asia was the high rate of private saving, it was low until the mid 1970s. During the 1960s it was 14.5 per cent in South Korea and 14.2 per cent in Taiwan which was slightly higher than in the U.K. and almost half of Japan. South Korea and Taiwan belonged to the countries with the lowest level of gross domestic savings rate in the Third World. In 1970 the gross domestic savings rate in Korea (15 per cent) was much lower than other Third world countries like Bolivia (31 per cent), Tunisia (22 per cent), Algeria (36 per cent), Thailand (21 per cent), Malaysia (27 per cent) and Argentina (23 per cent).

and counter-revolutionary movements. South Korea and Taiwan became nation-states under the sole influence of the United States due to the geopolitics of the Cold War. South Korea and Taiwan were the two most important countries in the capitalist bulwarks against the socialist bloc in Asia. There has been consistent system competition as well as military confrontations between the two blocs.

To contain socialist expansion, the US provided economic aid as well as military aid to help the anti-communist regimes in East Asia.<sup>38</sup> Because East Asia has been considered strategically important to contain socialist power and maintain American hegemony in the world (Cumings, 1987: 65-66), the US provided huge amounts to Korea and Taiwan which were suffering from extreme poverty in the 1950s and early 1960s. For example, sixty-four per cent of the total US foreign aid to underdeveloped countries went to the countries against communism in Asia - South Korea, Taiwan and Philippines (Wood; 1986: 40-41). The US economic aid constituted about 75 per cent of total import during the period from 1953 to 1960 in South Korea (Krueger, 1979: 67). Because of the low domestic saving rate, the foreign aid significantly contributed to the capital accumulation necessary for the investment. According to one econometric estimation, foreign aid contributed to about 4 per cent of Korea's growth rate over the period 1960 - 1970 (Ibid, 1979: 211). Access to American aid have also influenced the possibility of alliance with foreign capital and production technology. South Korea received the largest World Bank loan given to any credit institution between 1978 and 1981.<sup>39</sup>

After the defeat of the KMT regime in mainland China, Taiwan was considered more important than ever before to contain communist power. Washington assisted the KMT regime by massive economic and military aid to strengthen the refugee regime (Haggard and Pang, 1994: 62-65). US government agencies and the KMT regime jointly formulated Taiwan's economic reforms to demonstrate the superiority of the market economy against the communist system. The US economic and military aid to Taiwan, which was almost 80 per cent of Taiwan's import surplus with about 1.7 billion and \$2.4 billion, contributed to vitalize economic growth in the 1950s and early 1960s (Stubbs, 1994: 367). The military alliance also made it easy for Taiwan to get international finance and receive massive Foreign Direct Investment (FDI) during the 1960s. The US government launched several programs to facilitate foreign capital investment in Taiwan which eliminated the risk of investment due to military tension between Taiwan and China (Gold, 1986: 79). While the American political support of Chang Kai-Sek's KMT regime stabilized its

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<sup>38</sup> In fact, the distinction between economic aid and military aid is not clear-cut since the donor's decision does not necessarily correspond to the receiver's usages. See Wood (1986: 10-15) for conceptual problems associated with foreign aid.

<sup>39</sup> The amount of the loans to South Korea was \$605 million, which was almost twice bigger than the one provided to Mexico and almost ten times that to Brazil. For details, see Wood(1986: 166-176).

shaky political power, economic aid financed the industrial basis for exports during the 1950s and 1960s. In sum, "South Korea received some \$813 billion in American military and economic aid or \$600 per capita. Taiwan, \$5.6 billion, or \$425 per capita"(Aseniero, 1994: 289).

The transition of developmental strategies was directly associated with the termination of the US aid. Although the KMT regime launched a series of the Four Year Economic Plans as early as 1953 (1953-1956, 1957-1960, 1961-1964), it was not before the late 1950s and early 1960s that the KMT regime emphasized the EOI strategy. As the US economic and military aid had been gradually decreasing during the latter half of the 1950s, the KMT regime adopted the EOI strategy to solve the balance of payment problem. The total US aid to Taiwan peaked in 1955 with \$ 442.6 million. It decreased to \$ 160.4 million in 1962, an almost 60 per cent decrease and finally ended in 1965 (Chang, 1965: 154-156). To respond to the balance of payment, the KMT regime adopted the mercantilist way of accumulating foreign exchange, that is the EOI, as a long term strategy.

### **Two Wars and the East Asian Economy**

As mentioned two wars contributed to the rise of the East Asian economy since 1945. They were the Korean War in 1950, which continued for three years, and the Vietnam War, which prolonged for more than ten years. The outbreak of the Korean War in 1950 contributed to the growth of the Taiwanese economy as well as the revival of the Japanese economy (Cumings, 1984). Japan as the key base of the United Nations military forces was able to "take off" again with the "Korean War Boom". The American military's purchase of goods from Japan increased "from zero in 1949 to nearly \$600 million in 1951 and \$825 million in 1952" and due to the war economy Japan could expand exports from \$510 million in 1949 and \$1.36 billion in 1951 (Stubbs, 1994: 367). Furthermore, the impact of the Korean War extended to Southeast Asia with the rapid increase of the demand of strategic materials like rubber and tin.<sup>40</sup> Three years war destroyed almost everything in Korea but completely revitalized Japanese industrial production to the pre-war level.

The increased US military spending directly affected the exports of goods and services in the East and South East Asian countries. The Vietnam war substantially contributed to Korean and Taiwanese economic growth. As a result of Korea's participation in this war, the country "received about \$50 million per year in remittances in the late 1960s"(Stubbs, 1994: 369). As an exchange of Korea's favours, the US also permitted Korean enterprises in construction of ports and roads and arsenal transportation in South Vietnam. Major big enterprise groups like Hyundai, which were rather medium size enterprises at that time, succeeded in contracting with the US

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<sup>40</sup> The most benefited country among the South East Asian countries was Malaysia where the price of rubber tripled during the Korean War Boom (Lim, 1965: 98-100).

military and seized the opportunity to expand their enterprises.<sup>41</sup> In the 1970s the total amount of overseas work contract reached nearly 20 per cent of South Korean exports (Aseniero, 1994: 240). Thus the Korean government and enterprises got hard currency necessary for new investments in industry (Cole and Lyman, 1971).

**Table 1: Exports to South Vietnam as a Percentage of Total Exports and GNP**

	1964	1965	1966	1967
Japan	0.5/0.1	0.4/0.1	1.4/0.3	1.7/0.3
Taiwan	7.9/3.1	9.8/3.6	16.2/6.4	11.5/4.8
Hong Kong	0.4/-	0.6/-	1.4/-	1.5/-
South Korea	5.2/0.6	8.5/1.2	5.5/0.9	2.4/0.4
Singapore	2.4/-	3.7/-	7.6/-	9.0/-
Thailand	0.7/0.3	1.6/0.6	2.7/-	- / -
Philippines	- / -	- / -	0.2/-	0.4/-

Source: The Economist Intelligence Unit, *The Economic Effects of The Vietnamese War in East and South East Asia*, London: Spencer House, 1965, pp. 21-23.

South Korea was not the only beneficiary of the Vietnam War. During the 1960s US economic aid to Taiwan gradually declined and was suspended in 1965 but alternatively Taiwan could utilize the opportunity of exports to Vietnam to get hard currency (Cumings, 1984: 33 and Stubbs, 1995: 369). As Stubbs shows, "Taiwan's exports to Vietnam tripled from \$34 million in 1964 to over \$90 million in 1968" (1994: 369). Exports to South Vietnam represented 9.8 per cent of total exports of Taiwan in 1965, 16.2 per cent in 1966 and 11.5 per cent in 1967, which were corresponding to 3.6 per cent of the GNP in 1965, 6.4 per cent in 1966 and 4.8 per cent in 1967 respectively (The Economist Intelligence Unit, 1968: 22-23). Although Taiwan did not send military to Vietnam, it could together with other countries in Southeast Asia rapidly expand export industries, supplying goods for the Vietnam War.<sup>42</sup> The economic impact of the Vietnam War on

<sup>41</sup> Hyundai in Vietnam operated as a subcontractor of the RMK-BRJ, the big US conglomerate responsible for military construction work, naval base construction and waterway dredging (Kirk, 1994: 77).

<sup>42</sup> Singapore, Thailand and Malaysia also benefited from the Vietnam War providing and transporting war related materials. See Stubbs(1989).

Taiwan was an expansion of markets for products such as sugar, iron and steel products, chemicals, textiles and transportation equipment.

During the 1960s and 1970s South Korea and Taiwan pursued ISI first and EOI later. When they experienced the difficulty of getting hard currency due to the decline of economic aid from America, they pursued the ISI strategy to reduce increasing trade deficits. The American commitment in Asia-Pacific and two international wars in Asia after the Second World War significantly contributed to the foundation of the East Asian Economy. Especially the Vietnam War provided 'a breathing space' for the anti-communist bloc in East Asia to the take-off their economies (Hersh, 1995: 8).

### **Accessibility of the US Market**

The linkage of economic alliance and diplomatic alliance was the core element of the United States foreign policy during the Cold War (Verdier, 1994: 207-217). The trade-security linkage aimed at keeping foreign countries into the American security framework was established just after the Second World War. With respect to the East Asian economy, one of the most important effects has been the accessibility of the American market by the NICs. The mode of incorporation of the Third World into the international economy has been determined according to geopolitics and locations within global production system. Under US hegemony, South Korea and Taiwan have been allowed to export industrial products to the American market with preferential tariff treatment under the General System of Preferences(GSP).<sup>43</sup> As the military tension escalated in Asia, Washington more strongly needed political and economic cooperation with the Asian countries. Because of the political and military alliance between the United States and the East Asian countries, Korea and Taiwan could penetrate the American market under the favorable climate guaranteed by the United States.

South Korea and Taiwan exported labor intensive goods such as garments, clothes, textiles, shoes, and travel goods to the price competition market in the United States. The competitiveness of the exporting countries in this market mainly came from low wage costs. South Korean and Taiwanese firms could utilize the low wage labor to expand their share in the price competition market. The United States has been South Korea's largest trading partner since 1945. South Korea is the seventh largest trading partner with the US in the late 1980s. The US sponsored Korea and Taiwan for exporting industrial goods, as it did for Japan in the 1950 and 1960s. One consequence has been that Korea and Taiwan followed the trade pattern of Japan with the United States (Yoo, 1985).

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<sup>43</sup> The Generalized Systems of Preferences(GSP), which allows certain exports from developing countries to the developed countries with duty free, is an international trade rule for developing countries, in the form of a GATT waiver to the Most Favoured Nation rule. However, each industrial country defines the criteria and utilizes the rule for its own political and economic benefits. See Jackson (1994: 278-281).

As discussed above, the structural segmentation and special treatment of the non-communist NICs in the American market contributed to the successful landing of low priced and low quality goods from these countries. This peculiarity has been crucial to the increase of the NICs trade surplus. Korea and Taiwan enjoyed trade surpluses with the United States and could compensate for the trade deficit with Japan with them. In the 1990s the US trade deficit mainly comes from trade with East Asia including Japan, South Korea, and Taiwan. The USA trade deficit with the NICs was about 31 billion in 1988, which invoked aggressive unilateralism to manage the trade deficit problem.<sup>44</sup> South Korean and Taiwanese firms could effectively utilize the market niches in the large but segmented American market. The choice of the American market was an economic choice to maximize profit, but the constraints given to firms in South Korea and Taiwan were rather political due to the Cold War.

### **Global Capitalism: Flow of Capital and Labor**

During the 1970s the advanced industrial countries experienced serious economic crisis due to the labor shortages, high wages, environmental pollution, sharp increase of production costs mainly due to oil shocks. One way to escape from the problems was to move more capital to the Third World countries. For the last three decades, FDI increased more than twelve times from \$9,200 million in 1960 to \$103,200 million in 1988. The annual growth rate of FDI has been almost 40 per cent, which is greater than the growth rate of world trade (13 per cent) and GDP (12 per cent) (UN, 1992: 1). The absolute majority of capital export, 87 per cent of the total FDI strategy, has been executed by the major industrial countries, America, Britain, Germany, Japan, France, Netherland, and Canada.

FDI in South Korea and Taiwan has been dominated by Japanese firms in the 1960s and 1970s. The Japanese investments in Korea was 76 per cent of total investment with 1108 firms out of 1464 firms at the end of 1981. Small and medium size capital with labor intensive industry and low productivity moved to South Korea and Taiwan (Ozawa, 1979: 26-28; Koo, 1985: 182-189). Relocation of firms to South Korea and Taiwan was mostly declining labor intensive companies with heavy industrial pollution (UN, 1992: 346). Japanese manufacturers competed with American manufacturers to utilize low waged, disciplined and well educated workers in Taiwan (Gold, 1986:79). Having lost competitiveness against Japanese manufacturers with low price, American firms invested in Taiwan to recover the market shares on the American market. Japanese firms also

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<sup>44</sup> The Reagan administration announced South Korea and Taiwan graduated from the preferential tariff system under the General System of Preferences(GSP) in 1988. Since then the US government demanded balance of payment adjustment with super 301 provisions of the Trade Act (Bayard and Elliott, 1994: ch. 7). With the end of the Cold War, economic interest have become more salient than diplomatic relations in US policy making. A shift to "aggressive unilateralism" in the US reveals the change of environment that shapes foreign economic policy (Bhagwati and Patrick, 1990).



invested in Taiwan to compete offshore production of American firms. This consequence was a product of the KMT policy to solicit foreign capital by allowing foreign capital investment. Although the proportion of direct foreign capital investment to the total capital formation was small, its contribution to trade is not so low. FDI constituted 24.6 per cent of exports in Korea in 1978 and 25.6 per cent in Taiwan in 1981 (Shin, 1995).

Dictatorial regimes in East Asia provided 'the best business climate' for Japanese and American capital with repressive labor policy and with cheap and abundant labor. Manufacturers in Japan and America, mainly competing in the price competition market in America, transferred their capital to South Korea and Japan. As labor movement organization intensified and wages increased, the Korean capital as well as foreign capital began to move to Southeast Asia, particularly to Indonesia, Malaysia, Thailand, the Philippines and Vietnam.<sup>45</sup>

The crisis of the Western economies took place in the context of a simultaneous rise of the Third world in the 1970s. With the defeat of the United States in Vietnam, the coalition of the oil-exporting countries in the Middle East was the peak of Third world political ascendancy with the name of resource nationalism. Since 1975 the Middle East countries undertook big construction projects with surplus oil dollars. The Korean government sent several private construction firms including Hyundai and Daewoo to take advantage of such projects, as soon as the South Vietnam construction market was closed. It orchestrated the labor export policy as part of the strategy to promote industrial export, controlling the process of labor migration through government organization and assisting companies to win contracts with the Middle East countries. Korean construction firms employed temporary contract workers with limited terms for work in the Middle East. Workers from South Korea, with other workers from Southeast Asia, accounted for 5.1 million, almost 70 per cent of the total workers of 7.1 million in the Middle East in 1985 (Birks, Seccombe and Sinclair, 1988: 267).

The outflows of workers had been a significant source of release from pressure from high unemployment and a large inflow of remittance contributed to improve the balance of payment. In 1974 Korean workers in the Middle East were only 395, but rapidly rose to 172,968 in 1982, which was 1.17 per cent of the economically active population and almost 4 per cent of the total employees in 1982. As the construction projects in the Middle East ended, the size of the Korean workers in that area also declined since 1983. The export of workers to the Middle East contributed to the reduction of the unemployment rate. At the same time it significantly contributed to the formation of hard currency necessary for the trade and industrial investment.

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<sup>45</sup> The total amount of investment in Southeast Asia from Korea increased by 109 times from \$10.3 million in 1984 to \$1,092.0 million in 1994 (Korean Bureau of Statistics, 1995:362). Taiwan's foreign investment in South East Asia also rapidly increased concentrating on Malaysia, Indonesia and Thailand. During the period of 1987-1994 the total amount was almost \$15,200 million (Schive, 1995: 76).

Later South Korea became a labor importing country from Southeast Asian countries (Fong, 1992).

Remittances from migrant workers had been substantial resources for the balance of payments and total national income. Before 1973 most of the remittances came from the workers in Vietnam and a small numbers of miners and nurses in West Germany (UN, 1987: 64). It peaked in 1967 by \$ 114.7 million, which was 35.8 per cent of total export and almost 87 per cent of the total export to America. After the end of the Vietnam war, the major source of remittances was the Middle East region. The Korean government imposed a mandatory remittance rule by which at least 80 per cent of the earnings of workers should be remitted through Korean banks (Athukorala, 1993: 105). It was an effective remittance mobilization policy to maximize workers' deposit in Korean banks. Remittance from the Middle East also substantially contributed to the GDP growth. They amounted to 2.7 per cent of the GDP in 1979, 2.3 per cent in 1980, 2.5 per cent in 1981, 2.7 per cent in 1982 (see Table 2). One study from the UN reported that the effects of remittances to the GDP growth was between 1.3 per cent and 7.1 per cent from 1976 to 1981 (UN, 1987: 91).<sup>46</sup> Considering the fact that the economic growth rates were 6.8 per cent in 1979, -3.9 per cent in 1980, 5.5 per cent in 1981, and 7.5 per cent in 1982, the economic effects of remittances were substantial. As the outflows of workers decreased in 1983, the impact of the remittances to the Korean economy became less significant.

From the 1950s to the 1970s, there has been sequential changes of economic factors contributing to economic growth in South Korea and Taiwan. Economic and military aid in the 1950s was crucial. As the amount of aid gradually decreased, each country tried to solve the balance of payment difficulties inflicted by the ISI strategy. As this strategy turned out to be less effective to provide hard currency, both countries began to promote EOI through active economic policies. The timing of the Vietnam War was crucial for both countries in mobilizing financial resources. With the Vietnam War Boom, Taiwan could find an alternative source of hard currency with exports to Vietnam. The Vietnam War also contributed to the Korean industrialization with the involvement of the Korean army and business. Remittances and profits from this involvement, in fact, became a significant source of foreign currency, which compensated for the lack of investment capital. At the same time, the resource nationalism in the early 1970s in the Middle East became an alternative source of hard currency as the Vietnam War ended in 1975. The Korean government and business exploited the oil dollars by participating in the construction projects in the Middle East. Korean firms recruited temporarily Korean workers and labor exports

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<sup>46</sup> The estimate of contributions of remittances to GNP growth was done by dividing the net increase in remittances in constant prices by the net increase in GNP in constant prices.

to the Middle East significantly contributed to the balance of payment and the growth of GDP in the 1970s.

**Table 2: Remittances from Labour Migrations in South Korea (Millions of US Dollars)**

	Remittances (1)	Export (2)	(1)/(2) per cent	per cent of GNP	per cent increase of GNP
1965	18.4	175.1	10.5	0.6	5.8
1966	57.3	250.3	22.9	1.5	12.7
1967	114.7	320.2	35.8	2.7	6.6
1968	86.5	455.4	19.0	1.7	11.3
1969	69.2	622.5	11.1	1.0	13.8
1970	48.4	835.2	5.8	0.6	7.6
1971	46.4	1,067.6	4.3	0.5	8.0
1972	56.8	1,624.1	3.5	0.5	4.6
1973	113.3	3,225.0	3.5	0.8	12.6
1974	114.4	4,460.4	3.2	0.6	8.0
1975	158.2	5,081.0	3.1	0.8	4.6
1976	303.4	7,715.1	3.9	1.1	11.8
1977	584.2	10,046.5	3.4	1.7	10.3
1978	769.8	12,710.6	5.1	1.6	9.4
1979	1,158.3	15,055.5	7.7	1.8	7.1
1980	1,292.4	17,505.9	7.4	2.3	- 3.9
1981	1,673.4	20,670.8	8.1	2.5	5.5
1982	1,939.4	20,879.2	9.3	2.7	7.5
1983	1,663.0	23,203.9	7.2	2.2	12.2
1984	1,490.0	26,334.6	5.6	1.8	8.5

Source: Bank of Korea, *Economic Statistical Yearbook*, various years.

## **Summary and Discussion: Interaction of Multiple Factors and the Applicability of East Asian Economic Model to the Other Third World countries**

Although it is not totally useless, it is misleading to find one key factor to explain economic growth in East Asia. This is so, because there are a multiplicity of factors which might contribute to economic growth. In a closed economic system and a system with no state intervention into the economy, increase of more than one of the three factors of production - capital, labour and technology - results in the increase of productivity. However, the increase of productivity does not necessary generate economic growth since the profitability of goods does not solely dependent on productivity. Rather the profitability of goods rely on the market demands which is an aggregated outcome of individual consumer's preferences.

Growth theory only focuses on the supply side, the growth of human capital, technological improvement and increase of capital investment etc., but it cannot explain why export-oriented industrialization in East Asia has been more successful than in Latin America (for example, Lucas, 1993). This approach totally neglects the role of the state and international political economy. It also downplays the fact that the effectiveness of human capital on economic growth depends on the context within which it operates.

The state or neo-state approach (Johnson, 1987; Amsden, 1989; Wade, 1990; Weiss and Hobson, 1995) ignores that the state itself does not produce commodities in capitalist societies. The state produces only economic policies and sets rules to regulate, govern and promote economic activity of private enterprises. The role of the state is crucial in the formation and maintenance of economic rules and institutions. Nevertheless, it does not produce commodities except public services or public goods.

Production of commodity takes place in the organization of production, firms or workplace, where management and labour are major actors. The extraction of labor power from workers have shown distinctive patterns according to the relationship between labor and capital. Furthermore, unless the quality and price of the goods produced in the private enterprises are good enough to increase demand, state policies are not effective in promoting economic growth through the activities of private enterprises.

By contrast, the market approach or neo-classical approach (Krueger, 1981 and 1990; Hughes, 1988) miss the role of state intervention in the economy and the nature of the soft budget constrained firms in East Asia. The state command rather than the market demand initiated the growth dynamic of the East Asian economy. The state has oppressed market competition as well as political competition with protection from foreign competition and permission of monopoly. Although the state never totally replaced the function of the market, and never denied private

ownership of production, the state initiated and implemented the operation of the economy through a series of economic planning, investment management and control over trade and market in South Korea and Taiwan.

The effectiveness of state intervention into the economy depended on the state capacity to mobilize finance and foreign loan, get preferential treatment from the importing countries, etc.. The Cold War provided a friendly environment to the South Korean and Taiwanese firms during the 1960s and 1970s. Taking advantage of the military and economic alliance with the United States, South Korea and Taiwan received massive economic and military aid which contributed to the formation of capital. Moreover industrial products from South Korea and Taiwan penetrated into the price competition market in America with the economic alliance of the United States.

In this paper I have argued that a more holistic and historical explanatory approach is necessary to comprehend for economic growth in East Asia. The above three explanations are based on the state level in the sense that only internal dynamics of the economy have been taken into account. We should furthermore consider the international politics and economy which operate as an environment for the East Asian economy. Systemic competition including wars between authoritarian capitalism and authoritarian socialism accelerated economic growth under the American hegemony in East Asia.<sup>47</sup>

Moreover, I argue that we should identify the micro foundation of economic growth to fully understand the economic dynamism in East Asia. Factory despotism as a characteristic of work organization in East Asia also contributed to the accumulation of capital in East Asia as market despotism did in the early capitalist development in the West. Despotic control under the state's oppression of labor made it possible to exploit workers through extremely long working hours and high rate of industrial injuries.

To highlight my argument, I will briefly summarize my argument as follows.

First, there has been despotic control of workers by management at the workplace. Under factory despotism, the increase of the input of the labour factor could be achieved by simple measure such as an extension of working hours and days. As the case of Korea shows, the economy of scale in big enterprises substantively enhanced the productivity and profitability during the economic upswing.

Second, the major characteristics of strategic enterprises in East Asia is the soft budget constraint which is quite similar to that in Eastern Europe. However, the soft budget constrained firms in East Asia generated growth dynamics through the scaled economy and state disciplines. More importantly private appropriation of the profit with the help of the state accelerated the

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<sup>47</sup> It is interesting to note that the Cold War factor is considered as important by many researchers. But it is totally ignored in major analysis of economic growth in East Asia (Krueger, 1990: 244; Wade, 1990: 346).

competition for profit. Because FDI in East Asia was much less than that in Latin America, disjuncture of production and consumption did not generate economic dependency.

Third, the developmental state in East Asia paved the way to rapid economic growth at the expense of civil rights. The above two characteristics were also byproducts of the operation of the developmental state. The military regime in Korea and the martial law regime in Taiwan managed the economy as they controlled the army brigade, oppressing workers' rights and demands.

Fourth, the Cold War and the US hegemony provided a safe and favorable economic climate for Korea and Taiwan to develop authoritarian capitalism through export-oriented industrialization. Two wars in Asia since 1945 contributed to reinforce the authoritarian regime and promote East Asian growth. Moreover Korean and Taiwanese enterprises could take advantage of the price competition market in the US under the political and military alliance with the US. The US allowed easy access to the American market with favorable conditions. The competitiveness of South Korean and Taiwanese goods mainly came from the low wage and the scale of economy until the early 1980s.

It is obvious that in the real world the state, politics, economy, class conflicts are in continuous interaction at various levels. Sometimes it is arbitrary to delineate and accentuate one part of the whole processes. Thus we need a holistic approach to capture the complex totality of capitalist industrialization in East Asia. How to do a holistic approach is also a matter of debate. The assertion of a holistic approach itself does not guarantee the explanatory power of the argument. The most important imperative is to find out a more comprehensive and at the same time a more parsimonious holistic model.

The approach presented in this paper gives us a good reference for the discussion about the applicability of the East Asian economic model to other Third World countries after the Cold War. According to the different explanations of East Asian economic growth, policy implications or lessons from East Asia suggested by scholars are also different. For instance, Hughes(1990) and the World Bank(1993) among others argue that the East Asian model can be replicated in other developing countries. They totally ignore the difference of international context between the 1960s and the 1990s. Due to the demise of the Cold War and the US hegemony, the US became more defensive in its trade policies. And all the advanced countries are now experiencing an economic recession and, thus, the entry-cost to their market is much higher than before. In other words, it is very difficult for other developing countries in the Third World to imitate the South Korea n or Taiwanese export-oriented industrialization strategy.

Wade(1990: ch. 11) provides different prescriptions from Hughes and World Bank, emphasizing the major characteristics in South Korea and Taiwan. His prescription is very specific with an economic and political recipe. But he makes a mistake ignoring the role of work

organization and technology, i.e., the micro-foundation for economic growth. If all developing countries are imitating the policies of the South Korea n and Taiwanese governments, will they see steady and rapid economic growth as the case in East Asia? It depends on the other conditions such as repressive labor control and quasi command economy, which inevitably implies state dictatorship as well as managerial dictatorship. More importantly, he underestimated the economic effect of the Cold War on the rise of East Asia which substantially affected the effectiveness of state's economic intervention.

We can not easily infer a recipe for economic growth from the experience of the East Asian countries because there were many temporal or historical elements contributing to economic growth. To fully explain the operation of the economy in East Asia, we need a new holistic approach within a comparative historical framework. The East Asian experience provides a theoretical challenge to the compartmentalized social science which hinders rather than promotes a proper understanding of interconnectedness of politics and economy, and local production and global world system.

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