PREFACE

The role of government in a market economy has long been a controversial issue in many countries ever since the end of the Second World War. Every country has its own market system which reflects not only its own economic but social, political, cultural and ideological characteristics. The active role of government has received credit for the economic development in some countries, while it has been criticized for generating a great deal of inefficiencies to the market in other countries.

From the beginning of 1980s, countries in East Asia and Pacific region have adopted a series of adjustment programs which reduce the government intervention to the minimum level and activate further the function of the free market system. Meanwhile, East European countries, after the collapse of the socialism, have adopted various adjustment programs which aim at moving from the centrally-planned socialist economy to the free market economy.

Such a change in these two areas, East Asia and East-central Europe, raises a common very important issue: What is the appropriate role of government in a market economy in different countries. Experience-sharing and the cooperation to find an answer to the common task is the motive for us to meet together. The first conference was held in Seoul in April 1991, and it is needless to say that the major theme was the role of state and market. The conference ended up with a long future research agenda. However, the strongest feeling shared by all the participants of the conference was that the optimal combination of the market and the state was essential for the economic development in both East Asian and East-Central European countries.

The second conference was held in Budapest, Hungary in April 1992. The same agenda which we had discussed in 1991 were reviewed. The optimal combination of the market and the state during the process of economic reform in both regions was again the main focus.

This book arose from the Second East Asian and East-Central European Conference held in April 1992 by the Korea Economic Research Institute, the Institute of East and West Studies of Yonsei University, and the Central European Research Center. I would like to thank all the authors for their co-operation in the production of this book and especially thank his excellency Bela Kadar, minister of International Economic Relations of Hungary for his support in organizing of the conference. I also thank to the Rockefeller Brothers Fund for their financial support for the conference. I hope the information and the ideas presented in this book can be valuable asset to all the people who believe in the beauty of the free market economy system.

March 1993

Korea Economic Research Institute
President, Jong-Hyon Chey

CONTENTS

EDITORS AND CONTRIBUTORS

Anuwar Ali
Faculty of Economics, University of Kebangsaan Malaysia, Malaysia

Mate Babic
Professor, University of Zagreb, Croatia

Hsin-Huang Michael Hsiao
Deputy Director, Institute of Ethnology, Academia Sinica, Taiwan

Kap-Young Jeong
Professor of Economics, Yonsei University, Korea

Ku-Hyun Jung
Professor of Business Administration and Director, Institute of East and West Studies, Yonsei University, Korea

Shin Il Kang
Research Fellow, Korea Economic Research Institute, Korea

Dalchoong Kim
Dean, Graduate School of International Studies, Yonsei University, Korea

Hakun Kim
Professor of Economics, Yonsei University, Korea

Jaehong Kim
Research Fellow, Korea Economic Research Institute, Korea

Laszlo Lang
Director, Central European Research Centre, Hungary

Chung-Cheng Lin
Professor of Economics, National Central University, Taiwan

Jozef Soldaczuk
Professor, Foreign Trade Research Institute, Poland

Marjan Svetlicic
Professor, University of Ljubljana, Slovenia

Somsak Tambunlertchai
Programme Coordinator, The Asian and Pacific Development Centre, Malaysia

Suk-Bum Yoon
Director, The Asian and Pacific Development Centre, Malaysia (on leave from Yonsei University)

Introduction

INTRODUCTION

Shin Il Kang and Jaehong Kim

Government intervention into the free market was earlier considered crucial for economic development. Centralized planning, state ownership in some strategic areas, public sector investments for rapid industrialization followed logically. However, by the beginning of this decade, a large shift in that role became necessary not only due to new economic pressure, both internal and external, but also because of many developments which have already taken place. Thanks to the public sector initiatives, basic physical infrastructure has already been built in many countries. Social services have been substantially expanded, new financial institutions have begun to function, and, probably the most important, new enterpreneurs and market opportunities induced greater participation of the private sector to the development process. Continued government intervention in economic activities will not only tend to stifle market incentives but also prove to be inefficient and costly. Hence the need for a further readjustment in the role of the state including the public sector is raised.

In the wake of global recession in the early eighties, countries in the East-Asia and Pacific regions were compelled to adopt new economic adjustment measures. Compared to other regions which witnessed dramatic decline of income and growth, economies of East Asia were credited with more pragmatic adjustment policies resulting in quick recovery and early resumption of economic growth. A gradual decline in the interventionist role played by the government and the public sector constituted a noteworthy part of the new adjustment program.

East European countries did also adopt adjustment programs such as price decontrols and introduction of new western-style production methods. However, such adjustment programs did not work, and only resulted in high inflation and unemployment rates. The fundamental reason to such a failure was the fact that those countries were still under a planned-economy.

In the end of eighties and the beginning of nineties, those countries in eastern Europe find themselves that transformation of the economic system from the socialist centrally-planned to a free market economy is the true solution to the economic growth and stabilization. The collapse of the Soviet Union and the EC integration accelerate the reforms of economic system through privatization and deregulation. However, innate bureaucracies and immature capital market remain as the barriers to overcome to the success of the transition process.

East Asian countries confront the same problems as the East Central European countries even if they are at different stages of economic development. The common task is necessarily to make its own economic system with the role of government at the minimum level to give full incentive to the market, which implies that they need further readjustments for such goals as the reduction in the role of state as producer and provider of goods and services, the enhancement of the role of the private sector as the engine of economic growth, the reinforcement of a competitive market economy, and finally achieving the equity objectives of the society.

1. The role of state and market in East-Asia.

Most East Asian countries have maintained a market economy system during past three decades. Furthermore, these area has a good reputation of successful economic growth as is seen in the NIES and the ASEAN countries. It is generally said that the secret of their success is the cheap labor and the strong growth-oriented government polices. However, to the question that who deserves credit or blame for the performances of the market economy in the East-Asian countries, it is hard to reach a consensus. During the conference, we tried to touch on this controversial issue, that is the role of the government and the private sector in a market economy, and, from the experiences of Korea, Taiwan, Malaysia and Thailand, could identify some common as well as some country-specific features. We have no doubt about that understanding the history of the market economy in those countries will give us a valuable lesson for the better future of our market economies.

The first common feature is the dominating role of a strong and authoritarian government. This may be a natural phenomenon if we recall that in early stage of the market system the private sector has little experience and capability, and so the central government is necessarily required to take the initiative in promoting the market. The government has played a major role in such areas as economic planning, choosing target industries, capital mobilization, direct investment, subsidization to and protection of the domestic industries etc.

For Taiwan, Hsiao pointed out that the nature of the rule of the KMT regime can be best characterized as "authoritarian corporatism". As he argues, the concept of the "governed market", which was developed after criticizing the neoclassical economic theorizing of east Asian formula of the state and market relations, may well be useful and relevant to the Taiwan reality. Hsiao's description about the Taiwan government's role against the market can be equally applied to the other East-Asian countries. Hsiao also argues that for the state-business integration, new government agencies should be established and a new style of bureaucracy should also be fashioned. By doing so, the state will be able to respond to the increasing social demands and interest articulations from the broader civil society, not just from the big business class, and make them compatible with long-term political democracy and social justice of the society as a whole.

Hakeun Kim tried to evaluate the role of Korean government in the export-oriented industrial policies on the basis of empirical evidence. He first tests the effect of the financial policy of the Korean government and finds that we cannot have a conclusive answer, which may be inconsistent with the general description about the strong and effective role of the Korean government in the process of industrialization. As to the tax policy on the export promotion, he makes an argument with reservation that it has made a significant incentive effect to the private sector together with many market distortions.

The ever-growing dominant role of the public enterprises in the national economy should be the second common feature of the market economy in those East-Asian countries. As the political as well as the economic democratization have been spreading in these countries the weight of the public enterprises is reducing in quantitative figures. However, they are getting more power in such major areas as electricity, gas, petroleum, transportation, telecommunications, financial intermediaries, and etc. At the conference, all agreed that changing the ownership structure via privatization was one of the most important basic conditions for the market economy to function in the proper way.

To the privatization issue, Kang has identifies several points to be taken into consideration based on the lessons from the Korean privatization process. First, by comparing the firm's performances before and after privatization, he found that risky businesses and regulated businesses did not show any efficiency improvement after privatization. He also pointed out that the privatization in Korea aggravated the gap between the large firms and the small to medium firms. The government should be very careful about how to distribute the shares to the private sector. Kang also warned that the partial privatization, as is observed in Korea, will make those concerned firms subject to both the government regulations to the public enterprises and those to the private sector, and will necessarily create more serious market inefficiencies.

The third basic feature is the deepening dichotomy between the large firms and the small to medium sized firsm. It is believed that unequal distribution during the period of rapid economic growth has evoked a serious social conflict in these countries. It happens not only between the big businesses and the small to medium firms but between the urban industrialized and the rural agricultural areas. Hsiao emphasized this problem in Taiwan, and Jaehong Kim highlighted recent conflicts between the Korean government and the big business groups.

2. Transition toward a market economy: experiences of the former socialist countries in East-Central Europe.

While East-Asian countries are undergoing a period of economic democratization and market liberalization, the former socialist countries in Eastern Europe such as Hungary, Poland, Czechoslovakia, Slovania, Crotia are undergoing a transitional period from the socialist economy to a market economy. Recent political and economic changes in East-Central Europe provide some, albeit limited, experiences of post-communist transitions. The evolving delicate and controversial interrelationship between crisis and transition, politics and economics, the roles of the state and the free market, moral and psychological attitudes to the past and present, self-determination and nationalism etc. may point to immediate risks and dangers as well as opportunities in the future. As Svetlicic said, there is too much of oversimplification about the transformation process in East-Central Europe. Too many believe that all these countries are undergoing the same process. This may be true if it means that all of them are in the process of democratization and economic transformation. However, it should be remembered that these countries have different starting positions. Different inherited economic system, different ethnic structures, and different roles of foreign direct investment of the individual countries require differentiated approach to each country.

Needless to say, the way to the market economy is never an easy one. Lang, based on the experience of Hungary, which started the transition earlier than other counties in East-Central Europe, describes the difficulties as follows.

Conclusions to this outline of thoughts will inevitably be short. What has been said boils down to the simple fact that post-communist transition will, by definition, be long and tardy processes with several predictable and unforeseen risks and dangers looming down the road. The controversies that surround these transformation do not yield to easy solution. Vicious circles rarely do.

However, the role of the state should be even more important than ever for the successful transition from the market socialism economy to the free market economy system. Lang suggests several things for the state to do such as investing soft-money into infrastructural development, promoting dialogue with and support of the pro-market anti-statist political forces, lessening external influences that might call for reactive nationalism, and presenting a role model or a vision for a cooperation and an integration in the region of East-Central Europe.

What is the appropriate role of the state for the successful transition? The transformation program of Poland provides a new testable policy of so-called "shock therapy" to this question. Poland eagerly needed to resolve the intensifying hyper-inflation problem and the Poland government adopted a radical anti-inflationary stabilization program, which is called a shock-therapy, as the precondition of the transition to a market economy. Soldaczuk evaluates such a extremely strong government intervention policy. According to his observation, there can be no doubt that the shock therapy has achieved a remarkable success in stabilizing the economy. However, it should be pointed out that it went too far so as to deepen and prolong a very severe economic recession. Soldaczuk confirms the knife's edge nature of the government intervention, especially during the period of unstable economic environment.

Slovania and Crotia, the ex-Yugoslavia, which are at the very primitive stage in the process of transformation to a market economy, require a different role of the state from Poland. Because they are seriously suffering from the war in the Balkan area, the first priority of the government is to achieve a political and social stability. Svetlicic points out the importance of foreign direct investment and cooperation with foreign countries for the transition of the Slovenia, and is particularly emphasizing the possibilities of trade partnership between Slovania and the Asian NIES for mutual benefits. The role of Slovanian government then should be to assert of Slovania as an new entity in the world, separate from the negative Balkan picture of Yugoslavia branded with the war. As Svetlicic argues, it may be true that all negative effects of development in other parts of former Yugoslavia are tremendously affecting Slovania in spite of the fact that Slovania offers, after the so-called Yugoslavia army left in 1991, a perfectly stable business and living environment.

Meanwhile, Babic describes Crotia as being still under a socialist self-management economy. That means the basic reasons for the market inefficiency have not yet been eliminated. This is why Babic stresses that the most important role of the Crotian government is to insure the functioning of a free market in all Crotian segments of economic life.

3. EC integration and its impacts to the East-Asia countries.

The world economy is currently undergoing a drastic restructuring. The cold war is over due to the dramatic collapse of the Berlin Wall and the Soviet Union. There is no more a ideological conflict between the socialist economy and the market economy. Instead, globalization and regionalism emerge as new international environment which will give crucial impacts particularly to the East-Asian and the East-Central European countries. Yoon identifies the nature of the global economic restructuring and its impact particularly on Asian-Pacific countries. Based on his observation, Yoon is recommending some policies such as strengthening Asian-Pacific economic cooperation, overcoming regionalism to pursue globalism following a non-exclusive and non-discriminatory principle, and accomplishing the goal of technological breakthrough.

The participants to the conference particularly show interests in the EC integration, and Korea and Taiwan demonstrate their own forecasting and reacting strategies. Lin and Jeong suggest some strategies to the Taiwan and Korean government respectively to cope with the EC integration, which can also be applied to the other east-Asian countries. They stress the importance of the direct investment in EC nations as a way to penetrate into the integrated EC market. It means that the governments of east-Asia countries should switch from the traditional export-oriented industrial policy to a new direct investment oriented policy. It then provides a new role to the state, and the essence of the new role should not be an intervention into the domestic market but a cooperation with and incentive provision to the domestic market in a new era of regionalism and globalization.

PART I

The Role of State and Market in East Asia

The Political Economy of State-Business Relations in Taiwan: Formation and Transformation

Hsin-Huang Michael Hsiao

I. Introduction: East Asian Development Reexamined

Toward the end of the 1980s, the study of East Asian development has moved beyond the paradigmatic debate between the modernization theory and the dependence/world system perspectives and begun to closely look at those important contexts and agents that have been contributing to the making of the East Asian success and those consequential development issues. Though the original theoretical formulations were consciously retained, empirical explanations were more carefully clarified and criticially assessed against the East Asian reality (Hsiao, 1992a). The specificity of the individual society within the general framework of the East Asian NIEs (Newly Industrialized Economies) is now being paid greater attention as to how the broader global economic contexts interplayed with the domestic actors such as the state politics, business sector, labor and other socio-cultural fabrics during the course of post-war development (Hsiao, et al. 1989a; Amsden, 1989; Wade, 1990). Lessons, cautions, and warnings are also being drawn from the East Asian experience for the rest of the developing world (Winckler and Greenhalgh, 1988; Deyo, 1989; Bello and Rosenfeld, 1989; Gereffi and Wyman, 1990; Wade, 1990). Much more concrete analysis of the transition of the authoritarian state, the class transformation, the emergence of the middle classes, and the rise of social movements have been added to the research agenda, and some useful works are being increasingly produced (Cheng and Haggrad, 1992; Hsiao, 1991, 1992b, 1992c).

It is rather an encouraging direction for the development scholarship to go beyond the general portrait of what East Asia has accomplished or the native praise of the East Asian model for uncritical emulation, and to go into a more penetrating examination of what actually has been going on within and beneath the unfolding East Asian development drama.

In the decade of the 1980s, three major approaches emerged in the literature of East Asian development studies. Each of the three approaches has centered its focus on one context or agent that is believed to have played a critical role in the development process of East Asia.

The first is the global political economy approach that takes the world economy as the crucial external context and it has incorporated East Asia into the global market and provided new opportunity structures for the East Asia to take advantage of. It is a sort of revised world system explanation in that the dependency of a peripheral state on the core state within the world economy is not necessarily doomed to be underdeveloped. Rather the dependency could be managed and made beneficial to the ascent of a peripheral state or a peripheral region.

The second approach takes the state seriously in its role of steering and guiding the state development strategies and policies to meet the challenge from the global political economic system. The state is viewed as active and an interventionist in both external and internal economic activities. The following issues have caught much attention among scholars in this approach. The question of the relative autonomy of the state vis-a-vis the dominant local class in embarking on national development policies is the most discussed topic. The relationship between the state and the market force and the role of leadership or followership the state has played in that relation are also much stressed. Finally, the debate of whether or not authoritarianism is a necessary evil for development in the case of East Asian NIEs is an another unresolved issue that has occupied many scholars working along this line of analysis.

The third approach, compared with the previous two, is a rather new focus of East Asian development studies. The two former approaches have respectively asserted that 1) the unique world political economy in which East Asia was integrated in the post war era has been conducive to capitalist development in this region, and 2) the unique nature of the state in East Asia and the development strategies adopted all have been functional in the initiation and sustaining of successful development there. The third approach, on the other hand, calls our attention to another important agent of capitalist development, on the other hand, calls our attention to another important agent of capitalist development, i.e., the business sector, and the role it has been playing in the course of East Asian development.

It is quite convincing to argue for a new look at business if the picture of East Asian development is to be complete, as business is the central actor in any capitalist development after all. Provided with favorable timing and external linkages with the global political economic contexts and with the fact that the active developmental states have responded positively and forcefully to the world system, the success story of East Asia still can not be fully told if the business chapter is missing. The essence of this business approach lies in its emphasis on how the business sector has responded to the state development initiatives and the world market opportunities at the beginning and then later, in turn, reshaped the course of capitalist development in East Asia.

The purpose of this paper is to take this new approach to reexamine Taiwan's postwar economic development experience. As suggested by this general analytical framework, three interrelated themes are to be explored here.

First, the relations between the state and business and the political economic contexts in which the state forces have been interacting with the different sectors of the business in Taiwan.

Second the mechanisms employed by the state to strengthen the links with business and the business response to those relations, and how the two actors interactions have been institutionalized and stabilized in the course of Taiwan's capitalist development.

Third, the change and transformation of the state-business relations and the sociopolitical forces behind the changes, and the future prospects and implications for Taiwan's further socio-political development.

II. The Political Economy of the State and Private Capital in Taiwan

Taiwan's political economic structure has been characterized for a long time by a strong and authoritarian yet developmental state and a bulk of politically weak yet economically dynamic small and medium businesses along side with an ever-growing powerful big business sector. This structure has been quite stable since the years when Taiwan began its export-oriented industrialization (EOI) in the 1960s.

The nature of Taiwan's KMT authoritarian developmental state has been established in different phases. The authoritarian corporatist rule of the KMT state was already firmly rooted in Taiwan even before the state-led rapid industrialization took shape in the 1960s. The export-oriented industrial development further perpetuated the political authoritarianism over all aspects of the civil society including the business sector. In other words, unlike in Latin America, Taiwan's bureaucratic authoritarianism was not deliberately established for enacting the state-led export promotion strategies, but rather, was a preexisting structure. The dynamic and impressive industrial growth then in turn legitimized the state's powerful authoritarian rule after the export-oriented industrial development phase.

On the other hand, the business sector as a whole was first nurtured and boosted in the post land reform import-substitution industrialization (ISI), and it has been more or less subjected to the state's corporatist control since the 1950s. The first generation of landlords-turned-capitalists was created in the 1950s, and then the first generation of export businessmen was produced in the 1960s. And by the 1970s, the big capitalists that dominated the domestic market and a great many samll and medium entrepreneurs concentrating in the foreign markets have constituted Taiwan's business sector.

It is not exaggerated to say that both the big capitalists and the small and medium businessmen were, in face, the products of the state's leadership in executing the consequential industrialization strategies in responding to both the internal and external political economic challenges. The land reform policy that produced the first generation indigenous capitalists in Taiwan was forcefully implemented by the KMT regime from the Mainland to ensure its political control over the then agrarian Taiwan society. The post land reform first ISI strategy in the 1950s was adopted primarily to meet the domestic economic needs and to build local industrial capabilities and the main beneficiaries of such a strategy were the dominant state-owned enterprises, the Mainlander-owned industries and the emerging Taiwanese landlords-turned-capitalists, and a few local entrepreneurs who made their quick response to the state's industrial initiatives.

The export-oriented industrialization (EOI) strategies that followed the first ISI phase, then fostered an even larger number of local business establishments. It witnessed a significant rise in Taiwanese small and medium export-directed enterprises existing side by side with the ever growing-in-scale larger business sector controlled by both Mainlanders and Taiwanese originated in the previous ISI phase. The strategic shift from ISI to EOI though not necessarily a clear cut one, was induced and pressed by both domestic market constraints, external US pressures, and then the foreseen expansion of the world market concentrating in the west. The global market provided a new opportunity and the state responded in a way that turned out to be favorable to Taiwan's later development course. And the result was the emergence of the dynamic export manufacturers in large quantity yet small in scale. What should be pointed out is that under ISI protectionist policy and the state's political maneuver on business, the existing big businesses had already enjoyed oligopolistic positions in the domestic market and, therefore, were not interested in expanding their business to the uncontrollable and non-protected foreign markets. The rising small and medium businesses then could have the chance to fulfil the "call" from the state's EOI initiatives.

The resulting large quantity of small and medium businesses aiming at the world market should not interpreted as a conscious and intended policy consequence that had been planned by the state. Rather, it reflected the inequal division of labor in the unique political economy of Taiwan that was dominated by the KMT state and KMT state and its protected big businesses and the state-owned enterprises in the domestic market. In other words, the newly emerged export market with high competition and without the state's direct guarantee was then left to the hands of those originally left behind, small and medium businessmen who saw the world market as the only channel to gain and to move upward. The "dichotomous or dual market structure" was then rooted in Taiwan's political economy as of the late 1960s (Chou, 1989).

One other important external contextual factor that unintentionally produced such a dual market (business) structure came from the core states, particularly the US. In the immediate post war years, Third World countries and east Asia alike were seeking rapid industrialization by ISI strategies aimed to spawn local industries manufacturing local substitutes for imports, while the US saw its interests being best served by global free trade. US firms and their capitalists with the most efficiency could drive out competition in unprotected markets. To this aim of undermining the ISI model, the USAID, the World Bank began to formulate the strategy of EOI, encouraging the Third World to employ their reserves of plentiful and cheap labor to produce low-tech manufactures such as textiles, garments, and shoes, for export to advanced country markets where their low labor costs would give them a competitive advantage (Bello, 1991). A series of policy recommendations were therefore urged by the World Bank and the US. Taiwan, in this connection, was directly pressured by the US aid instrument and began the process of "structural reform" by issuing the "19 point financial reforms" in the late 1950s and the early 1960. Included in the package were devaluing the New Taiwan currency to make exports more competitive, relaxing control over foreign trade, allowing the entry of foreign direct investment in setting up export manufacturing enterprises, and initiating the singular exchange rate along with eliminating import restrictions. In 1960, "The State for Encouragement of Investment" was also issued in order to offer greater tax-reducing incentives to stimulate private investment and export. Moreover, the EOI strategy of Taiwan coincided with the needs of US multinational enterprises in the 1960s in seeing the opportunity to move their operations to Taiwan for utilization of local cheap labor to export manufactured products back to the US and to world markets. Such "re-export" activities of the US firms had a dual purpose: to gain a higher return rate for their investment by lowering labor costs and to compete with Japanese imports like televisions, micro-chip, and computer goods in the US market (Bello, 1991).

Foreign direct investments from the US and Japan in Taiwan had induced a wide range of support for small and medium enterprises that saw the opportunity to take advantage of the newly-emerged export promotion policies set up by the state. More importantly, the export market was not interesting to big businesses. One other arrangement that helped accelerate the growth of small and medium firms and manufacturers was the so-called "OEM" (original equipment manufacturer) by the US investors, whereby the local manufacturers were assigned to produce products then later sold under their the US brand names. Taiwan has been a subcontracting center since the 1970s, and a sophisticated institutionalized arrangement was then established. In fact, the dynamic export performance was, in most part, attributed to those local OEM factories and firms that constituted the main body of Taiwan's local small and medium enterprises (Shieh, 1989).

The dual market structure, therefore, should be understood within the above-mentioned internal and external contexts, especially the nature of state-business relations and the pressure from the World Bank and the US government, and those multinational corporations.

In the early 1970s, caused by the withdrawal from the UN and the oil crisis, Taiwan faced a serious setback in economic performance. The drop in business confidence and the outflow of capital brought about the temporary hold on export dynamism, and the diplomatic setback even led to the KMT state's legitimacy crisis. The state then began the second ISI strategy to restructure the domestic industrial structures by means of developing energy-intensive and capital-intensive industries and large scale infrastructural projects.

Under the second ISI initiatives, the state enterprises increased their significance in leading domestic investments, while the big businesses also received an even greater boost from the state and turned into "business groups," Taiwanese versions of conglomerates. The small and medium businesses, on the other hand, which survived the world energy crisis and recession at the time were reenergized for further growth and development from the late 1970s. From the 1980s, Taiwan's political economic structure of state and private capital has been strengthened, though it also underwent transformations.

Without doubt, the state has been exercising the dominant role in Taiwan's economy, and under the state's effective political and policy mechanisms, both big business and small and medium enterprises were created. The domination on the economy of the KMT state not only took the form of hands-on direction and guidance to the business sector as in South Korea, but, in Taiwan, the state has also physically owned massive segments of the economy by controlling significant numbers of state-owned and even party-owned business operations, in addition, the state owns about 70% of the island's land.

The following are further portraits of the relative weights of Taiwan's three business sectors: state/party enterprises, big business, and small and medium enterprises.

1. The State and Party Enterprises

The origin of Taiwan's state-owned enterprises had been from the taking over of ex-Japanese Zaibatsu and Japanese colonial government after the war. Later, more new state enterprises were established. In 1952, state businesses accounted for as much as 57% of total industrial production, 43% of domestic capital formation, and employed 17% of Taiwan's civilian employees. At the completion of the first ISI in 1960s, public enterprises industrial output fell behind private business for the first time, and the figure dropped to 48%; their share of domestic capital formation was about 34%, and they hired 11% of the labor force. In the mid-1970s when the EOI was turning into the second ISI, state enterprises once again received a big push from the state. Though their share of overall industrial production dropped steadily to 22%, yet they still contributed a growing 43% of domestic capital formation and employed 12% of Taiwan's total employees. In the late 1980s, the state enterprises accounted for below 20% of Taiwan's industrial production, their average share of domestic capital formation was about 22% and they hired under 10% of Taiwan's total employment (Lee, 1992).

It is true that, judged by the above figures, the relative weight of state enterprises in Taiwan's economy has been declining over the past four decades. However, the actual significance of the state sector's involvement in the economy was still far greater. The heavy penetration of the state in such strategic and key sectors as petroleum, electric power, steel, gas, railways, shipbuilding, postal and telecommunications, tobacco and spirits, banking and other financial segments has all reached a monopolistic level, and the nature of state and bureaucratic capitalism, as reflected by such state dominance in those crucial sectors, was thus labelled by some experts (Amsden, 1979; Kuo, 1991; Chen, et al., 1991).

As late as 1990, ranked according to sales, four of the top ten businesses were state-owned, and the largest private firm, Nan-Ya Plastics was outstripped by three state enterprises (China Petroleum, Taiwan Tobacco and Wine Monopoly Bureau, and China Steel Crop). Again, among the top ten firms ranked according to assets in 1990, as many as six were state-owned (1990 Commonwealth Top 1,000 Enterprises). Moreover, the state enterprises have also diverted their investments in to 40 large private businesses and 7 foreign firms in Taiwan (Lee, 1992). By so doing, the state sector could, in fact, control the directions of these private firms as well.

In addition to the direct control of the state business sector, the KMT party also owned wholly or partly around 50 companies, mostly through two powerful and privileged party-owned investment firms. These party-owned companies ranged from communications to petrochemical steel, electronics, and even financial and securities industries. (*Excellence Magazine*, 1989; Chen, et al., 1991). The later development in the joint venture of the party investment firms and the state enterprises with the big private companies has even further empowered the party's penetration in to Taiwan's private sector. What has emerged is a new kind of party-state-private capital bloc. Yet it can be free from bureaucratic supervision and enjoy a great deal of the state's special favorable privileges through political manipulations (Chu, 1989). According to unofficial estimates, about half of the total assets of Taiwan's corporations are controlled directly or indirectly by the state and the part (*Asian Wall Street Journal Weekly*, Oct. 9, 1989).

2. The Big Businesses (Business Groups)

As mentioned earlier, at the end of the first ISI, several big private enterprises emerged with direct state assistance. US aid was used to advance the interests of KMT-linked Mainlander businesses of Shanghai and Shantung origins and a few local Taiwanese landlords-turned entreprenuers. With profits guaranteed by a closed market and costs subsidized, Mainlander-owned enterprises were the main beneficiaries of the state's ISI initiatives. They became the upper level of the business power structure in the period prior to 1960. Of the top 21 Mainlander-controlled business groups, 15 were established long before 1960s. Even in 1981, among the top ten private business groups, three were Mainlander-owned (Far Eastern, Yue Loong, and Pacifid Electric Wire).

The first generation of Taiwanese landlords-turned-capitalists that forged political ties with the KMT state were another business segment that benefitted directly from the state's ISI and EOI strategies in the 1950s the 1960s. In most cases, the Taiwanese big groups were also formed in that period under KMT partronage. Later these were joined by other Taiwanese industrialists like Formosa Plastics' Y.C. Wang, who made a quick response to opportunities presented by the state's industrial priorities which were greatly assisted by US aid in the early 1970s. The Taiwanese gradually topped the Mainlanders to resume a dominant role in Taiwan's big private business sector. Toward the end of the 1980s, among the 97 private "business groups" (multi-company establishments) in Taiwan, 75 were Taiwanese owned, 13 were in the hands of Mainlanders, and the remaining 9 were jointly controlled by both Taiwanese and Mainlanders (Peng, 1989).

The KMT state has been constantly ambivalent towards the Taiwanese big business groups, and there has always been an ethnic tension management between the Mainlander state and the Taiwanese businesses. There were fears on the part of the KMT state of the Taiwanese ambitions for self-determination and independence if they were excessively empowered both politically and economically. It was not sheer speculation to say that in the second ISI phase in the 1970s, an ethnic power struggle between the state and the Taiwanese economic interests was a consideration when the state enterprises were given the dominant role in leading major industrial projects. Though the rationale given by the state was that private capital did not have enough capability to make the huge investment needed to support accelerated industrial expansion in Taiwan, the unspoken reason was that the KMT wished to solve its legitimacy crisis and resume its economic domination by boosting the state-controlled sector. And behind such a move was the Mainlander state's efforts to continue to exercise the strategic direction of the island's economy vis-a-vis the up-and-coming private capital controlled by the Taiwanese business class (Bello and Rosenfeld, 1990).

One other political mechanism to keep the Taiwanese business class in check was co-opting many rising Taiwanese elites or their sons to run for political office. It was, indeed, a calcualted effort in the late 1970s to cement the political links between the KMT state and the Taiwanese business class. It is predictable that the political and economic interests will be strengthened between the state and private capital, Mainlander and Taiwanese alike, in the 1990s since such indications have been visible since the 1980s. Also, the Taiwanese big businesses have been linked with their Mainlander counterparts through joint investments and positions in the governing boards of trade associations and other business organizations (Namazaki, 1986). The Taiwanese and Mainlander divide in business circles will be eliminated and they will certainly merge into very powerful capitalist interests bloc.

In 1988, the top 100 business groups in Taiwan accounted for 34% of the total GNP, yet employed only 4.63% of Taiwan's labor force and comprised 700-800 firms (China Credit Institute, 1990-1991). The business groups have heavily concentrated their investments and business operations in those capital and technology intensive industries, they began to enter the financial sector, in banking and securities after the state permitted new banks to be established in 1991. As in the 1980s when the big industrial capitalists emerged in Taiwan's private business sector, a new breed of big financial capitalists will be formed by the mid-1990s. It is important to point out that behind these new private banks are again those powerful interests from the big industrial capitalists who finally merged their industrial capital into this newly opened financial sector. In other words, what is to be seen is a rising joint economic force of the industrial and financial capitalists that will exert even more power and influence in Taiwan's political economic arena in the future.

3. The Small and Medium Enterprises

Outside the above powerful state-party-private capital core were a large number of small and medium entrepreneurs. In 1989, there were 773,511 registered business enterprises in Taiwan, and 97.72% of them were considered small and medium businesses, with capital under NT$40 million (US$1.5

million) and total assets below NT$120 million (US$4.8 million). To make the picture more dramatic, 99% of all enterprises in the manufacturing sector like food products, garments, non-metal furniture, and printing, etc. were in the hands of those small and medium businessmen. They produced about 71% of Taiwan's employment, and contributed around 46.3% of Taiwan's industrial production in value terms, yet constituted only 26.11% of all business sales in Taiwan (Wei, 1991). According to the Industrial and Commercial Surveys from 1966 to 1986, more than 95% of all manufacturing units hired fewer than so employees, 80% fewer than 20, and 70% fewer than 10 (Shieh, 1989).

However, the small and medium enterprises which were the back-bone of Taiwan's trading economy, accounted for more than 60% of the total exports in the 1980s. Taking manufacturing exports alone, they contributed up to 65%. And more than 70% of Taiwan's small and medium enterprises' total business income was generated from exports.

All the above figures have characterized Taiwan's small and medium business sector very well: it is not just relatively small compared to those big businesses, it is in absolute terms small in capital, sale, production, and the labor employed in individual business units. Yet, as a whole, these businesses provided many more jobs than the big businesses, and they are the primary source of the dynamism of Taiwan's export economy, now the No. 12 trading power in the world in 1991. Moreover, the very existence of the large numbers of small firms with significant capital decentralization should be appreciated as one of the major structural reasons behind the relatively equal income distribution at least before 1980.

Obviously, the source of dynamism of small and medium businesses has been their links to the world market. Without this external market connection, the small and medium enterprises would not have been growing at such a rapid rate, from 170,000 in the early 1960s to more than 750,000 in the late 1980s. One of the key policy mechanisms provided by the state's EOI to promote the dynamism of Taiwan's small and medium-export businesses was the tariff and tax rebate system. Under that policy, the exporters were qualified to gain refunds on customs, duties and other taxes for their imports they required for export productions. This policy mechanism also helped encourage Taiwan's exporters to be internationally competitive.

However, by this policy mechanism alone, one can be misled to believe that the small and medium enterprises have been paid special care by the state over the years. On the contrary, they have not been assisted financially in any other way by the state, and they were let alone in their desperate efforts to be financed. For decades, the small and medium entrepreneurs were not able to take advantage of bank credit which went mainly to the state and private big enterprises. Only about 30% of the loans from Taiwan's bank system went to the small and medium enterprises (Lin, 1989). As a result, they were forced to be heavily dependent on the curbside or informal money market for financial needs. The massive and widespread informal financial market was then critical to the survival and growth of Taiwan's small and medium enterprises, and provided more than 80% of their financial requirements in the early 1970s (Bello and Rosenfeld, 1990). Even in the 1980s, the small and medium enterprises still have to rely heavily on various informal and private financial sources such as rotating credit associations at much higher interest rates than the secured bank loans that have failed to get access to. According to the study report on the problems of Taiwan's small and medium enterprises, in 1991 more than 40% of this sector's financing still came from the private loan market (*China Time Evening Post*, April 5, 1992).

Clearly, the small and medium enterprises, in sharp contrast to those big businesses, have been peripherialized in the domestic political market vis-a-vis the state, even though they have been very active in their pursue of material gains in the world economic market.

III. The Evolving Mechanisms of State-Business Relations

To lead to a broadery yet penetrating analysis of state-business relations in Taiwans' post-war era, one should first identify the relations of the KMT state to the market. And in the understanding of state vs. market dynamics, the political nature of the state or regime should first be clarified.

As pointed out briefly in the previous section of this paper, the nature of the rule of the KMT regime on Taiwan since the war could best be characterized as "authoritarian corporatism". It is authoritarian because the party has dominated all political organs, and rulers are selected without any due process influenced by popular preference or sentiment. It is corporatist because the state has chartered limited, hirearchical and subordinated interest groups in the civil society, giving them a monopoly of representation of various occupational or civil interests, and, therefore, the state has been able to maximize compliance and obedience of the civil society under its authoritarian political system.

Such authoritarian and corporatist political rule and control over the civil society has indeed provided the basis for the KMT state to assume a position of preeminence in the economy. Having not ignored the very political arrangements identified above, Taiwan's KMT state, in interacting with the economy, has been more than a "rent-seeking regime." It did have a set of clear objectives for industrial development for different phases, employing relevant industrial strategies, such as the first ISI, EOI, and the second ISI. To make a more accurate characterization, the KMT on Taiwan can be qualified to be an "authoritarian capitalist developmental state" in which the centralized state was equipped with not only corporatist arrangements but also effective development policies that could secure various economic development objectives.

The concept of "the governed market" as proposed by Wade (1990), after criticizing the neoclassical economic theorizing of the East Asian formula of the state and market relations, is useful and relevant to the Taiwan reality. Wade argued that East Asian economic performance was due in large measure to a combination of 1) very high levels of productive investment, making for fast transfer of new techniques into actual production; 2) more investment in certain key industries than would have occurred in the absence of government intervention; and 3) exposure of many industries to international competition in foreign markets. In this formulation, the state, using incentives, controls, and mechanisms, has been able to "gudie" or even "govern" the market process of resource allocation so as to produce different production and investment outcomes than would have been achieved with either "free market" or "simulated free market" policies (Wade, 1990). The emphasis on the dirigisme of the state in directing or influencing the market, however, can not be mistaken for a mere "market repressing intervention." As analyzed elsewhere, can not be mistaken for a mere "market repressing intervention". As analyzed elsewhere, the most important aspect of such a model of dirigisme is not because of the authoritarian political control that has made Taiwan's state intervention active and beneficial to development but in spite of it (Hsiao, 1992). Such a qualification on Taiwan's state vs. market dynamics is crucial to further understanding of the state and business relationship.

The bases of the KMT state's authoritarianism can be attributed to the following structural elements and control mechanisms (Chu, 1989):

First, the KMT state has been tightly controlled by a highly coherent ruling coalition, with a hierarchy of small Mainlander power elites heavily relying on the Chiang-centered power bloc, and a paternalistic patron-client network was deeply rooted in the party-state structure until the death of late president Chiang Ching-Kuo in the late 1980s.

Second, ideological indoctrination has been great and effective and almost all cultural and educational media were tightly controlled by the party state as effective tools for such ideological domination both in the state apparatus and in the civil society.

Third, the corporatist control employed by the party-state has been very widespread and powerful, occupying all organizational resources in different levels and realms of society.

Fourth, the most physical and direct political control of the party-state has been the presence of a highly penetrating intelligence system in almost every government, military, and social sector.

The above political mechanisms which the KMT state has possessed to maintain and strengthen its rule on Taiwan have had direct and indirect impacts on the economy and business as well.

Partly due to its ideological inclination and partly due to practical considerations, the KMT has established a material base for its political authoritarianism owed directly to a strong state party sector. Over the years, the financial connection between government revenue and the party establishment has always been an open secret. By such material endowments, the state could be in a more autonomous position vis-a-vis the private business sector. Moreover, through the economic bureaucracy, the state enterprises and the party corporations, the KMT regime could effectively coopt and integrate private business elites based on very different political considerations. It has absolute power in distributing almost all economic resources and profits by means of policies and measures. Since the 1960s, the KMT state has been able to develop a developmental coalition with the big private businesses first of Mainlanders and later of Taiwanese. The exchange of political loyalty and economic benefits and privileges has been the principle that has consolidated the state and big businesses.

Therefore, it is not surprising to find out that almost all big private businesses and their founders have one place or another strong ties with the state or the party. If not necessarily all political ties, the big businesses all have rendered their compliance and subordination to the authoritarian developmental state in order to maximize their business gains primarily from the domestic market that was protected by the state's industrial policies. And that is why in the past four decades under authoritarian rule, no big business ever challenged the state in any political way. As pointed out, the ethnic tension did exist between the Mainlander-controlled state and the local Taiwanese-concentrated big businesses, and for that reason, the Taiwanese capitalists were even more cautious to express any political opinions. And they are perfectly aware that as long as they have not gone overboard to challenge the state on political ground, they could be well taken care of by the equally sensitive state.

It is not to suggest that the consensual relations between the state and the big business was based on genuine trust and confidence. Rather the tension between the state and the business, and within the business, has been carefully managed in order to avoid any uncontrollable conflict. In addition, though the state held the official position of protecting the market for big business, to whom special privileges could be given was in the power of the state and the party bureaucrats. In that delicate situation, personal connection and network became very crucial and the cultivation of personal trust between business elites and political elites was a must for individual businessmen. The personalized business and state relations have further smoothed the potential tensions that could be caused by overt political control.

Pen's study of the "quanxi" (relationships, connections, and network) of Taiwan's big businessmen also found that the personal "guanxi" between the businessmen and the state elites or bureaucrats has been the base for the broadly defined political relations of the state with business. This was particularly evident among the the first generation big capitalists (Peng, 1989). Nevertheless, the long lasting state and business relationship is an imbalanced one with the state in a preeminent position. To put it in a more accurate way, the state has exercised the "paternalistic authority and dominance" over big business through which the dirigisme or the resulting governed market could be upheld and sustained until the recent political transition took place in the 1980s (cf. Chang, 1991).

One other important mechanism that has shaped the paternalistic authoritarian state-business relationship has been the state corporatist control in all levels of business associations. Such a corporatist control mechanism was effectively used by the party organs central to local levels to be responsible for supervision and surveillance. Within the private business sector, the national, provincial, and municipal trade associations were more or less the administrative or even party arms of the KMT state. The Department of Social Affairs of the KMT party headquarters has long possessed the decisive power in determining the outcomes in elections of key positions of the national trade associations such as the National Federation of Industries (NFI) and the National Federation of Commerce (NFC). Not coincidentally, the chairmen of these two trade associations, since their establishment have all been party members and all have been awarded posts in the Standing Committee of the KMT. Another cross-industrial and sectoral business association, The National Association of the Promotion of Industry and Commerce (NAPIC), has the same situation. This particular business association, organized in the 1950s, has been the forum for the big business elite and the key state economic/financial officials in the form of monthly breakfast meetings. Again, it also served the party's political purpose.

The NFI and NFC were in the hands of the Mainlander business elites before the 1970s, where as the NAPIC had Taiwanese business leaders in its governing body in the early 1960s. In a sense, the NAPIC was considered to be a corporatist mechanism for the KMT to integrate Taiwanese business elites (Hsu, 1991).

Up until the late 1980s, the three national business organizations all have been the effective structures for the state's mobilization and control over Taiwan's big business sector. The pattern of the state's monitoring system over business held the same in the provincial and local levels. In addition, the tax and intelligence branches were the bureaucratic arms to keep business in check when needed.

At the local level, state-business relations added another political dimension, i.e., the local political factions. The KMT has employed several mechanisms to coopt or demobilize the existing local factions that might present threats to the party state rule in the localities. These means all shared one common character, that is, to distribute local economic resources and economic rents to the factions in a differential way (Chu, 1989).

The first mechanism was through arbitrary permission based on political consideration for specific factions to dominate certain local economic activities like local bank branches, credit and cooperatives, producers' cooperatives, credit departments of farmer and fishermen's associations, and local bus transportation. One statistic has shown that among 89 country-based factions, 81 factions owned at least one of the above regional monopoly activities.

The second tool the state used was through privilege loans granted by public banks. Almost all provincial assemblyment could access such privilege with the party state's permission. The third one was by means of contracts for public construction at the local level, and by which the local factions could maximize their gains. The fourth means was to benefit particular factions with a windfall profit under the guise of legal or administrative procedures such as city planning or public infrastructure projects. Many land speculation schemes were, in fact, the common practices by which the local factions and political entrepreneurs could engage in exchange with the local or even the central party state bureaucracy. One last scheme was that the virtually illegal economic activities were protected by the local government and party.

One of the political consequences is that those local factions and political entrepreneurs grew bigger and stronger under the state's patronage at first and later became a direct threat to state's legitimate rule if the prices were not considered right by the factions. Toward the end of the 1980s, the growing tension between the state and the local factions and the local economic interests has increasingly become a constant problem for the party to negotiate and even comprise at every election. In other words, the clientel that the KMT has relied on to deepen its domination at the local politics level via economic rewards distribution has been challenged by the empowered local political entrepreneurs when the overall authoritarianism was undergoing a transition to democracy at the national level. However, the tension was not necessarily democracy driven, rather, in most cases, it only reflected the ambition on the part of local factions to move upward to the national political arena.

What happened to those small and medium enterprises who have been, for the most part, excluded from the political economic interests bloc that protected the domestic market for big business and local political factions? As discussed in great length in the previous section, the small and medium entrepreneurs turned to the foreign markets for economic opportunity and prosperity such as existed in the world economy. The state policy did provide incentives for boosting exports and the resulting gains for the export sector, but it did not offer a deliberately favorable political environment for any particular enterprises to receive special privileges as it did for big business. The state also did not develop any sophisticated mechanism to integrate the small and medium businesses into corporatist structure as it has done for big business. Furthermore, the small export business has not been assisted by the state and public banking system when financing was in great need, and all risks in entering the unknown world market were their own.

Without any elaborate state support or political blessing, the small and medium businesses then turned to the traditional networks, which existed in families and interpersonal relations for help in their business endeavors.

The widespread family enterprises within the small and medium business sector, thought dynamic and flexible in their response to the changing world market situations, have been limited for growth and expansion by such hands-off attitudes of the state. The outcomes of the small and medium enterprises geared for foreign markets has been very impressive. But the remarkable outcome should not be misconceived as proof of the state's "correct" free market policy for Taiwan's economy. As analyzed in detail above, the state is by no means a free market follower in its deliberate intention to govern Taiwan's domestic market. It also led to what Hamilton has praised in Taiwan's state-business relations as a "strong society model" where the state has been "letting the people prosper" (Hamilton, 1988). What should be qualified about Hamilton's assertion are the following:

First, under the authoritarian corporatism, the civil society in general or business in particular has never been strong vis-a-vis the state. Even the dynamic small and medium enterprises later developed into a "strong" private sector and relatively free from the state's heavy control, still can not be taken as supporting evidence. It was an unintended result and not the state's intention in the first place. Furthermore, in the course of export development, the small and medium enterprises were in no way in the position to be termed "strong" in facing state bureaucracy.

If the business enterprise model is used to exemplify the "strong" traditional networks of family and "quanxi" ties, and to justify the functional aspects of such social and cultural foundation, one still should recognize the fact that the authoritarian and yet paternalistic state-business relations have, in fact, perpetuated the enduring traditional business practice and culture. For both big and small businesses alike, the KMT state has not been notable for its hospitality and they have developed a well-justified wariness and a well-honed set of defensive weapons to ensure their business survival in an uncertain and unkind political world (Redding, 1991). In political circumstances, the family and the close ties are the first and last resorts, and to the small and medium businessmen the only resort for capital needs and management.

Second, the KMT state would let business prosper if the business rendered its political loyalty for economic gains. In big businesses, it is particularly evident. In small businesses, the state let them prosper from the world market rather than the domestic market as the state has protected that for its big business clients. Such "letting small businesses prosper" in the foreign markets is because the state has been preoccupied politically with the domestic market and opened a door for the politically weak small businesses to compete in the world economy without guaranteed risks. The large numbers of small and medium enterprises have indeed prospered and made Taiwan is miracle possible, but it can not be attributed solely to the state's genuine pro-small business ideology or strategy.

The most striking nature in the relations with the state for the small and medium enterprises has been its much less political calculation in the interaction than the state-big business relations. The small exports manufacturers and firms, in their contacts with the state, were more on the bureaucratic level than on the political level, and they have very loose and indirect relations with the state. In the eyes of the KMT state, the scattered small scale businesses oriented to economic opportunities outside of Taiwan constituted a very little if not non-existent threat to the regime. Therefore, the state has not paid much serious attention to those trade associations organized by small and medium entrepreneurs.

Being alienated from state political connections, the small and medium enterprises, for their business survival and development, turned to the other two networks for the necessary resources. This first is the family (kin) network and other affinity and ties based on the "tung" (sameness) such as class mate, coworker, provincial origin, same local origin, and same surname, etc. The other kind of network is marketing links with foreign corporations. The OEM arrangement based on subcontracting at the local production unit has been the msot popular link with the world markets through US buyers like K-mart, Sears, J.C.Penny, H.P, T.I, IBM, etc. and the Japanese multinational enterprises. The Japanese marketing firms have been playing crucial roles in arranging and controlling Taiwan's exports, estimated in the range from 33 to 50% (Lin, 1989). The major Japanese trading firms that have operated in Taiwan include Mitsubishi, Marubeni, Mitsui, and Beisei. The profits of the US buyers and Japanese traders from Taiwan's low export prices of products have been significant but, on the contrary, the Taiwanese small producers have actually gained low profits and have been dependent on the foreign companies for world market links.

In other words, beneath the glorified picture of the dynamic small and medium export sector that has been ignored by many official statements and economists' accounts is the marginalized political role of this sector unsupported by state credit policy and exploited by multinationals, self-perpetuation of traditional business practices, dependence on high-interest informal money market, and self-exploitation of themselves and their families. In the final analysis, under the "dual market structure" lies a "dual power structure" in which small businesses have engaged in "mutual exploitation" with other disadvantaged, groups such as farmers and labors, where big business and local factions with strong economic interests have exerted more and more influence on various levels of the state's decision-making bodies.

IV. Transformation and Future Prospects of State-Business Relations

After almost three decades of authoritarian, paternalistic yet protective, state-big business relations, the "interests bloc" of the two important political economic sectors has been consolidated and strengthened in Taiwan's social structure. Behind such consolidated state-big business relations was the growing politicial influence of big business interests on the state's decision-making processes through direct and indirect means. It has been becoming more evident since the 1980s when political liberalization and organized social movements began to take shape. It should be added that the increasing pressures presented by big business on the state would realize anyway as the situation was derived from the spread effect of accumulative capital. However, as state authoritarianism was greatly affected by the demands of political democratization originating from the larger civil society, the growing political influences from big business have become much more visible and intensified (Hsiao, 1992b). In other words, the consolidated state-big business relations in the 1980s also witnessed an unprecedented transformation.

The most noticeable indication of the increasing visibility of direct business participation in Taiwan's politics can be found in the active growing involvement in national elections by the capitalist class from the 1980s. The increasing number of seats held by the business elites in Taiwan's law-making body, the Legislative Yuan, has been most significant. As Kuo (1991) has demonstrated, based on the calculation of the class origins of the candidates and the elected Legislative members from 1972 to 1989, in sharp contrast to the working class and the middle class, the capitalist class has occupied more and more seats over the past two-decade period. Though the percentage of candidates with chief employer backgrounds had been stable (21%-25%), the percentage of the elected seats controlled by them was noticeably increased from 19.4% in 1972 to 30.6% in 1989. Kuo's study further shows that if the chief employers, the proprietors and other big businessmen, are grouped together as the capitalist class, then more than 45% of the current Legislative members represent capitalist interests in 1989. Moreover, there is a great increase in commercial and financial capitalists holding seats in this law-making body, while the number of manufacturing industrialists remained about the same. As discussed above, the empowerment of the Taiwanese business class was also reflected in the changing ethnic composition of the Legislative members since the 1980s. Finally, the KMT has been much more inclined to endorse capitalists and big businessmen as party candidates for various elected posts int he 1980s.

Moving from the central level politics to the local political arena, according to Chen's class analysis of the provincial assemblymen between 1968 to 1985, the capitalists and top executives from both private and public enterprises constituted as high as 75% of all the seats. If further demonstrates the over-representation of this class' interest even in the provincial law-making process (Chen, M.T., 1990). Such an observation can also be supported by another calculation on the occupational backgrounds of both provincial, country, and township councilment who were elected in the 1970s and the 1980s (Chen, S.F., 1988).

Therefore, it is quite evident to conclude that under the authoritarian paternalistic state rules, Taiwan's businesses (especially the big ones) have been fostered in great number and gradually have been moving to participate in all levels of politics. The big businessmen have concentrated their political influences at the central level, with the local factions with strong business -economic links at the local level. As for the large number of small and medium entrepreneurs, over the years they had been virtually excluded from the political process at the central level, though some did get involved in local politics. Compared to their big business counterparts, the small and medium businessmen were in the peripheral position outside of Taiwan's domestic political mainstream.

With more and more visible and stronger representation in the central level political decision-making process, big business interests have been further well protected and even promoted exceedingly at the expense of other social and public interests. Since the 1980s, a number of state industrial and financial policies or laws were made in favor of big business interests and others were even blocked or deferred under the great influence of those legislative members on behalf of the big businesses. The former cases included: the Ministry of Economic Affairs' new policy change (1984) in the code regulating textile exports was resisted at first and later modified in great extent in the interest of protecting the vested interests of those big textile industrialists, and the Ministry of Finance decision (1989) to recollect the tax on stock exchange profits again received a strong setback by the "stock Legislative members" and finally the Ministry receded to reduce the tax rate from the originally planned 1.5% to only 0.6% in order not to upset the ever-expanding financial capitalists (cf. Kuo, 1991).

The latter cases included strong resistance by the capitalist interests in the Legislative body to the state's decision to enact the Consumer Protection Law, the Environmental Protection Law, the Fair Trade Law, and the Environmental Impact Assessment Act. Though the Fair Trade Law was finally passed in 1991 after more than ten years delay in the Legislative Yuan, the other three are still pending as they were perceived by many elected capitalist members to be threatening to business interests.

Even to the already enacted Fair Trade Law, the big business interest groups still take a wait and see attutide. The social economic objectives of this law are to regulate big business practice and to avoid or minimize the social inequality caused by the over expansion of business conglomerates. However, to the big business elites, the state companies and party enterprises with heavy state protection and special political privileges should first be regulated in a more vigorous manner. In other words, a certain degree of resentment is shared by the business elites towards the state's "anti-business" sentiment by enforcing this law. Certainly, such negative attitudes are not shared by the larger non-business population.

What has been observed is the seemingly weakened state in making autonomous policy decisions vis-a-vis the big business interests. and the state is forced to compromise with the pressures from the once subordinated business sector. The Legislative Yuan, the highest law-making body in Taiwan, has been increasingly controlled by many elected capitalist members in making decisions on economic and financial matters, as the business and capitalist interests have pretty much dominated the Economic Committee and the Finance Committee of this body.

The liberalization of the authoritarian KMT state as demanded by the political opposition and social movements since the 1980s has already transformed the state from hard authoritarianism to soft authoritarianism. In the process of adjustment to the proper role and function of the state bureaucracy, the old rule of the game is no longer useful for the state to govern the civil society at large. When the state began to adjust itself to be more responsive rather than being domineering in facing various and often conflicting demands from the civil society, the powerful interests groups usually could take more advantages from the "puzzled" state at the time. And it has been the case of the transformed state-business relations since the 1980s.

To put it more critically, it was the non-business sector of the civil society and the opposition in the political society that forced the authoritarian KMT to liberalize, yet it is the big business and capitalist interests which have benefitted the most financially from political liberalization. The Big business has protected its gains in the domestic market under the authoritarian rule, and again, during the liberalizing and democratizing episodes, big business is also better equipped to exploit the situations to either minimize the loss or maximize the possible gains. Sad to say, under both the authoritarian and the democratizing regimes, it seemed that the big businesses could not lose.

But the small and medium enterprise have not been so fortunate in the course of political transformation. In the 1980s, the export manufacturers have faced many internal developmental problems like labor shortages, raising labor costs, and escalating land prices. They also experienced external threats from the Southeast Asian manufacturers, competition and the protectionism from the west, and finally competitiveness in the world market has been reduced further because of the valuation of Taiwan dollars since the mid-1980s. The official policies adopted by the state to deal with the development problems included industrial restructuring from labor-intensive to capital-intensive and high-tech industries, diversification of trade in the world market, and transferrence of laborintensive industries from Taiwan to the Southeast Asian region. However, these policies could not solve the immediate and desperate problems that the small export producers and traders have confronted, that is, how to survive in business in the short run. To the small export manufacturing firms, the pronounced state polices were at the best long term solution to Taiwan's industrial development, but not a workable and effective remedy for their very survival difficulty. In other words, during the bad times since the 1980s, to the small export manufacturing businesses, the state still did not render much quick and substantative help. they had to, once again, rely on their own efforts to survive.

As they had done in the 1960s and the 1970s to take chances in the foreign markets for exports, in the 1980s, they took risks again to explore the labor market in Southeast Asia and Mainland China for their own survival by transferring or expanding their production operations there. In Southeast Asia, it is the traditional Chinese network and not state assistance that helped their business opportunites. In Mainland China, as such trade and investment of Taiwan's businessmen with the Mainland in the early 1980s was legally prohibited, the small and medium entrepreneurs risked their property and the danger of punishment by the KMT state. They were the first group to engage in "unofficial" economic relations with the Mainland. The self-made spirit, the quick response to the new opportunities, and the daring to risk have, once again, helped the small firms make in the "foreign" markets outside Taiwan.

In the late 1980s and the early 1990s, the KMT state then endorsed, though reluctantly, a series of more open policies toward Taiwan's trade and investment with Mainland China. The state finally recognized the reality of active Taiwanese trade and investment on the Mainland and further modified its Mainland policy in a pragmatic direction. A cabinet level Mainland Affairs Council was established and a semi-governmental Straits Exchange Foundation was formed; both are responsible for future policy-making and implementation at official and civilian levels. The Straits Foundation is charged by the KMT with a mission of "front line" contact with PRC officials in dealing with civilian and business disputes that have occurred or might occur in the future.

In reprospect, behind the changed Mainland policy of the KMT state, in large part, were the big capitalists' initiative and pressure (Hsiao and So, 1992). It was only after big business entered Mainland investment and developed vested interests there, and only after they had begun to exert pressure on the state through various effective channels, that the state shifted its Mainland policies to more pragmatic ones. President Lee Teng-Hui, unlike the late Chiang Ching-Kuo and his father Chiang Kai-Shek who held anti-capitalist (business) ideology, is known for his favorable attitudes toward business, and he has a list of close Taiwanese big business friends. He often consulted them on many economic issues, and trade and investment policies on Mainland China were certainly the main concerns in those days. Besides this direct influence on the president from the big business interests, the Legislative Yuan also served as a source of pressure on the state officials through those elected capitalist members demanding more liberal and open trade policies towards the PRC. The close relationship between the KMT and big business on the Mainland issue was also revealed by the fact that many influential capitalists are the donors of The Straits Exchange Foundation and serve as board members.

The small and medium enterprises initially opened the Mainland market at their own political risk and made the profit reality known to big business, and later big business followed with greater financial and political power.

Under the more flexible Mainland policies, though the small manufacturers also benefitted, they now have to face competition from their fellow big businessmen on the Mainland for labor and raw materials that could be taken away by the financially powerful big business operations. Furthermore, they also worry that their existing privileges to do business on the Mainland by means of informal means like many back door tactics, may disappear once the communications and relations between the two sides are officially institutionalized as is being actively pushed by the big business interests.

It is not unknown that some Taiwanese manufacturing investors in southern China were either killed or kidnapped for financially related reasons and what the state in Taiwan could do so far to help or to prevent this was limited due to the unclear political relations between the two sides. So there are some "self reliant mutual aid associations" organized by Taiwanese small and medium businessmen in different localities of southern China where Taiwanese capital is concentrated (*China Times Evening Post*, March 17, 1992). What has been seen in Taiwan's small and medium entrepreneurs' struggle for survival in the past three decades of export drive was constancy and persistence. Without much assistance and special privilege given by the state, Taiwanese small businesses survived various crises, and they have doen it by themselves. They could not, as the big businessmen had usually done, ask for help from the state authority. As constrained or inspired by the unfavorable state-small business relations, they had to be prepared for any possible crisis internally or externally. They were in no position to exert any substantative pressure on state actions either an individual capacity or in collective action. By and large, to most small and medium enterprises, political liberalization so far has not improved their bargaining positions vis-a-vis the state power in any direct manner.

One should not, however, evaluate the overall impacts of Taiwan's political transition from authoritarianism based only on its repercussions on the state's relations with business. The weakening autonomy of the state's economic and social policy-making in facing strong and organized pressures from the big business interests did cause some alarming signs. To many concerned critics, the transformed state-big business relations to favor the later and at the expense of the general public interest was indeed the crucial factor in worsening the social inequality in Taiwan since the 1980s. It is not to suggest that the pre-liberalization state-business relationship was a better one. It simply points to the problem that the state has been trapped in the political economic setting that was created by itself in the past, and the costs incurred were then transferred to the society as a whole. The state, in its intention to bring big business back under its patron-client arrangements, has not only conceded in various policies to the big business interests but also engaged in a number of aggressive actions to win back business' political loyalty and support.

First, since General Hao Ber-Chung took power as premier in mid-1990 as the compromising political power distribution of the intra-party struggles between reforming and conservative factions and between Taiwanese and Mainlander ethnic lines, the state began to take tougher a position to respond to demands from the social movements such as the labor movement and the environmental movement that have threatened the business interests. Criminal codes were applied to suppress the activism brought about by the mobilized civil society in the forms of organized social protests.

Second, in order to win business confidence, the state insisted on going ahead with the controversial industrial projects that have been objected to and effectively halted for some years by the opposing environmental groups and local residents. The typical examples are the questionable industrial zone in central Taiwan, the China Petroleum Company's construction of the fifth Naptha Cracking Refinery in the South without having solved the serious pollution problems already in the local community, the Formosa Plastics Group's planned new petrochemical refinery in the southwest costal area, and the most debated fourth nuclear power plan to be constructed by the Taiwan Power Company in northern Taiwan. All these actions are an attempt to strengthen state power and to develop a new developmental coalition with big business.

Third, in mid-1991, the ambitious Six Years National Construction Plan was launched by the premier with a total budget of NT 8.2 trillion dollars (about US$ 3,600 billion dollars) with the dual political economic purposes of strengthening Taiwan's links with foreign capital and further tightening up the big business political connections with the state by sharing this newly created economic pie.

Fourth, in a more politically direct way, the party state began to search for a new coalition with the rising business elites who are either the successors of well-established big business or the emerging successful entrepreneurs in various business sectors including a few important electronic and computer manufacturers and exporters. The newly organized fourth cross-sectoral business association, the Association of Industrial and Commercial Development (AICD) is a good illustration. The members are the hand-picked participants in a KMT-sponsored business leaders training programme. The AICD is quickly emerging as an organized collective force on behalf of the rising business elites in addition to NFI, NFC, and NAPIC that are still controlled by the elder generation of business leaders. In a sense, the AICD can be viewed as an organized forum by the younger generation of businessmen to compete with the older ones for political influences. Since the AICD has a large number of successful medium exports businessmen as members, it can also be seen as a move to cultivate the domestic political market that has long been dominated by the big business establishments. The party state, on the other hand, certainly sees it as an opportunity to check the over-powerful big business interests. It is, therefore, important to see how the AICD will interact with the state power and how it will shape the future directions of the already changed state-business relations.

Fifth, besides developing a new alliance with the new business elites, the state also tried to restrengthen its political control over business by expressing its disapproval of some business support to the opposition Democratic Progressive Party (DPP) and its activities. In a speech to a group of important business leaders in September, 1991, Premier Hao warned his business audience in a rather coercive tone not to support the DPP-backed Taiwan Independence Movement. Though the overt political statement was later severely criticized by the DPP and public opinion, the intention behind such a political move can not be ignored.

So far, the increasing political capital possessed by big business backed by its accumulation of economic capital during the course of the political transition from authoritarianism to democracy has further weakened the KMT state's relative autonomy vis-a-vis the civil society. But the state, in responding to such an unprecedented challenge, has shown its biased attitudes in conceding to the big business interests on the one hand, and repressing the demands for further social and economic reforms made by the social movement sector in the civil society, on the other hand. It may be unfair to say that the liberalizing state has not relaxed its control over the civil society. By lifting various bans on civil organization, the press, and specific religious organizations, the state did respond to the demands of liberalization from society and has tried to be more responsive to the needs of various segments of the general public. However, what is at issue here is not the mere softening of the tight control on society, rather it is whether or not the state has redirected the sources for its political legitimacy to broader and more democratic bases. Essentially, the transition to democracy requires a reorganization of the overall state-society relations in a more balanced and egalitarian direction.

In this sense, the liberalization of the authoritarian KMT state was exploited by the transformed state-business relations to expand the political and economic interests of the big business and not for the general well-being social justice. The new kind of state-society relations has not yet been institutionalized and, unfortunately, the state has not shown any definite movement in this direction. Instead, the state took a different direction in still narrowing its political base to the business sector by either restrengthening its ties with big business or extending its coalition with the newly emerging business elites from the export sector. The even more crucial task and challenge to establish a genuine democracy in Taiwan by institutionalizing the broadened bases in the resurrected civil society certainly has not been met by the seemingly weakening state.

The emerging social movements, despite their primary objectives aimed at political liberalization, in calling for more social equality and economic justice, could serve to prevent the weakening state from being charged by the increasingly powerful big business interests. In other words, the emerging social movements not only press the state to loosen its control over society, but also demand that the state redirect its class and sectoral coalitions. The state could in a way develop a social coalition with the social movements as its backing to reshape its distorted relations with the big business interests.

The crucial taks before the KMT state at the present is to learn the new reality immediately. To organize and accept the unreversible trend towards democracy should be a precondition to the reformers within the political center in order to generate popular support and even to accelerate further democratization. As for future state-civil society relations, the state should identify the new social interest groups emerging in the different social movements and readdress the existing corporatist structures that have long been the licensed representational monopoly with their respective social groups such as farmers, laborers, intellectuals, business and the others. The existing limited numbers of hierarchical and subordinated corporatist structures under the previous authoritarian rule have been more and more alienated from their constituencies and have even become a target of opposition. In recognizing the new elements and social forces in different sectors of the mobilized civil society is to accommodate the demands from the social movements and to actively engage in a societal transition from "authoritarian corporatism" to "democratic corporatism." In such state-civil society relations, though the state does not assume unified state direction and control, the state still can assume a more autonomous position without being charged by one particular dominant class or powerful interest group.

This seems to be the most desirabl prospect for the future of Taiwan's state-civil society relations in which the state-business relationship is an integral part. To envision such a prospect, new government agencies should be established, old agencies should be either expanded or reorganized, and a new style of bureaucracy should also be fashioned. By so doing, the state then can effectively respond to the increasing social demands and interest articulation from the broader civil society and not just the big business class and make them compatible with long-term political democracy and social justice of society as a whole.

And only after this task or challenge is fulfilled by the state, can the internationally praised political liberalization be firmly guarded and lead to bona fide democracy in Taiwan.

References

Amsden, Alice, "Taiwan's Economic History", *Modern China* 5:3, 1979, pp. 341-379.

"The State and Taiwan's Economic Development," in Peter Evans, et al., (eds.) *Bringing the State Back in*. Cambridge: Cambridge University Press, 1985, pp. 78-106.

Asia's Next Giant: South Korea and Late Industrialization, Oxford University Press, New York, 1989.

"The Spread and Impact of Export-Oriented Industrialization in the Pacific-Rim, "*Third World Economics*, (Nov. 16-30 and Dec. 1-15).

Bello, Walden and Stephanie Rosenfeld, *Dragons in Distress: Asia's Miracle Economies in Crisis*, San Francisco: The Institute for Food and Development Policy, 1990.

Chang, Chia-Ming, "The Business-Government Relations in Post-War Taiwan, "*Journal of Sunology: A Social Science Quarterly* 6:1, 1991, pp. 13-34.

Chen, Ming-Tung, *The Mobility of the Local Political Elites under an Authoritarian Regime (1945-1986)*, PhD. Dissertation National Taiwan University, Taiwan, 1990.

Chen, Shi-Meng, et al., *Disintegrating KMT-State Capitalism*, Taipei Society Report 1., 1991.
Chen, Su-Feng, *The Social Mobility of the Elected Political Elites in Taiwan*, Master Thesis, Tunghai University, Taichung, Taiwan, 1988
Cheng, Tun-Jen and Stephan Haggard (ed.), *Political Change in Taiwan*, Boulder: Lynne Rienner Publishers, Inc., 1992.
Chou, Tien-Cheng, "The Small and Medium Enterprises in Power Periphery," in Hsiao, H. H. Michael et al. *Monopoly and Exploitation: The Political Economy of Authoritarianism*, Taipei: Taiwan Research Fund, 1989, pp. 97-118.
Chu, Yun-Han, "Monopolistic Economy and Authoritarian Political System, "Hsiao, H. H. Michael, et al., in *Monopoly and Exploitation: The Political Economy of Authoritarianism*, Taipei, Taiwan Research Fund, 1989, pp. 139-160.
Deyo, Frederic, *Beneath the Miracle: Labor Subordination in the New Asian Industrialism*, Berkeley: University of Califormia Press, 1989.
Gereffi, Gary and Donald Wyman (eds.), Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia, Princeton: Princeton University Press, 1990.
Hsiao, H. H. Michael, "The Farmer's Movement in Taiwan in the 1980s: facts and Explanations," *Bulletin of the Institute of Ethnology*. Academia Sinica, No. 70, 1991, pp. 67-94.
"Explaining the Taiwan Development Model: Lessons to be Learned," in Dalchoong Kim, et al., *The Role of Market and State: Economic and Social Reforms in East Asia and East-Central Europe*, Seoul: IEWS, Yonsei University, 1992a.
"The Rise of Social Movements and Civil Protests," in Cheng and Haggard (eds.), *Political Change in Taiwan*, op. cit., 1992b, pp. 57-72.
"The Labor Movement in Taiwan: Retrospects and Prospects," in Denis F. Simon (ed.), *Beyond the Economic Miracle*, Armonk: M. E. Sharpe (forthcoming), 1992c.
Hsiao, H. H. Michael (ed.), *The Middle Class in Changing Taiwan*, Taipei: Chiu Liu Publishing Company, 1989.
Hsiao, H. H. Michael and Alvin So, "Ascent Through National Integration: The Chinese Triangle of Mainland-Taiwan-HongKong" paper presented at the 15th Conference on "The Political Economy of the World System," Honolulu, Hawaii, March 28-30, 1991.

Hsiao, H. H. Michael and et. al. (eds.), *Taiwan: A Newly Industrialized State*. Taipei: Department of Sociology, National Taiwan University, 1989.

Hamilton, Gary and Nicole W. Biggart, "Market, Culture, and Authority: A Comparative Analysis of Management and Organization in the Far East," *American Journal of Sociology*, 94 (Supplement), 1988, pp. 52-94.

Hsu, Ruei-Hsi, "The Trade Associations under State Corporatism," paper presented at the Conference on "History and Culture in Modern China", ISSP, Academia Sinica, Jun. 12-13 1991.

Kuo, Liang-wen, *Capital Formation and Social Inequality in Taiwan*, Ph. D. Dissertation, UCLA, Lee, Bith-hain, 1991.

Lee, Bih-hain, "The Debate on Taiwan's Public Enterprises and State Capitalism," paper presented at the Conference on "The State and the Society in Democratizing Taiwan," March 7-8 Taipei 1992.

Lin, Chung-Cheng, "The Mutual Exploitation Cycle of the Underprivileged Groups under the Authoritarianism" in Hsiao, H. H. Michael, et al., op. cit., 1989, pp. 161-196.

Namazaki, Ichiro, "Networks of Taiwanese Big Business: A Preliminary Analysis", *Modern China*, 12:4 (Oct. 1986.), 1986.

Peng, Huai-Cheng, *The "Guarmxi" and its Transformation of Taiwan's Entrepreneurs*, Ph. D. Dissertation, Tunghai Univeristy, Taiwan, 1989.

Rudding, S. Gordon, *The Spirit of Chinese Capitalism*, Berlin & New York: Walter de Gruyter, 1990.

Shieh, Gwo-Shong, "Black-hands Becoming Their Own Bosses: Class Mobility in Taiwan's Manufacturing Sectors," in *Taiwan: A Radical Quarterly in Social Studies*, 2:2, 1989, pp. 11-54.,
"Network Labor Process: The Subcontracting Networks in the Manufacturing Industries in Taiwan," *Bulletin of The Institute of Ethnology*, Academia Sinica, No. 71, 1991, pp. 161-182.

Wade, Robert, *Governing the Market*, Princeton: Princeton University Press, 1990.

Wei, Chi-Lin, "The Relationship and Its Development of Taiwan's Big and Small-Medium Enterprises," *Proceedings of the Conference on The Relations of the Business, Government, and Society, Taipei, Institute for National Policy Research, 1991.*

Winckler, Edward Susan Greenhalph *(eds.), Contending Approaches to*

the Political Economy of Taiwan, Armonk: M. E. Sharpe, 1988.
Yuan, Chien-Fa, *The Expansion and Ascent of Taiwan's Business Groups*, Ph. D. Dissertation, Tunghai University, Taiwan, 1990.

The Role of the Government and the Private Sector in Economic Development: The Experience of Thailand

Somsak Tambunlertchai

I. Introduction

Thailand is a medium-sized country with an area of 514,000 square kilometres and a population of 57 million. The country's gross domestic product (GDP) in current prices, 1990, was estimated to be 2,051.2 billion baht, or 80.4 billion U.S. dollars. With a per capita income of US$1.413, it is classified by the World Bank as a middle-income economy. The country has, in recent years, received much attention from the international community. There have also been expectations that it will join the club of newly industrializing economies (NIEs) in the near future. The high economic growth in recent years, together with the rapid expansion of exports, has contributed to this new-found attention.

Thailand is essentially a capitalistic market economy where free enterprise predominates in most economic activities. But the the Government or the State has played an important role in fostering economic growth and development. The Government has not only carried out the classical functions of the State such as keeping law and order and providing necessary public goods, but has also steered the course of the country's economic and social development by its economic policies and strategies. The Government influences the decisions of private enterprises by its policy measures. A number of Government institutions have been created to help attain development objectives; there has also been direct involvement by the Government in economic activities in some areas which are traditionally carried out by the private sector in a typical market-oriented economy. There is, however, a general tendency for the Government to reduce its involvement in direct production activities while the role of the private sector tends to increase over time.

This paper presents Thailand's experience in economic growth and development over the last three decades, and distinguishes the role of the Government versus that of the private sector in the process of economic development. Following this introduction, Section 2 provides an overview of the country's past development experience. The different roles played by the Government and the private sector will be discussed in Sections 3 and 4. In Section 5, the last section, some major economic problems confronting the country are outlined and some concluding remarks on the role of the Government in economic development are made.

II. Overview of Past Development Experiences

Thailand is traditionally an agrarian economy in which the agricultural sector contributes significantly to GDP, employment and export earnings. In the past three decades, however, the Thai economy has undergone significant changes. The share of agriculture in GDP and export earnings has continually declined while that of manufacturing and services has considerably increased. The labour force engaged in agriculture has also declined over the years. But the structural change in terms of the labour force has been much less compared with the change in production and exports. In 1990, the agriculture labour force still accounted for 58.7 percent of the total labour force, while the share of agriculture in GDP and exports in the same year was 14.4 percent and 17.1 percent respectively. Studies on rural economic activities, however, reveal that a significant proportion of agricultural households are also engaged in a variety of non-agricultural activities, and part of the income of rural households is from non-agricultural sources (Akrasanee, *et al*, 1983).

Thailand's economic development in the decade immediately following the Second World War was characterized by the active involvement of the Government in manufacturing. A number of State enterprises were established to produce manufactured products, including cement, paper, sugar, gunny bags and a variety of consumer products. The State enterprises were relatively large in scale while private enterprises in the manufacturing sector were virtually all small factories or home industries, of which rice mills comprised a significant proportion. Other major manufacturing activities were saw-milling and the production of textiles and clothing, handicrafts and some simple household goods (Ingram, 1971, Chapter 12).

Since the 1960s there has been a sharp change in policy emphasis toward industrialization. The Government began to restrain itself from direct involvement in industries, but instead, concentrated on promotion of private investment by providing various investment incentives. The Government also spent a large amount of funds on public infrastructure. Particular emphasis was placed on the building of multipurpose dams and highways. The Board of Investment was established in 1959 to provide incentives to private investors in manufacturing while certain service industries and foreign investment inflows were actively promoted.

The annual average growth rate of real GDP in the 1960s was around 8 percent. The high economic growth was led by strong public sector investment in infrastructure together with the expansion of agricultural commodities and the rapid increase in private investment in the manufacturing sector, especially in import-substituting industries. The rapid growth of the economy was accompanied by noticeable changes in the structure of domestic production and foreign trade. In domestic production, a modern industrial sector came into existence as a result of increased private investment from both domestic and foreign sources. There was also a significant diversification of products in the agricultural sector, with a rapid expansion of cropping areas. Other economic sectors, notably banking and finance, construction, and trade also witnessed considerable growth and structural change during the 1960s.

Besides its rapid growth, the Thai economy also enjoyed substantial economic stability in the 1960s. The rate of inflation was kept below 2 percent per annum throughout the decade. Although Thailand suffered trade deficits every year since 1957, the country's balance of payments in the 1960s had a surplus for most years as capital inflows in terms of foreign aid and loans, direct investment, and service incomes more than compensated for the drain of foreign exchange. The Government was also able to finance its development projects not only from increased tax revenues as a result of economic expansion, but also from foreign aid and loans.

In the 1970s, the Thai economy continued to experience rapid growth and diversification. There was rapid expansion in manufactured exports during this decade. In the 1960s, agricultural products accounted for the bulk of the country's exports, while the share of manufactured exports was negligible. The share of manufactured exports rose from around 2 percent of total exports in 1960 to 10 percent in 1970. By 1980, the share of manufactured exports had increased to 30 percent. The expansion of manufactured exports has continued up to the present time, and manufactured products have surpassed agricultural commodities in the country's export earnings since 1985.

Despite the energy crisis and other external disturbances, Thailand managed to grow at an annual average rate of 7.9 percent in the 1970s. There were, however, more economic fluctuations in terms of growth and inflation in this decade. Following the first oil crisis, the growth of the economy decelerated in the mid-1970s, and the rate of inflation was at double-digit levels in 1973 and 1974. The deficit in trade balance also increased considerably. Although the economy was able to recover in the second half of the 1970s through a surge of public sector investment and the rapid expansion of manufactured exports, the average rate of inflation was much higher than the previous decade. Furthermore, the respectable growth was partly financed by increasing fiscal deficit and foreign borrowings, which led to a heavy debt servicing burden in later years.

Following the second oil crisis, Thailand entered the 1980s with a considerably slower economic growth. GDP growth from 1980 to 1986 averaged only 5.5 percent a year. The economy was also beset by a number of economic problems. Externally, Thailand was confronted by deteriorating terms of trade due to depressed commodity prices and increased oil import prices. Consequently, the trade deficit and external debt service burden increased substantially. Internally, the large budget deficit and rapid public debt accumulated since the mid-1970s constrained the Government's ability to finance economic expansion. The domestic financial sector also plunged into serious trouble. The decline in economic growth together with the sharp increase in the world's interest rate led to widespread failures of finance companies together with the collapse of illegal chit funds. All major economic forecasts during the 1984-86 period painted a gloomy picture on the future growth of the Thai economy.

Contrary to expectations, a dramatic turnaround in economic conditions emerged in the second half of the 1980s. Since 1987, economic growth has accelerated, export earnings have expanded, and foreign exchange receipts from tourism and foreign investment have increased significantly. Economic growth accelerated to double-digit levels during 1988-90.

Several factors have contributed to the economic upturn in recent years. These include the decline in oil prices and the recovery in the prices of agricultural commodities and the upturn of the world economy in the second half of the 1980s. The international currency realignments after the Plazza Accord in September 1985, together with the more flexible management of the external value of the Thai currency, have also contributed to increased exports of goods and services. More importantly, the acceleration of direct investment flows in recent vears have also been influenced by the changes in the value of major currencies. In response to the rising cost at home, resulting from the currency appreciation, more and more investors from Japan and Taiwan have come to invest in Thailand and to use the country as a base for export. Besides direct investments, inflows of investment in financial securities in the stock market have also increased substantially during 1988-90.

Thailand has continued its growth momentum in 1991. But the rate of growth has been reduced somewhat to 8.5 percent. Foreign investment inflows have also slowed down. The economic boom in recent years has created a number of problems for the Thai economy. The growing volume of investment has accelerated the demand for infrastructural facilities. Key infrastructure in various areas, notably transportation, communication and power supply have not been able to catch up with the increased demand, and constraints and bottlenecks have become more apparent. A shortage of skilled manpower, particularly in engineering, is another problem resulting from the investment boom in recent years. Ther is also concern for the increasing trade deficit which could constrain further the growth of the economy.

III. The Role of the Government

Despite being a market economy where the private sector plays a dominant role in determining what and how commodities and services are to be produced, the Thai Government has, in fact, played an important role in fostering economic growth and development in the country. However, judging from the size of Government expenditures or the share of Government investment and consumption in GDP, the magnitude of Government intervention in Thailand could be considered small compared with most other developing economies. Furthermore, the proportion of direct involvement of the Government in total economic activities also appears to be shrinking in recent years. In 1990, Government consumption and investment accounted for 16.2 percent of GDP. If the expenditure of various State enterprises were added, the share of the public sector in total economic activities could be significantly higher. However, it is believed that when expressed in relation to GDP, the share of public sector spending could be around only 25 percent in recent years.[1]

But the Government's involvement in the economy has, in fact, made a significant impact on the country's economic and social development. The roles played by the Government in Thailand are wide-ranging. Among the important roles of the Government are direct involvement in economic activities through various State enterprises; formulation and implementation of macroeconomic and sectoral policies which influence private investment decisions; formulation of development strategies and identification of priorities in economic and social development; provision of necessary public infrastructure and institutions for economic development; and fulfillment of a variety of functions relating to the long-term development objectives of the country, such as those on population control, education, health and sanitation, rural development, environmental protection, etc. In what follows, only a few examples in some of these areas are presented.

As mentioned earlier, there was much State involvement in the production of manufactured goods during the 1950s. The direct involvement of the State in the manufacturing sector was not based on the ideological beliefs of socialism.

Rathter it was a strategy of the Government to make a quick start on industrialization. It was also an attempt to reduce the domination of Chinese residents in Thailand in the process of industrialization.[2] However, the State enterprises soon ran into serious trouble. The operations of these enterprises were very inefficient, and corruption was believed to be widespread; most of these enterprises showed substantial losses in their business (Ingram, 1971, p. 281).

Following the change in the power structure of the Government in the late 1950s, the policy on industrialization was revised to encourage invest-

---

1. Public sector expenditure in Thailand was quite high in the early 1980s. During 1980-82, Government consumption and investment was around 20 percent of GDP. An estimate of consolidated public expenditures including Government consumption and investment, and recurrent and capital expenditures of State enterprises, was made by a World Bank mission in 1983. The consolidated public expenditure in 1980 was estimated to be 34.2 percent (World Bank, 1984, p. 65). But the World Bank report also noted that this estimate involved double counting in terms of GDP as both intermediate and final expenditures of the State enterprises were included. Government consumption and investment as well as State enterprise expenditures as percentage of GDP should be much less at present as private investment and consumption expanded very rapidly in the second half of the 1980s and particularly in recent years.

ment by the private sector, while the Government's direct involvement in production activities was reduced. The Government concentrated instead in providing the necessary infrastructure for industrial development. This policy is being continued at the present time. Currently, State enterprises are mostly those involved in the provision of public services such as electricity, public transportation, telecommunications and water supply. There are still a few commercial and industrial enterprises which are owned by the Government, but these State enterprises are relatively unimportant either in terms of their proportion in public investment or in comparison with the private enterprises in similar lines of business.

Like other developing countries, the Thai Government plays an important role in setting the strategies for economic development. The changes in industrialization strategies, for example, can be traced from the different national development plans. Thailand started economic planning in 1961. The first and second national development plans implemented in the 1960s stressed, among other things, the Government's intention to promote industrialization through private enterprise, and to extensively develop economic infrastructure on electricity, transportation and communication. The industrialization strategy during the 1960s was focused on import substitution. Import tariffs were revised serveral times to give more protection to domestic industries. The investment promotion law also gave high priority to import-substitution industries, including assembly activities using exclusively imported parts and components.

Promotion of foreign direct investment inflows has always been an important policy since 1960. Foreign investment projects under the investment promotion programme can enjoy various investment incentives such as income tax exemption at the initial stage of investment, and exemption or reduction of import duties and taxes on intermediate and capital goods. Although the incentives under the investment promotion programme have been revised

2. During the 1950s, people of Chinese origin residing in Thailand were still not sufficiently assimilated into Thai society, and they were the ones who controlled the big businesses in the country. In contrast, ethnic Thai citizens were mostly farmers, civil servants or those engaged in some traditional service activities. Leaders in the Government in the immediate post-war period believed that to achieve modernization and rapid economic growth, Thailand should be industrialized. And as most Thai people were not interested in entering into business, it was thus the duty of the Government to initiate the process of industrialization by setting up a number of State enterprises (Suehiro, 1985, Chapter 2).

several times, reflecting the changes in industrialization strategies, the policy of promoting foreign direct investment has not been changed.

The strategy of export promotion was set out in the Third Development Plan (1972-76). There was also an emphasis on the decentralization of industrial location. The investment promotion law was revised to give more incentives to export industries and those located in provincial areas. This policy of export promotion and dispersion of industrieal location has continued to be emphasized in various national development plans to the present time.

In the 1970s more attention was paid to small-scale and regional industries. There was a chapter for industrial adjustment aimed at promoting labour-intensive, resourcebased and export industries through rationalization of the incentive structure in the Fifth Development Plan (1982-86). An ambitious programme to develop industrial activities along the eastern coast of the country, including the development of petro-chemicals and fertilizer, was also initiated during the Fifth Plan period.

Although national development plans are important documents which specify the Government's policy emphases in different periods, it is worth pointing out that economic planning in Thailand is a kind of indicative planning which sets out a general guideline or framework of operations for the Government and the private sector. Being an open economy where foreign trade and investment play an important role, the growth and stability of the economy are inevitably affected by the world economic situation. In this regard, the Government is entitled to design policy initiatives which aim to solve immediate economic and social problems but are not included in the national plan. Presumably, these policy initiatives should not be inconsistent with the major objectives and strategies of the plan. In addition, certain policy measures specified in the plan may not be implemented and economic targets set may not be achieved as a result of changing economic circumstances. There are annual and midterm reviews to monitor the progress as well as the validity of various targets set out in the plans, and necessary adjustments are made accordingly.

Maintenance of economic stability has always been the main emphasis of economic policies in Thailand. The role of the Government in maintaining economic stability was highly visible in the difficult years in the first half of the 1980s. To curb high inflation resulting from the oil price hike and to respond to the high international interest rates, restrictive monetary measures were applied in the early 1980s. As the Thai currency (baht) had been tied to the U.S. dollar, the appreciation of the U.S. dollar in the first half of the 1980s substantially eroded the international competitiveness of Thailand's exports. The Thai baht was devalued (at around 10 percent) in 1981. But the rapid appreciation of the U.S. dollar, to which the baht was tied, soon offset the results of the devaluation. In November 1984, the baht was devalued again (by about 15 percent) and since then the baht has been tied to a basket of currencies, instead of being solely linked to the U.S. dollar. The Government also tried to limit public expenditure and foreign borrowing and started to encourage private sector enterprises to participate in large-scale infrastructural development projects, such as those in the Eastern Seaboard.

By the mid-1980s, when international oil prices and interest rates were reduced significantly, and as the Thai economy plunged into recession in 1985, the Government started to implement several measures including downward adjustments of dmoestic interest rates and oil prices, and upward adjustments of wages and salaries of civil servants and State enterprise employees to help boost the economy.

With the improvement of the economy as well as the Government's fiscal position, several measures on liberalization have been implemented in recent years. In 1990, Thailand accepted the obligations of Article 8 of the International Monetary Fund's Agreement to further liberalize foreign exchange transactions. In 1991, import tariffs on machinery and automobiles were substantially reduced. A value-added tax system has been introduced to replace the business tax system with a cumulative tax burden on different stages of production. The financial system has also been further liberalized to allow commercial banks and financial institutions to determine their interest rates without officially-imposed ceilings.

Wages and prices in Thailand have largely been subject to market forces without Government intervention. Since 1974, a minimum wage has been set and the minimum wage level has been adjusted upward many times. But the minimum wage legislation has not been strictly enforced and most small legislation has not been strictly enforced and most small enterprises have been paying their workers less than the legal minimum.

Price controls have rarely been imposed; although for some strategic products and services, for which the prices are politically sensitive, such as petroleum products, electricity and public transport, prices are determined by the State enterprises concerned and the changes are subject to Government approval. During the 1980s, the prices of oil and public utilities have been adjusted to be more in line with market conditions. Recently, the prices of oil have been allowed to float in accordance with the market mechanism without any government control. The price of rice, which is the main staple of Thai people, was subject to an export tax called rice premium for a long time. The rice premium was designed to obtain Government revenue, and later also served to curb excessive export and cushion the impact of world market prices on the domestic price. The rice premium has been abolished since the mid 1980s when the world rice price was low and since then has not been reintroduced.

Like other developing countries, there exist numerous public institutions in Thailand in charge of the provision of services and assistance to private businesses and citizens. These institutions are usually put under the jurisdiction of different ministries. The Ministry of Agriculture and Ministry of Industry, for example, have several divisions and institutions in charge of agricultural and industrial promotion in various aspects. There are also public services directed at supporting long-term development objectives such as those in the areas of education, health and social development. Most schools at the primary and secondary levels are run by the Government.

IV. The Role of the Private Sector

Although the Government has the mandate to design policies and strategies for economic and social development, it is the private sector that actually carries out most of the economic activities in Thailand. Since 1960, the Government has generally refrained from direct involvement in productive activities, and also supported private investment through the provision of infrastructural facilities, and public utilities. Over the last decade, due to the financial constraints of the public sector, private enterprises have been increasingly involved in infrastructural development projects which were previously solely carried out by the Government. Since the early 1980s, private sector enterprises, including foreign investors, have actively invested in the construction of industrial estates, deep sea ports, transport and telecommunications systems. In the last two years, the Government has approved a number of large infrastructural development projects, including installation of three million lines of telephones throughout the country, and the mass transit system in Bangkok, with exclusive private investment.

There have also been attempts to privatize some existing public enterprises by allowing private investors to hold shares in these enterprises through the sale of shares in the stock market. Another strategy used by the Government for privatization is to allow private sector enterprises to manage or operate some newly-constructed infrastructural or public service projects, such as the operations of the deep-sea ports on the Eastern Seaboard. But the Government's intention to privatize existing State enterprises and to allow private-sector companies to operate in certain activities which used to be under the control of State enterprises has encountered opposition from employees in existing State enterprises. They fear that they may lose their jobs or that other private enterprises in the same type of service may out-compete the existing State enterprises. State enterprise employees have traditionally dominated the labour union movements in Thailand. Following a military coup in February 1991, the power of State enterprise labour unions has significantly been reduced, and the opposition to the privatization attempt initiated by the Government could be lessened in the future. However, as a number of public enterprises are heavily in debt, it is possible that even if these enterprises are offered for sale to the general public, there may not be enough interest to take over the enterprises.

An interesting development since the early 1980s has been the co-operation between the Government and the private sector through the establishment of a Joint Public-Private Consultative Committee (JPPCC). The Committee is chaired by the Prime Minister with key Ministers in the Cabinet and representatives of the private sector associations as members. This Committee gives chances to members of the private sector to have frequent dialogues with the Government on various problems affecting their businesses. Members of the Chambers of Commerce of foreign countries in Thailand also have the opportunity to express their concerns and requests on various policy and administrative issues which affect their businesses in this Committee. The scope of work of the JPPCC has been expanded to regional and provincial levels, and various regional and provisional committees have been established.

As the economy becomes more outward-oriented and as the world economic environment changes rapidly, prompt reactions to emerging issues are necessary. The Thai Government has increasingly recognized the importance of private sector participation in economic policy-making. Since the early 1980s, private sector representatives have been made members of some important government boards and committees such as the Board of Investment (BOI) and the National Economic and Social Development Board (NESDB). Members of the private sector have also been invited to participate in the preparation of the national development plan.

Different Prime Ministers and their cabinet members were accompanied by members of the private sector to foreign countries on official visits over the last decade.

The Chinese community has played an active role in Thailand's economic development. The population in Thailand is predominantly Thai, with a Muslim minority in the South and approximately five million ethnic Chinese. However, most of these minority groups have now been fully assimilated into Thai society, and enjoy the same rights and privileges as the Thai majority. Consequently, there is virtually no social conflict among people of different races and religious persuasions. One notable feature in Thailand is the prominence of people of Chinese origin in commerce and industry, but almost all of them have now been accepted into the Thai business community. The utilization of the talents of these Chinese-Thai entrepreneurs could be an important factor for the successful development of the country's industrial and service sectors.

Besides the private sector, there is also an increasing number of non-governmental organizations (NGOs) operating in Thailand, involved in activities in areas such as population control, rural development and environmental protection. Most of these NGOs obtain funds from international sources, and they are operating on a non-profit basis. The activities of these NGOs have largely been consistent with the long-run development objectives of the country.

In addition, there are also institutions which have been created by Government initiatives, but do not operate as Government enterprises. An example of this is the Industrial Finance Corporation of Thailand (IFCT) which was established by a Government Decree to provide long- and medium-term financing to industrial enterprises, but the corporation has remained a privately-owned institution in order to ensure the efficiency and flexibility of its operations. Another example is the Thailand Development Research Institute (TDRI) which was set up in 1985 to conduct research on public policy issues. TDRI was to serve as a "think tank" for the Government and has had close association with the National Economic and Social Development Board (NESDB) which is the Government agency in charge of national development planning. But the research institute is an independent institute supported by funding from various sources, and is not under the control of the Government.

V. State Versus Market

From the experience of economic development in Thailand described in the previous sections, it is evident that the Government has played an important role in the economy, and Government or State interventions in economic activities are wide-ranging and extensive. However, economic policymakers in Thailand have generally been able to create an environment in which private entrepreneurial initiatives could be utilized to promote the country's economic growth, and economic activities could be carried out in a rather competitive environment. To be sure, many distortions remain in the economic system and there is also widespread "rent-seeking" activity both in the Government and the private sector. But the country seems to be able to maintain a reasonable level of macroeconomic stability and implement an incentive system which has been conducive to private investment. The intervention by Government or State, in general, has not seriously hampered the functioning of market forces. Entrepreneurs in the private sector can carry out their businesses in response to the economic incentives provided by the Government, and industries and services which are consistent with the country's comparative advantage could be developed over time.

Tracing the changes in the strategies on industrialization over time, one can observe the gradual correction of the distortions in the price system, first through the reduction of direct involvement by the Government in production activities in the 1970s and then through the transition from import substitution to export promotion over the last two decades. Although a number of import-substituting industries are still heavily protected by import tariffs even at the present time, the various incentives given to exporters since the early 1970s have been able to reduce the bias of the incentive system against export industries to some extent. The adjustments in the exchange rate have also worked to give a favourable impact to export industries.

But the free enterprise system in favour of the business sector has also created quite a number of problems which are undesirable for long-term economic and social development. Among the more serious problems is the disparity in income distribution. Although the real income of the majority of people has improved much as a result of rapid economic growth, there is evidence of increasing income disparity among residents in different economic sectors and among geographical regions. Despite rapid economic growth, there is still widespread poverty in the rural areas. It is estimated that in 1989 nearly a quarter of the country's population was still living below the poverty line

(UNDP, 1991, Table 17, p. 192).

In recent years, there has been increasing criticism that the Government's pro-market development strategies have benefitted largely the people in the modern economic sector and those residing in Bangkok and other urban areas, to the neglect of the welfare of the great majority of the population who reside in rural areas. For example, quality health and education services are still beyond the reach of low-income households in the rural areas. Thailand also appears to have the lowest level of high-school enrollment among the six countries in ASEAN, which implies insufficient Government attention and hence insufficient public expenditure on secondary school education.

While the Government has placed much importance on the private sector recently, the term "private sector" is not without qualification. Private-sector representatives in the JPPCC, for example, are exclusively those from relatively large enterprises. Industrial enterprises covered in the BOI promotion programme are also mostly large-scale enterprises, and numerous small-scale enterprises have not only been excluded from the official promotion programme, but have also gained little access to the various services provided by the Government (See, for example, Na-Ranong, 1990, Chapter 3).

As a rule, among the private sector enterprises, it is those who are relatively large in scale and who are in the modern sector, such as those in the financial or export businesses, whose voices can be heard by the policy-makers, while the smaller ones' interests are not being attended to. As in many other market-oriented economies, there is a significant degree of concentration of wealth within a few big business groups, and big-business families usually have significant influence in the country's policy-making process (See, for example, Suehiro, 1985, and Phipatseritham, 1987).

In Thailand, over 90 percent of the industrial enterprises are small-scale enterprises with fewer than 50 workers, and those with fewer than 10 workers, in fact, comprise the majority of the industrial enterprises of the country. Many of these small-scale enterprises are still using traditional techniques to produce simple products. These enterprises are now facing increased competition from several fronts and their survival is increasingly threatened. As Government services provided in industrial promotion are pitifully inadequate, it is very difficult for these traditional small enterprises to upgrade their efficiency over time.

Among the private sector enterprises, farm households are, on average, the poorest. Farmers in Thailand are not formally organized, and their voices are the least to be heard by policy-makers. As a matter of fact, in Thailand the term "private sector" has rarely been applied to farmers although they are the great majority among the private citizens of the country. The well-being of the farmers depends partly on the policies implemented by the Government, including those in the areas of irrigation, agricultural extension services and pricing policies on their inputs and outputs. As rice has been subject to heavy export taxation for a long time and agricultural inputs such as fertilizer and agricultural machinery are industrial products with some degree of tariff protection, the incentive system tends ot be heavily biased against the poorest households of the country (Siamwala and Setboonsarng, 1987).

With improvement in communication and better access to information, the income disparity among different social and economic groups could lead to increased frustration for those who are left behind in the process of economic development. More and more residents from rural areas are migrating to the capital city and its surrounding provinces to seek a better fortune, but many of these people are unable to find suitable jobs in the formal sector and have to be engaged in the informal sector of the urban areas. This, in turn, has created more slums and other social problems in the capital city.

Other serious problems confronting Thailand at present include the depletion of natural resources and the deterioration of the environment. Although the country is rich in natural resources, some of these resources are being quickly depleted. Forest areas have been reduced over time as a result of illegal logging and penetration of forest land by businessmen as well as rural residents. Fishery resources in the Gulf of Thailand are also being exhausted due to over-fishing. The country's natural environment is quickly deteriorating as a result of rapid urbanization and industrialization without proper planning and control of the environment. In Bangkok and its adjacent provinces where most industrial and other economic activities are located, the level of air pollution had been increasingly worsening. Environmental pollution has also spread to other major cities and some tourist spots. The Government has recently paid some attention to the environmental problem, but concrete action to protect the environment still seems to be lacking.

In the 1990s, Thailand will also have to face a number of challenges on the international front. These include increased trade protectionist sentiments in developed countries which are Thailand's major export markets; more intense competition from other developing countries which are also keen to promote their labour-intensive and resource-based exports; and rapid technological development which could lead to fundamental changes in comparative advantages among countries. To maintain a reasonable economic growth rate is by no means an easy task, and strenuous efforts will have to be made, among other things, for the development of human resources and the upgrading of the indigenous sector's technological capabilities.

The considerations mentioned above on various problems confronted by the country have not led to the conclusion that the Government should refrain from intervening in the economy. On the contrary, they point to the areas of "market failure" to which the Government has not paid enough attention, and intelligent intervening will have to made to correct these problems.

References

Akrasanee, Narongchai, *et al*, *Rural Off-farm Employment in Thailand*, Bangkok: Industrial Management Company Limited, 1983.

Akrasanee, Narongchai and Somsak Tambunlertchai, "Transition From Import Substitution to Export Expansion: The Thai Experience", in Seiji Naya and Adira Takayma, (eds.), *Economic Development in East and Southeast Asia: Essays in Honor of Professor Shinichi Ichimura*, Honolulu and Singapore: East-West Center and Institute of Southeast Asian Economies, 1990.

Ingram, James C., *Economic Cha Change in Thailand: 1950-1970*, Kuala Lumpur: Oxford University Press, 1971.

Na Ranong, Wattara, *Dissemination of Information and Provision of Services to Regional Industries*, Bangkok: Thailand Development Research Institute, 1990.

Phipatseritham, Krirkkiat, "Financial Power and Economic Policy Making," (in Thai) Paper presented at An Annual Symposium of Faculty of Economics, Thammasat University, 1978.

Siamwala, Ammar and Suthad Setboonsarng, *Agricultural Pricing Policies in Thailand*, Bangkok: Thailand Development Research Institute, 1987.

Suehiro, Akira, *Capital Accumulation and Industrial Development in Thailand*, Bangkok: Chulalongkorn University Social Research Institute, 1985.

Tambunlertchai, Somsak, "Economic Prospects and External Economic Relations of Thailand," *Asian Development Review*, Manila: Asian Development Bank, 1989.

United Nations Development Programme (UNDP), *Human Development*

Report, New York: Oxford University Press, 1991.
World Bank, *Thailand: Managing Public Resources for Structural Adjustment,*Washington D.C., The World Bank, 1984.

The Role of the State and Market Mechanisms in Malaysia

Anuwar Ali

I. Introduction

This paper will basically highlight the role and the size of the state in Malaysia, particularly during the last two decades; and this will be examined within the planning framework that the Malaysian Government has set to achieve its development objectives, generally within the context of the country's Five-Year Plans. Although the Malaysian economy is market-oriented, it must be noted at the outset that the state does "plan" through a series of Five-Year Plans, in which the state sets its principal objectives and targets that are to be met within each of the said periods.

However, within this broad planning perspective, the role of the private sector has always been duly emphasised within a market-oriented system. In this sense, some have regarded Malaysia as a "planful society" with a mixed economy where private enterprise predominates but the state plays a significant role (See Higgins, 1992, pp. 148-183).

In spite of the country's historical background, it may be more useful to examine the "new" role of the state within the context of the important political-economic changes that have been experienced during the last twenty years. A among the most significant landmarks in the country's development planning process was the introduction of the New Economic Policy (NEP) that was initiated to encompass a planning period of 20 years; i.e. 1971-1990. Undoubtedly, much of the policy debate in this country during the last two decades has been focussed on matters related to the implementation of the NEP. Now, the NEP has come to the end of its planning period and has been replaced by the National Development Policy; although, in terms of the major policy thrusts of the state, there has been only a minimal change of focues.

While the implementation of the NEP necessitated active state participation in a wide range of economic activities, the state was, nevettheless, operating within the framework of the market system which focuses on the role of private cpital. In *Section II* we shall thus examine the relationship between the role of the state and market mechanisms in the economy. The awareness of the importance of market mecahnisms on the part of the state means that it has, at all times, to respond positively to changes emanating from internal, as well as external, factors. These policy responses are certainly an integral part of the role of the state, and they therefore, deserve special mention; these will be examined *Section IV*.

In this paper, we shall also assess the performance of the state and examine its impact on the development process, especially during the implementation of the NEP as it has had important repercussions on the pace of economic development in Malaysia. This will be done in *Section III* where we shall examine the leading role of the state in the implementation of the NEP during the last two decades.

And finally in *Section V*, we shall extropolate whether the role of the state will become increasingly significant or otherwise. It is equally important to indicate the extent of its future involvement in economic activities and assess its priorities during the next decade of the country's development, especially in the context of the numerous challenges that Malaysia has to face during this decade.

II. The State Within A Market-Oriented Economy

Since the country's Independence, the Malaysian economy has been based on a "laissez faire" system in which the allocation of resources is chiefly dependent upon the decisions of the private sector according to price signals emanating from the market mechanism. In a sense, the activities of domestic capital are not restricted in any way, thus allowing it to be invested in areas where profits are expected to be maximized. In such an economic environment, during the early 1960s there was a substantial amount of investment being channeled into the tin mining and rubber growing sectors, and given that these were the main foreign exchange earners for the country during that period, economic growth was mainly propelled by these two sectors.

But, international patterns of trade do change, and such changes affect the export capacities of developing countries like Malaysia which are principally dependent on primary produts or resource-based activities. Being an open and export-oriented economy, Malaysia had to respond to these changes such that by the end of the 1960s, there was a compelling need for agricultural diversification and increased industrialisation. In this case, the state has to play an important role by providing the appropriate signals to the private sector or providing the policy thrusts which must be responded to by the private sector.

While the basic fundamentals of the Malaysian economy are oriented towards the market mechanism, the reliance on market forces alone is not sufficient to ensure sustainable growth and development such that, since Independence in 1957, the state, while relying on the private sector to provide the growth momentum, has been playing an affirmative role in providing the appropriate environment through various policy instruments and also through active participation and direct involvement in economic activities. This has been more apparent during the last two decades.

Throughout its thirty-four years of independent history, the country has witnessed the changing role of the state, to a large extent a reflection of the changing needs of the time. As implied earlier, during the 1960s, the role of the state was principally confined to providing the appropriate macroeconomic policies to generate private sector investments. At the same time, it was also largely responsible for providing basic infrastructure and public necessities including education, health, water and electricity.

It was during this period that the country began its industrialisation programme in earnest. To a large extent, it was left to the private sector to initiate industrial projects. But since domestic capital was very weak and had little expertise in manufacturing technologies, it was foreign capital that came in actively to these activities. However, during this import-substitution phase of the country's industrialisation programme, the state had to ensure that these industries were protected and thus high tariff walls were erected to insulate these industries from foreign competition. Without this kind of initiative, it would certainly be more difficult for developing countries like Malaysia to embark on an industrialisation programme. (See Hoffmann & Tna Siew ee, 1980, pp. 56-67).

It was within this framework that the private sector operated; the state principally played the role of a facilitator to encourage investments by the private sector. The mobilisation of the country's capital resources was left mostly to the private sector to channel them to the most profitable areas. Until now, this facilitating role is certainly one of the most significant influences in ensuring sustained growth in the economy.

During the 1970s and the 1980s, as we shall see later, the role of the state underwent numerous changes, some in subtle form. This was largely influenced by the political changes that had their beginnings in the late 1960s. But it was also a period which experienced tremendous changes not only in terms of the country's economic transformation, but also, equally significant, in terms of the increasingly conspicuous role of the state in directing the economic transformation itself and in its direct involvement in an array of economic activities.

Like any other developing country, the role of the state must be viewed within a boader socio-economic framework. Given Malaysia's colonial history and the multi-ethnic background of its population, the domestic scenario is invariably beset with a number of socio-economic cleaveges in society which are manifested through inter-ethnic income disparities, rural-urban differentials, and inter-state or regional imbalances. This had been perpetuated by the colonial structure of production that was reinforced by the dualistic economic structure which separated the indigenous population from the immigrant population, leaving the former principally in the traditional peasant sector while the largely immigrant Chinese community was in the modern urban and commercial sectors.

In whatever way one translates these differentials or imbalances, the ethnic disparities seem to dominate the developmental process, whether in terms of politics, economies or social development. (See, for instance, G.P. Means, 1991, p. 310). In this sense, the state's role appears to have its own uniqueness; and, in the last decade, this has become more significant in a country like Malaysia which seeks to develop its economic base and transform such a base from one that is agro-oriented to one with a larger industrial base.

The market-orientation and "openess" of the Malaysian economy has a long historical background dating back to the pre-colonial days when the then Malay States were a focal point of trade in this part of the world. This entrepot trade was expanded during a succession of colonial dominations, with the British coming in strongly during the late 18th Century which also heralded a new period of economic subjugation of the Malay States until the country's independence in 1957.

It was during the British colonial rule that the country's production structure was moulded, where British interests dominated the major export sectors leaving the Chinese population mainly in the business and commercial sectors. This was left almost intact when Malaysia gained Independence so that foreign interests, mainly British, were dominant in the mining and plantation sectors, the mainstay of the country's export structure.

While Jesudason (1989, p. 36) observed that colonial rule brought a great deal of economic dynamism to the country, he also noted that there were two critical problems arising from such rule. First, the manufacturing base was rudimentary, and, second, the development of Malay commerce and industry was miniscule. According to him, "in large part, both resulted from the colonial government's practice of subjecting economic development to market forces as much as possible, avoiding any project which would not pay commercially or incur a large government deficit."

III. The State's Affirmative Strategy During the NEP

The political aftermath of the inter-ethnic conflict in 1969 saw the introduction of the New Economic Policy, which coincided with the launching of the Second Malaysia Plan (1971-75). Unlike the earlier First Malaysia Plan (1965-70), the thrust of the new plan implied a more assertive role of the state in achieving its development objectives. With regard to this, Lo Sum Yee (1972, p. 91), observed that "maximum economic growth alone was not enough and an overall review of development needs together with a reappraisal of the concept, approach and method of economic development in the light of national unity was necessary. In short, maximum economic growth from henceforth has to compete with racial and political harmony as a paramount priority."

The two-pronged objectives of the NEP, i.e. to reduce the levels of proverty by raising income levels and increasing employment opportunities for all Malaysians and to restructure society so as to correct economic imbalances with a view to reducing and eventually eliminating the identification of race with economic functions, became the underlying goals of the state for the next twenty years.

The need to reduce the incidence of poverty and the process of restructuring society involves the modernization of rural life, the rapid and balanced growth of urban activities and the creation of a viable Bumiputera (indigenous people) Industrial and Commercial Community in all categories of enterprises and at all levels of operation so that they will become real and effective partners in all aspects of the economic life of the nation. Underlying this process is the implicit need for Malaysia to achieve a high level of economic growth to ensure that none of the enthnic communities will be deprived of the benefits of development.

The achievement of these two crucial objectives would certainly require substantial state efforts to ensure that the planned programmes were effectively implemented. Thus, according to the Second Malaysia Plan (1971-75),

There were two crucial components of the state's initiatives: the first, was to formulate policies or strategies that were in line with the need to enhance the activities of the private sector. In this sense, the state's policy-making framework had to be strengthened, ensuring that policies were constantly reviewed and assessed to reflect the ever-changing economic conditions. The second aspect related to the state's "direct involvement" in economic activities to ensure that the restructuring of the Malaysian seociety was achieved, so that the Bumiputera's share in economic activities would be enhanced.

The state's direct involvement in economic activities meant that there was an increase in public expenditure allocation for such activities. Most of these activities were undertaken through the creation of public enterprises. Consequently, during the 1970s, there was a proliferation of public enterprises, involving many economic activities including manufacturing and agriculture, urban development, business, banking regional development and others. According to UNIDO (1991, p. 39):

During the 1972-90 period, total investment in the economy, in fact, increased rapidly at the rate of 9.6 percent annually, while the total investment ratio to GNP in real terms reached 31.5 percent in 1990 compared with the projected figure of 22.3 percent by the First Outline Perspective Plan 1971-90. The largest increase in investment was brought about largely by singnificant increases in public investment which grew by 10 percent per annum during the period. At the same time, private sector investment expanded by 9.4 percent annually, and this picked up more strongly after 1986 so that by 1990 its share in total investment rose to 67.3 percent (Malaysia, 1991, p.38)

Despite the crowding out of some of the private sector concerns, resulting from the increased activities of the public enterprises, there was somehow a balance of interests which was characterised by a high level of growth during the 1971-90 period. In fact, by most international standards, the country achieved a reasonably high growth rate of 6.7 percent during the twenty-year period, so that income levels of the population were accordingly enhanced.

However, economic growth within a market-oriented economy had its own negative consequences. For instance, according to Yoshihara Kunio (1988, p. 91), while this has created a large number of government-connected capitalists, "the NEP enabled well-connected Malays to get rich quickly; and as a consequance, Malays who aspired to be capitalists expended much effort on establishing such connections and using them for business advantage. This in turn affected the business ethics of Chinese capitalists. By working closely with Malay capitalists or politicians it became possible to make a large sum of money-an accomplishment that would take decades even for the most successful Chinese capitalists before the NEP."

Despite such a negative impact, the domestic economy was nonetheless transformed, mainly arising from the industrialisation programme that was initiated in the late 1960s. The result was the increasing role of the manufacturing sector, whose share in the Gross Domestic Product increased from 13.9 percent in 1970 to 27.0 percent in 1990. There was also a shift in the employment structure of the country so that agriculture's share of 53.5 percent in 1970 declined to 27.8 percent in 1990, while the share of manufacturing increased from 8.7 percent in 1970 to 19.5 percent in 1990, which was accompanied by an increase in technical skills in most economic sectors. The goal of the state was to increase the transfer of human resources from agriculture to industry, in line with the said transformation.

During the 1971-90 period, the role and size of the public sector in the economy increased rapidly. However, with the emergence of resource constraints in the mid-1980s and the high levels of external borrowings, partly due to the activities of many public enterprises wishing to expand, there was an urgent, need to consolidate public expenditures with a view to reducing fiscal deficits as well as strengthening the economy. So, during the mid-1980s there was a slowing down in the growth of the public sector (See Malaysia, 1991, p. 13).

This was also accompanied by the privatization policy whose aim was to minimise the burden of subsidising public enterprises. There was also the element of competition with the private sector giving rise to the question of economic efficiency and resource allocation. Thus according to the Second Outline Perspective Plan (1991-2000), "accelerating the privatization programme will help bring about a greater stability in public expenditures and reduce fiscal deficits which will in turn allow for a more efficient public sector." (Ibid, p. 89).

IV. Policy Responses by the State

Much of hte sustainable growth and economic transformation which occurred during the 1971-90 period may also be attributable to the state's capacity to respond to changes that affected the nation. Being an open economy, that is, dependent on external demands for its products, Malaysia, usually a price-taker and subjected to the vagaries of the changing terms of trade, has no choice but to respond to these changes accordingly. While responding to these external changes, the state has also to consider the domestic socio-economic factors which greatly influence the formulation of policies. During the last two decades, there were a number of policy thrusts which indicate this capacity to respond.

In terms of agricultural policy, for instance, the agricultural diversification of the late 1960s and 1970s enabled the economy to shift its reliance on natural rubber as the country's major export earner to palm oil which became an important export earner. Smallholders were encouraged, through replanting schemes and price support for inputs such as fertilizers, to plant new cash crops such as oil palm and cocoa.

In the case of padi-farming, for instance, Mokhtar Tamin(1991,pp.19-42) observes that "output price supports and input price subsidies have featured very importantly in the goal of increasing padi farmers' incomes and thereby reduce the incidence of poverty among them". At the same time, a number of research institutes such as the Palm Oil Research Institute of Malaysia (PORIM) and the Malaysian Agricultural Research and Development Institute (MARDI) were established by the state to ensure that farmers benefit from new high yielding varieties and planting methods.

This complemented the programme of establishing new land schemes by the state through the Federal Land Development Authority (FELAD) and Regional Development Authorities to support the landless rural population and those without much land to till within the agricultural sector. The private sector too had been involved in the development of new land, particularly under the Regional Development Authorities.

While agriculture will still play an important role in the country's development, it is targeted to grow at an average rate of only 3.5 percent per annum during the 1991-95 period as compared with 4.6 percent attained during the 1986-90 period. However, the growth momentum cannot be sustained for long without the needed shift and the resource mobilisation to the other faster growing sectors, especially to industry. There was a clear reorientation of economic activities in this direction especially in the late 1960s, and this, of course, needed strong direction from the state.

In the early 1970s, the state's main concern was the relatively high level of unemployment, especially among the youth; in terms of policy response, this was translated into a number of policy initiatives to increase employment opportunities. It was especially evident in the manufacturing sector where the rate of labour absorption was relatively higher.

One of the major strategies in this respect was the encouragement of foreign direct investment (FDI) into manufacturing activities. Tax concessions, "pioneer status," were granted principally via the Pioneer Industries Ordinance immediately after Independence, although the new Investment Incentives Act of 1968 was followed by the Free Trade Zone Act of 1971 to promote the rapid development of "export processing zones." And still to-day, these export zones are almsot entirely dominated by FDI mainly from Japan and the United States. What the latter did was substantially increase job opportunities brought about by the establishment of relatively labour-intensive industries; the main ones being the electronics sub-sector and textiles.

In the early 1980s, fearing that domestic industries would be technologically left behind in a world of rapid technological changes, the state initiated a heavy industrialisation programme, to a great extent to take up the inability of the private sector to provide the industrial thrust in this area. Domestic capital was generally reluctant to invest in such projects, given the substantial amount of capital and the high risks involved, and equally important, the lack of technological capability to initiate such projects.

Thus, the state established a number of public enterprises to effect this policy; the principal instrument was the creation of the Heavy Industries Corporation of Malaysia (HICOM) in 1980. This was naother example in which the state had to take the initiative in order to broaden the industrial base. The increasing role of public enterprises became more apparent in the 1980s, such that their share in manufacturing value-added increased to about 24 percent in 1986 (See, UNIDO, 1991, p. 39). According to Sutcliffe (1971, p. 284); of course the path of economic growth in Malaysia was by no means smooth sailing; the high growth rates of the 1970s and early 1980s were interuppted by a deep economic recession in the 1985-86 period, partly the consequence of falling demand for the country's major exports. The recession created a new kind of urgency within the state planning machinery, and it was felt to be essential that a more conducive environment be created for the private sector to enhance its activities. In this sense, the state's role as a facilitator becomes more evident and crucial.

While this was being done, the state set the policy thrust, giving focus to the area of industrial development. Recognising that the country's industrial base was still small and its dependence on a very limited number of export products, the Industrial Master Plan (IMP) was launched in 1986 with a view to enhancing the industrial development of the country as well as enhanceing domestic technological capability within a planning period of ten years, up to 1995. It represents a comprehensive review of the major industries which are either resource-based or non-resourced based as well as the broad strategies for each of these industries. But, more importantly, it sets in motion a number of new incentives and measures which enhance the opportunities for increased investments by the private sector.

In the face of declining FDI inflows during the 1985-86 period, the response of the state became obvious by its making more concessions to foreign investors, especially in terms of equity holdings in locally incorporated companies. These relaxations by the state and the introduction of the Investments Promotion Act in 1986 has paved the way for substantial FDI inflows into the country since 1987. This was part of the macroeconomic adjustment process, including the state's efforts to consolidate public finances through budgetary control to stimulate the economy during this period.

A key element of this consolidation process was also related to the speeding up of the privatization exercise which aims at reducing the financial and administrative burdens of the state, promoting business competition and increasing skills and productivity, and reducing the size and involvement of the state in the economy (Ismail Salleh & H. Osman Rani, 1991, p. 116).

These adjustments, aided by improvements in the external environment, led to rapid economic recovery in 1987. This was reinforced by an expanding external demand for the country's exports, complemented by improvements in commodity prices and significant increases in demand for manufactured exports, especially semiconductors and textiles. There has been a great deal of optimism in the growth momentum of the economy since then.

In fact, the growth rate experienced during the 1988-90 period, which averaged 9.1 percent per annum, was the highest recorded since Independence. The rapid growth was also significantly induced by high private investment, which expanded by about 27.5 percent per annum in real terms. Apart from the petroleum sector, investment in manufacturing and services increased at an impressive rate, although foreign direct investment dominated the growth of private investment during the period.

V. Whither the Role of the State?

With the rapid changes and transformation expected within the domestic economy and the unavoidable impact of new world economic conditions as reflected in the changing patterns of investment and technology flows, there is little doubt that Malaysia has to face many more challenges before the end of this decade. Particularly relevant in this context is the country's goal to become an industrialised nation sometime in the future. This means that the industrial sector, as well as the modern services sector, will have a critical role to play and these will have to be properly upgraded if Malaysia is to become more competitive in the world market.

While it is imperative that the country expand its industrial base and enhance its technological capabilities to sustain a high growth rate, it is equally crucial that the benefits of such economic growth trickle down to ensure the well-being of all levels of Malaysian society. The latter is the more difficult to achieve, thus implying the need for the state to remain as proactive in many areas of public policies. As appropriately emphasized in the Second Outline Perspective Plan (1991-2000):

It is in this context that the role of the state will become more critical, not only in providing the direction in which the country's overall development will be pursued, but also, in complementing the activities of the private sector and in ensuring that a conducive environment is maintained for the latter. In the domestic context, there are still the issues of ethnic income disparities, rural-urban dualism, uneven regional development, etc. hich have to be resolved.

On the other hand, the industrial base of the country has to be strengthened if Malaysia is to enhance its export-led growth. It is the balancing between these domestic needs and the need to be competitive in the international markets that will determine the future course of the country's development. It is also in this sense that the role of the state will have the fullest impact.

Now that the New Economic Policy (NEP) has been superceded by the National Development Policy (NDP) during the Second Outline Perspective Plan (1991-2000), there is a growing awareness that the latter should be implemented more effectively, especially with regard to the private sector's reciprocity towards the socio-economic goals of the country. According to the Sixth Malaysia Plan (1991-95):

Thus, while the state provides a conducive environment for the private sector to invest in productive endeavours, the latter has to ensure that the socio-economic objectives which the country has set must be achievable. But, above all, this conducive environment must necessarily be conceived within a stable political framework. This is indeed very crucial for all developing countries, like Malaysia, to enable them to mobilise domestic resources for meaningful development. We have witnessed many cases of countries in which political instability causes the disintegration of the society's fabric, often leading to strife and thus the economy becomes demobilised and the private sector stifled.

In Malaysia, as well as its ASEAN neighbours, the issue of political stability is indeed paramount in the minds of the political leadership. This can be partly related to the country's openness and liberal policies towards foreign direct investments, particularly from the industrial countries. In a world which is increasingly competitive, not only in terms of international trade but also in terms of attracting FDI, and perhaps technology transfer, political stability within the country is indeed one of the major determinants for locating investments by the industrial countries.

In enhancing the development process, there will be a number of critical areas that ought to be given greater priority by the state. There are specific policy thrusts that have to be given critical attention; these include areas such as human resource development, science and technology (S&T) development, and enhancement of the provision of social infrastructure. Even the area of FDI and its dominance in the key industries will become a major issue in policy-making in the near future (See also Mohamed Ariff, 1991, pp. 67-90). For example, how would the state deal with this issue if locally-owned or managed enterprises were to be technologically upgraded and actively involved in export activities.[7]

In all these areas, it is the state which has to decide the policy thrusts or priorities, after which the market or private sector will have to respond accordingly. Indications are that these areas will become the main determinants which influence the potential achievements of the country's development goals. The upgrading of technical and engineering skills would require an assessment of the existing educational and vocational training systems apart from the industrial training schemes on the factory floor. In the case of S&T development, for instance, the country has to set its priorities in terms of the industries to be prioritiesed, the role of industry in R&D activities, etc. All these activities would obviously need some form of active state participation and policy direction.

The everpresent role of the state is well-reflected in its expenditure allocations during the 1991-95 period. During this period, the economic sector will be given the largest allocation, amounting to M$31,236 million (See Malaysia, 1991a, p. 62). However, its share in total allocations will decline from 65.2 percent in the Fifth Malaysia Plan to 56.8 percent in the Sixth Malaysia Plan, also reflecting the reduced presence of the state in the productive activities of the economy where the private sector is expected to play a larger role. In spite of this reduction, we will still witness the important role of the state in the mobilisation of the country's resources in areas in which the private sector is not directly involved at all. For instance, the poverty eradication programmes that the state has initiated have to be effectively implemented solely with the state's total commitment in this area.

One policy area which is critical in this respect is the state's drive towards transforming the economy into an industrialised one. An important prerequsite is the positive response from domestic capital or entrepreneurs. Apart from the fiscal incentives provided by the state, the private sector, for instance, still needs other support programmes which would allow domestic industries to be competitive, especially in world markets. For example, programmes to support the development of small-scale industries have been initiated by the state to overcome the constraints faced by these industries in areas like technical know-how, the lack of finance, marketing outlets, infrastructure facilities, etc. The issue is how such programmes can be implemented with the support of the private sector.

According to the Second Outline Perspective Plan, "the government will concentrate in areas where the market cannot function efficiently or in the provision of public goods such as health, education, defence and security as well as bringing about a better distribution of economic opportunities." (Malaysia, 1991, p. 88). This, however, does not mean that the state has little to do in terms of policy formulation and direct involvement in economic activities.

At the same time, there is also a need to strengthen policy formulation and assesment capabilities as well as the need to ensure that the implementation of policies is done in a manner so that all sectors of the economy will benefit from the growth process. For example, the modernization of the agricultural sector needs an array of strategies that would also involve the upgrading of skills among the rural population. Ther is also a need to enhance the links between the public sector and the private sector in terms of policy formulation. Although this has already been set in motion, there are still areas where improvements can be made.

VI. Concluding Remarks

As we have noted in the preceding sections, since the early 1970s, there is undoubtly an increasingly conspicuous presence of the state, not only in terms of identifying priorities in the country's development process but also in terms of being directly involved in economic activities. Despite the state's direct involvement, it certainly operates within the context of a market-driven economy in which the private sector plays a major role in promoting economic growth.

This is also conditioned by the fact that Malaysia has an open economy, operating according to the forces of demand and supply in world markets. In this respect the state must establish strong interactive relationships with the private sector and this is particularly critical in the context of the country's goal of expanding its industrial base and ensuring that the export sector becomes more resilient in an increasingly competitive world. But if we allow market mechanisms to dictate all economic activities, this may lead to distortions in the economy in many ways, for instance, the imbalances between the ethnic groups, income inequalities, regional disparities etc. which, if left unchecked, can lead to unnecessary social injustice.

While it is imperative that the country achieve a certain level of sustained economic growth, it is certainly important that the benefits of such growth spread to all levels of complex, given the multi-ethnic composition of the population. It is in this respect that the state will, therefore, have to take the initiative in many areas of public policies. The implication is that the state must always identify the appropriate priorities and provide the direction in which the country's overall development will be pursued, as well as ensure that the economic activities generated by the private sector will be in line with these development goals.

At the same time, a conducive investment environment has to be ensured by the state. While there are still the issues of ethnic income disparities, rural-urban dualism, uneven regional development, etc. which have to be resolved, the economic resilience of the country has to be strengthened if Malaysia is to enhance its share of international trade. It is in the balancing of these domestic needs and the need to be competitive in the international markets that both the state and the private sector must interact in a manner which will allow the country to achieve socio-economic progress while maintaining an economic system in which market forces will determine an efficient allocation of resources.

References

Higgins, B., "Development Planning," in E.K. Fisk & H. Osman Rani, (ed), *The Political Economy of Malaysia*, Oxford University Press, Kuala Lumpur, 1982.

Hoffmann, L., & Tan Siew Ee, *Industrial Growth, Employment, and Foreign Investment in Peninsular Malaysia*, Oxford University Press, Kuala Lumpur, 1980.

Salleh, Ismail & H. Osman Rani, *The Growth of the Public Sector in Malaysia*, Institute of Strategic and International Studies, Kuala Lumpur, 1991.

Jesudason, J. V., *Ethnicity and the Economy: The State, Chinese Business, and Multinationals in Malaysia*, Oxford University Press, Singapore, 1989.

Kunio, Yoshihara, *The Rise of Ersatz Capitalism in South-East Asia*, Oxford University Press, Singapore, 1988.

Yee, Lo Sum, *The Development Performance of West Malaysia*, Heinemann Educational Books, Kuala Lumpur, 1972.

Malaysia, *Second Malaysia Plan 1971-75*, The Government Press, Kuala Lumpur, 1971.

__________, *The Second Outline Perspective Plan 1991-2000*, National Printing Department, Kuala Lumpur, 1991.

__________, *Sixth Malaysia Plan 1991-95*, National Printing Department, Kuala Lumpur, 1991a.

Means, Gordon P., *Malaysian Politics; The Second Generation*, Oxford University Prss, Singapore, 1991.

Ariff, Mohamed, "The Changing Role of Foreign Direct Investment," in Hishashi Yokoyama & Mokhtar Tamin (ed.), *Malaysian Economy in Transition* Institute of Developing Economies, Tokyo, 1991.

Tamin, Mokhtar, "Agriculture in Transition: Some Development Issues," in Hishashi Yokoyama & Mokhtar Tamin (ed.), *Malaysian Economy in Transition*, Institute of Developing Economies, Tokyo, 1991.

Sutcliffe, R. B., *Industry and Underdevlopment*, Addison-Wesley Publishing Company, London, 1971.

United Nations Industrial Development Organization [UNIDO], *Malaysia; Sustaining the Industrial Investment Momemtum*, Industrial Development Review Series, Vienna, 1991.

PART II

The Role of State and Market in Korea

The Role of the Government in A Market Economy: Lessons from Korean Industrial Policy

Jaehong Kim

I. Introduction

Korea has often been referred to as a model of successful economic growth, and it is no doubt that the performance of the Korean economy during the past three decades deserves such praise. It is also said that the Korean government has played the leading role in the process of fast economic growth. This, too, contains a good deal of truth, in so far as the Korean government has always been a strong market interventionist from the early stage of economic development until now.

Under the six consecutive "Five-year (Economic) Plans", the Korean government has not only set the goals but also controlled the market by all kinds of policy tools utilized to accomplish those same goals. The success and failure of individual business firms has been critically dependent on decisions made by the government. The government has always taken the initiative in everyday economic activities, and the market or the private sector simply tagged along.

Such a story may not be surprising in many developing economies with strong authoritarian governments. However, it is the resulting performance that makes Korea's case the center of international interest. In this paper, I will not be so bold as to take on the daunting task of explaining how Korea could have achieved such economic success. Rather, sticking to the role assigned to me, I will review some major industrial policies from the 1960s up to the present, focusing on the role of the government under the free market economy system.

My simple question is whether the government has played an appropriate and effective role in the process of Korea's appropriate and effective role in the process of Korea's economic development, as is generally thought to be the case. Simple as this question might be, the answer is not so clearcut, as history unlike laboratory experiment, can never be compared with itself under different conditions.

The only question we can ask is whether the Korean government has chosen the best role among all feasible alternatives. The answer should necessarily be negative in the sense that no government could be perfect ex-post. Who can tell if the Korean economy would have shown a better performance if the government had allowed more freedom to the market? Therefore, I will confine myself to finding out what aspects of the role played by the government were inappropriate and why — not to discredit the government but to help assign a more appropriate role to her for the better future of our economy.

Being confident in the potential of the free market economy system, I am positive that the future of the Korean economy will be even more successful if the government stops playing the role of strong interventionist and performs her generic roles such as helping correct market failures, providing information to the market, showing national vision, and making fair rules that enable the free market to function efficiently. Having such a prejudice, I am going to briefly review the history of Korean industrial policies and introduce some aspects of the relationship between the government and big business groups in the recent political economy of Korea.

II. Little Philosophy

Before touching on the history of Korean industrial policies, let me briefly make some clarifications with respect to related concepts and terminology. First, what is the connotational meaning of "role"? When we say "the role of the government (market)", we implicitly require of the government (market) the undertaking of some actions for our interests. In this sense, we can interpret "role" in its original context whereby actors in a drama perform certain actions in order to accomplish prescribed goals. Role in our context should imply a required role.

We are playing a game called "economy". We are particularly interested in "the market economy" game which is based on the belief that the players' wants can be better satisfied if they are left free to produce and consume according to their own preferences in a playground called the market. In such a game, what is the role of consumers and firms, in other words, the role of the private sector of the role of the market in general?

Consumers and private firms are doing their best to get maximum satisfaction from the game of market economy even if they are not requested to do so. Fortunately, their behavior is not inconsistent with the basic philosophy of the game, and will make every player happy even though the players are doing just what they want to do without caring about other. What further actions could we require of the market?

My conclusion is that the role of the market — the consumers and the private firms — is just doing its own business following its own perference. I would like to stress this point because an inappropriate role description can easily destroy the unity among the members of the game without improving the cutcome. Let me take an example.

After three years of economic boom during 1986-88, the Korean economy began to suffer from several bad indices such as high inflation, growing trade deficit, decline of the manufacturing sector, etc. Meanwhile, the Korean government, doing her best to effect a recovery of the national economy, required the private sector to play the appropriate role. In the process, consumers have been blamed for excess consumption, workers blamed for not working hard and asking too high wages, and firms blamed for neglecting R&D investment and simply seeking profits without caring for the national economy. Such blame easily appealed to the public. However, that does not mean that we found a solution. On the contrary, the unity of the Korean economy, which has been at the core of our economic success, was significantly damaged. The market, especially the big business groups (BBGs) who considered themselves political scapegoats, blamed the government for shrugging off her responsibilities onto the market. Why are we wasting our energy doing such unproductive jobs?

The role of government is to promote the role of the market, that is, to make fair rules for the game and provide the players with a voluntary incentive to obey the rules. The task of the government is to foster an environment among social and economic institutions in which individual initiatives can be best stimulated. Building a modern nation consists essentially of establishing modern institutions, the essence of which is to both stimulate and limit actions of individuals and groups with a minimum of arbitrary restrictions imposed by the authority.

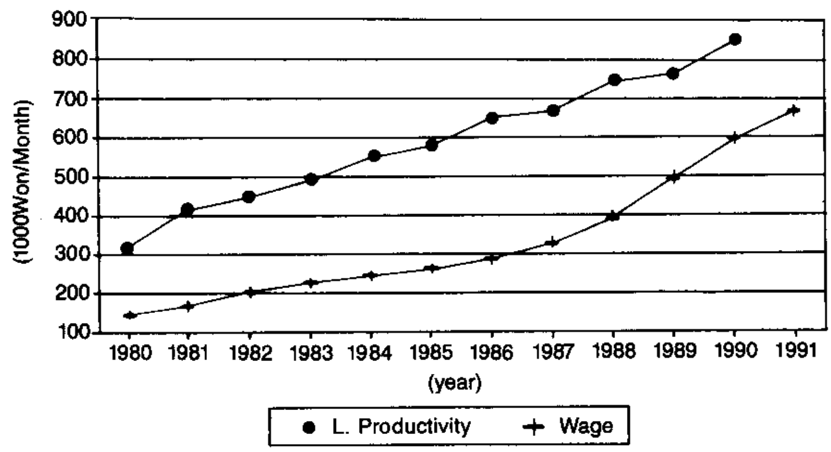
On the contrary, the role of the market is a residual role, that is, doing it own business under the rules and constraints set by the government as already mentioned. The market should not be blamed from angles of morality, motivation or ability. Even opportunistic behavior by the private sector should not be subject to blame by the government. I am saying this because it is the role of the government to make and implement fair rules which can effectively induce the maximum cooperation of the market for the welfare of the whole society.

I hope my philosophy brings about no misunderstandings. The point is that asking the market to play such-and-such a role may be very appealing at a populist level, but it seldom gives us the solution we require. Let me close this section with another example.

From 1989 Korea's trade balance began to deteriorate, and the national consensus was that we had to improve the international competitiveness of Korean products. The government and the (owners and managers of) firms laid the blame upon the rapid wages hike of the past several years. The frequently cited data was that the average annual increase rate of nominal wage during 1988-1990 was more than 20%, which was above the increase rate of labor productivity during the same period (comparison in the absolute level was seldom quoted; however, Figure 1 shows that the wage level is still lower than labor productivity.

It was also frequently mentioned that the workers have been asking higher and higher wages during the past couple of years. The government has devoted

Figure 1 Monthly wage and labor productivity in the manufacturing sector



herself to wage control in vain, arguing that wage stability is a prerequisits for the stability of price levels as well as for the restoration of our competitiveness in the export market.

Blaming workers and requiring them to follow the government's wage control policy could effectively satisfy the agreed-on interests of government and the (owners of the) firms, but it failed to solve the problem.[1]

III. Market Intervention by the Korean Government: A Historical Review

1. 1960s: "Export-Promoting Policy"

It is well-known that the 1960s in Korea was a period of economic infancy. During that time, the Korean government chose export-promotion as the first priority economic goal, which was the correct and inevitable choice simply because the domestic market was as yet underdevelopped. The government favored exporters in general without any specific industrial biases. The exchange rate was favorably to the made-in-Korea, direct subsidies and tax credits were given to the exporters, etc. It was the role of the government to allocate scarce resources, especially capital, to the most productive sector, export.

2. 1970s: Heavy and Chemical Industry (HCI) Policy"

Nevertheless, the trade balance did not improve sufficiently enough to meet the government's satisfaction. Concluding that this was because our exported products were not high value-added, the government modified her strategy and intensively and selectively supported the heavy and chemical industries. The government selected not only the industries (iron and steel, chemicals, nonferrous metals, machinery, electronics, and ship building) to be supported but also the firms to do business. The HCI policy was implemented through direct subsidy, tax credits, import and entry regulations, and direct control over the firms' investment decisions.

The HCI policy of the 1970s was the one of the most important cases

1. In April 1992, the government announced that as of 1990 our labor cost per hour in the manufacturing sector was $3.82, which was not higher than those of competing countries such as Taiwan ($3.95) and Singapore ($3.82). What has made the Korean government stop blaming wage hikes?

of government intervention in the modern history of Korea. It not only determined the basic structure of Korean industries but, together with the 1960s' export-promoting subsidy policy, became the source of the "economic power concentration" problem, or the BBGs' problem, following the terminology to be used later.

3. *1980s: "Industry Rationalization and Market Liberalization"*

During the traumatic balance-of-trade crisis period of 1979-1981 caused by the second oil shock, the Korean government abandoned the HCI policy of the 1970s. Even though the HCI policy deserves the credit for jump-starting Korea's industrial take-off, it also created many negative side-effects.

The industrial distortions generated by the 1970s' "unbalanced growth," stemming mainly from the wrong choice of target industries and excessive investment in the targeted sectors despited the national scarcity of capital resources, could be seen in the decline of the nontargeted labor-intensive sectors, retardation of market liberalization, especially in the trade and financial sectors, etc. High inflation, land speculation, and the market concentration of a small number of BBGs, called *chaebul* in Korea, were also among the serious negative consequences.

Admitting that these problems were generated by her excessive market intervention during the 1970s, the government changed her strategies and followed two major policy directions in the 1980s. One was that of "industry rationalization" to cure the existing problems generated by the 1970s' unbalanced growth policy, and the other was "market liberalization with the government's indirect and functional support" to enhance the long-run growth potential of the Korean economy.

The functional thrust of the new industrial policy was formalized by the Industrial Development Law of 1985 and the simultaneous repeal of the seven selective promotion laws. The basic goals of the Industrial Development Law were as follows: promoting autonomy of the private sector, rationalizing the government's industry support systems, and inducing more R&D. Under the Industrial Development Law, eight industries (four sunrise industries and four sunset industries) were rationalized. Such rationalization, however, must surely be again regarded as a market intervention measure by the government, just like the HCI policy. The most important tool to "save" the seven selected industries was the anti-competitive entry regulation. Wasn't it contradictory to the market liberalization slogan propounded by the government itself? The government, meanwhile, justified her action by saying that industry rationalization was not to deny the principle of market economy but to strengthen the function of the free market.

Accordingly, the strategy of the government policy shifted from "direct and selective" support to "indirect and functional" support for balanced growth. Instead of direct subsidies and credits to the targeted industries, indirect tax and financial support to induce more R&D investment were the major policy tools. Although there can be different evaluations of the actual effectiveness of such a policy change, it is generally agreed that the government tried to follow the market liberalization trend.

IV. Political Economy of 1992: "New Industrial Policy"

Many people in Korea are worrying about the country's recent economic performance. Even though the growth rate of GNP was again above 8% last year, nobody believes that the Korean economy is in good health. 1986 to 1988 was a period of economic boom. The GNP growth rate was 12.9% in 1988, 13.0% in 1987, and 12.4% in 1988. The trade balance showed a surplus for the first time in Korean history in 1986, and it kept increasing up to 1988. Furthermore, consumer prices were relatively stable during that period.

Figure 2 GNP growth and inflation

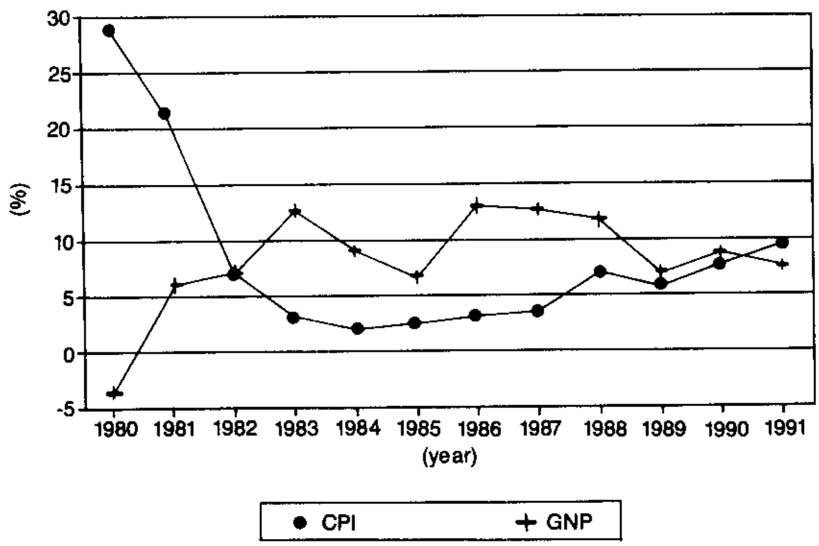


Figure 3 Trade Balance

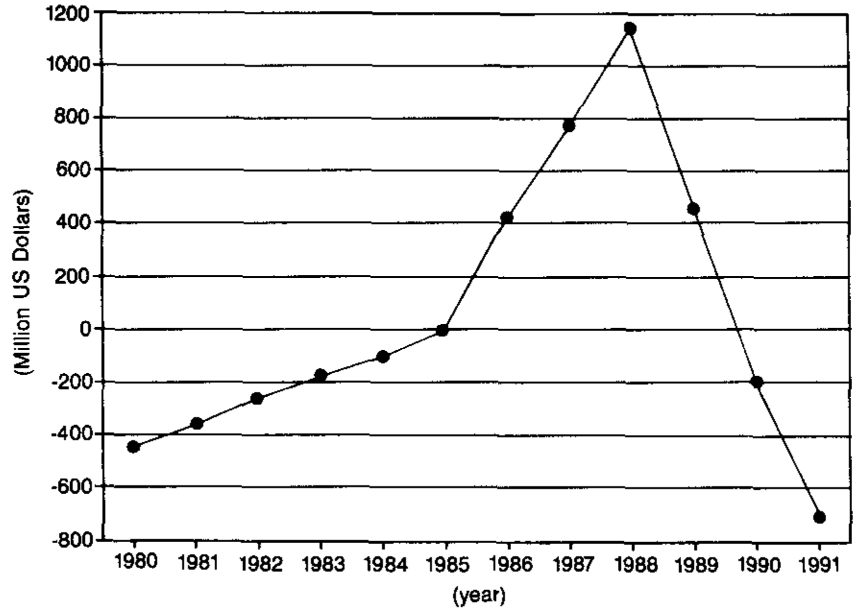
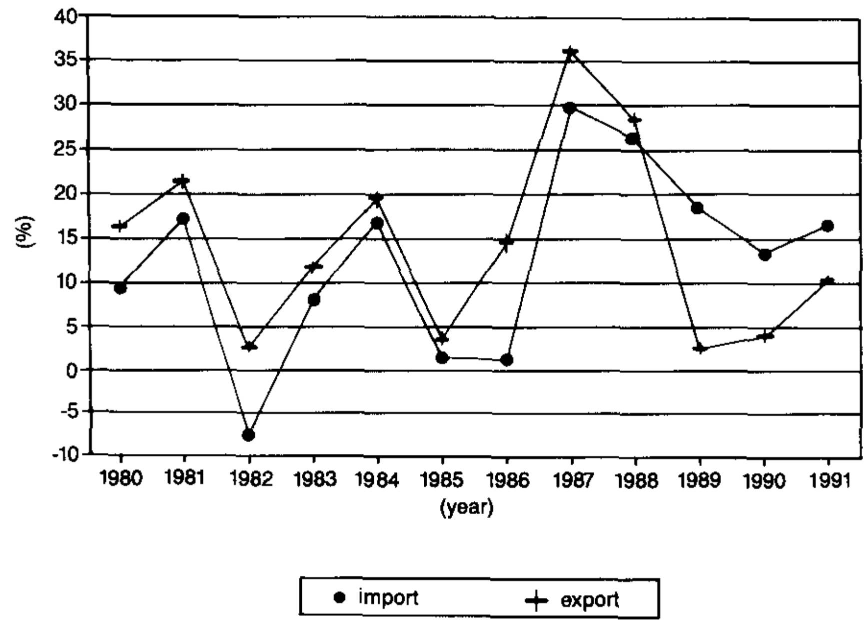


Figure 4 Export and import growth rates



However, things suddenly changed after 1988. The GNP growth rate dropped to 8.8% in 1989, crept up to 9.3% in 1990 and slipped to 8.4% in 1991. You may wonder why the Korean people are not be satisfied with such good indices, but the fact is that most believe that the Korean economy is in trouble in spite of the apparently healthy GNP indices.

The recent status of the Korean economy is described as "unstable high growth" by many in Korea. With few natural resources and an insufficient domestic market, the Korean economy remains highly dependent on exports and, it logically follows, on the manufacturing sector. However, the recent high growth rate of the Korean economy was mainly due to the abnormal explosion of domestic demand, with little credit attributed to exports.

In the meantime, the trade balance, which showed a record high surplus of 11.445 billion US dollars in 1988, plummeted to a record loss of 7.065 billion US dollars in 1991. The growth rate of exports has been staying below the growth rate of imports ever since 1989. This is noteworthy if we consider that exports has never grown more slowly than import in Korean history since 1971, with the exception of the oil-crisis years of 1974, 1978 and 1979.

The fact that the good-looking performance is due to the boom of the domestic market rather than success in the international market is the first reason behind the "instability" of the Korean economy. A cause for even greater concern about the economy is the fact that the domestic boom is being led not by the manufacturing but by the construction and service sectors. In 1989, the growth rate of the manufacturing sector was only 3.7%, which was the second lowest since the 1970s. While the manufacturing sector grew by 9.1% in 1990 and by 8.5% in 1991, the construction sector has expanded by 16.1%, 23.7% and 11.3%, respectively during the last three years. The service sector, for its part, has maintained a relatively steady pace with growth rates of 8.4%, 10.1% and 10.6% during the same period.

Together with such an unhealthy economic structure a, high inflation rate has become the bugbear of the Korean economy. Consumer prices increased 8.6% in 1990, and by 9.7% in 1991 (See Figure 2), telling quite a different story from the entire 1980s, when inflation was not a problem.[2]

Korean people, including the government and the big business groups, are in general agreement that restoring the competitiveness of Korean products

2. One explanation of the stability of the price level during the 1980s is that the Fifth Republic's number one goal of all the economic policies was price control.

Table 1. Difference in Iews between the Government and the BBGs

Government	1. BBG's internal structures are not sufficiently geared to international competitiveness - share concentration - lack of separation between management and ownership - lack of professional management - excessive diversification into unrelated businesses - unhealthy financial status due to mutual shareholdings and payment guarantees 2. the function of the free market is shown to be inefficient - excessive and inefficient private investment - economic power concentration - violations of rules of the game
BBGs	1. Government's market intervention is excessive and inefficient - excessive regulations 2. political instability - economic policies are affected by political interests rather than based on economic rationale 3. failures of macro-policies - high interest rates - inadequate monetary policy

in the international market and curbing price levels are the two necessary conditions for the Korean economy to stop struggling and keep the record of good performance in the future. However, the consensus stops there. When it comes to questions like "Who should shoulder the blame for the recent bad performance of the Korean economy?" and "What should be done to restore the competitiveness?", the government and the BBGs are divided.

The basic hypotheses of the Korea government, even though they may not be explicitly demonstrated, can be summarized as follows: The fundamental reasons for the recent bad performance of the Korean economy are the ineffectiveness of the free market system and the economy-wide structural inefficiency generated by the BBGs in Korea.

V. Ineffectiveness of the Free Market System: Impatience

The democratization movement starting from the "June 29th Declaration" in 1987 requires more economic freedom, even though "market liberalization" has continued to be a major economic slogan since 1980s, it is clear that Korea has never experienced a real free market system. Government officials and bureaucrats, who have the strong belief that the success of Korean economy during the past 30 years would have been impossible without the very effective role of the government, seem to be reluctant to trust the free market whose ability was never tested before. But then, we might ask, how can the market prove its own efficiency without being given the chance to do so?

Impatience and lack of confidence lead to short-sighted government decisions, which have increasingly tended to be untimely and served only to aggravate economic fluctuations. Here, Korea's petrochemical industry supports the view of monetarists.

Entry and investment into the petrochemical industry had been regulated by the Chemical Industry Promotion Law. In 1986, the Industry Development Law replaced the individual industry promotion laws, and the entry into and investment in the petrochemical industry began to be liberalized. Incidentally 1986 was the beginning of the economic boom supported by the so-called "three lows (low oil price, low dollar value, and low interest rate)".

The growing demand for petrochemical products, and the high profit margin attracted huge amounts of new investment. Finally in 1990 the government announced complete investment liberalization against the strong objections of the incumbents. As a result Samsung and Hyundai, the top two BBGs in Korea, have newly entered the market. The incumbents and the new entrants played a capacity-expansion game and finally ended up with an excess capacity problem abetted by difficulties in the export market. The operation ratio began to go down, stockpiles accumulated, and firms suffered from excessive (destructive) competition characterized by dumping and low profitability among other areas.

In 1991 the impatience of the government, together with the incumbents' lobbying to deter further entry, caused the government to decide re-introduce investment controls. In November 1991, the government ordered credit controls for the Bank of Korea and the Office of Bank Supervision & Examination. New investment in the petrochemical industry was virtually prohibited. This was just less than two years after the government liberalized investment.

However, things turned for the better again. In fact, the export of petrochemical products increased beyond expectation. This was due to many factors such as demand growth of the south-east. Asian countries and China, high labor cost of American products, reduced eagerness of Japan and the EC for exports, the sudden accident at the ethylene factory in Libya, and so forth. Once again the government announced that she was revising her investment control plan to the minimum level.

VI. BBG Policy

1. Background

In the 1960s and 1970s, BBGs grew faster than the rest of the economy under the support of government, particularly in the credit market, which was the result of the harmony of interests between government and BBGs in pursuing economic growth. The most important role of government was to allocate limited credit to the most productive businesses for the maximum returns, and it was quite natural that the government's support became biased towards a small number of large firms to take full advantage of scale and scope economies. The BBGs were the leading actors of the robust economic performance, with the government serving as the supporting director. Any malfunctions of the BBGs in terms of distribution or equity could not be questioned simply because escaping from poverty was the first national priority. The government also showed no concern about the BBGs because she was the dominant partner and the BBGs were only the followers.

However, things changed in the 1980s. While "growth" was the highest good in the 1960s and 1970s, "equity" was a new fashion of value in the 1980s. The negative side of the growth-first economic policy began to be uncovered. The public worried about the concentration of economic power in a small number of big business groups. They also began to blame the unfair government policies that helped the birth of such BBGs. Furthermore, even though the speed of rapid growth was lessened, the relative power of the BBGs strengthened in the process of democratization. The government began to show concern about the economic and political power of the BBGs.

Table 2. BBGs in Korea

Number of BBGs

	1987	1988	1989	1990	1991	1992
Number of BBGs	32	40	43	53	61	60
Number of firms	509	608	673	798	915	911

Degree of Concentration in the Manufacturing Sector

Production share of the top 30 BBGs (%)				
1977	1981	1985	1987	1989
32.0	39.7	40.0	36.8	35.2

Share Opening to the Public (as of 1991. 4.)

	Total number of firms (A)	Number of firms going public (B)	B/A (%)
top 5 BBGs	198	64	32.8
top 30 BBGs	561	161	28.7

She also admitted that something should be done to regulate the BBGs for both economic efficiency and social fairness. Many consecutive anti-BBG policies were tried; it was not an easy task for government to find a remedy. Emotional fingers wagging against the BBGs seemed to be an easy way out and, ultimately, proved so effective that the BBGs are now at the center of national criticism.

The BBGs are being blamed for their monopolistic behavior, especially in the credit market, excessive diversification, and concentration of ownership. Public opinion towards the BBGs appears to be too negatively biased compared to the general level of understanding and information about the BBGs.

Choosing appropriate policies towards the BBGs is one of the most important roles assigned to Korea government in the 1990s. The government should find an effective cure for the distortions created by the BBGs' concentrated economic power, without introducing more serious distortions. There should be no need to explain why this is so important. Equally important is that the government not make distorted economic and political decisions against the BBGs for the sake of pandering to public sentiment, which perceives the BBGs as the source of national inequity. The correct policy towards the BBGs is just like a knife's edge: it should be strong enough to get rid of all the negative effects of the BBGs; however, if it goes too far, the international competitiveness of the Korean economy will be seriously damaged.

What concerns us is the fact that every new policy to control the BBGs has been generating distrust between the government and the BBGs. Such a trend is reinforced by popular resentment against the BBGs' economic power and damages the cooperative relationship between the government and business. A "new compact" between the government and business is urgently needed to save the Korean economy.

2. Credit Control and "Specialization" Policy

Let us briefly go over the credit policy being utilized to control the BBGs. The government annually announces 50 BBGs that are subject to credit control. The top 30 BBGs are regulated by loan limits as well as by ex-ante approval of firm investments and land purchases. The next 20 BBGS are regulated by ex-ante approval of land purchases by the main correspondent bank. The loan limit was 5.8% of the total bank loan to the top 5 BBGs, and 10.81% to the top 30 BBGs in 1991.

However, the deterioration of the trade balance since 1990 has made the government loosen the credit control policy. The logic of the government was as follows: the Korean economy is necessarily dependent on exports. We need large firms that can compete with leading foreign firms in the international market to promote exports and to save the national economy. While almost all kinds of products are being exported by the BBGs, only a few have emerged as top brands in the international market. In this sense, excessive diversification by the BBGs weakened our international competitiveness. The role of the government is to induce the BBGs to put evry effort into their specialized businesses for stronger international competitiveness.

The incentive scheme proposed by the government was the "specialization" policy which became effective as of June 1, 1991. Each of the top 30 BBGs was to select a maximum of three core enterprises for specialization,

Table 3. Credit to the top 30 BBGs

(10 mil. Korean won, %)

	'90. 12	'91. 12	Change rate
Loans to the core operations (A)	100,672	139,064	38.1%
Loans to the non-core operations (B)	110,834	120,317	8.6%
(A)+(B)	211,506	259,38	22.6%
Total bank loans	1,111,628	1,374,073	23.6%

which would be exempted from credit limits. Two opposite reactions to the specialization policy have emerged: the BBGs are arguing that such a policy is a more stringent BBG regulation, and the public is arguing that the specialization policy is only a justification for abolishing the BBGs' credit control. What has made both sides think that the government is not doing the job correctly?

VII. Concluding Remarks

Can Korea's experiences be applied to other countries and vice versa? Some people in Korea, particularly those in the government, insist that we need to adopt the Japanese or German type economic system which they argue shows a better performance than the current American type free market system. However, it should be emphasized that merely importing a system is, in itself, hardly a guaranteed remedy for success. Each country should develop a system that is most appropriate to its own circumstances.

Then what are the lessons that are invariant with countries and time under the assumption that we keep the market economy system?

1) The key role of the government is that of making the rules of the game for the whole economy. Furthermore, the rules must be fair and transparent for the national consensus. The Korean government has made many important economic decisions for its own political interests. Now, the most seri-

ous obstacle to the government's playing its role is the national distrust of its policies.

2) Providing a stable and predictable economic environment for the market is the generic role of the government. First, the political environment should be sufficiently stable to allow economic stability. Second, government economic policies should be economically (not politically) rational and consistent. Finally, the government should openly and uniformly make information available to the whole market, and never act as a selective or discriminatory information creator, thereby encouraging the market to behave opportunistically.

3) The government should never blame the market for not playing its own role, because it will necessarily destroy national harmony and cooperative unity without solving the problem. The correct role of the government is to provide the market with an incentive system and induce the maximum cooperation voluntarily from all members of the national economy.

4) The government should not jump into the game impatiently without giving enough time to the market to prove its efficiency or to cure its own inefficiency. Market failure can be detected easily because any inefficiency without government intervention is necessarily due to the malfunction of the market. Contrarily, government failure is altogether more difficult to detect because government intervention (as long as the market is still alive) has already distorted the market. We should not forget that market failures are only necessary conditions, not sufficient conditions for government intervention. The Korean government has spent more than 30 years in proving itself, and this has bred an impatience in allowing the market room to prove itself.

The Role of the Government in Economic Development: the Korean Case

Hakun Kim

I.

Thirty years ago Korea was a divided nation, nearly devastated by her Korean War experiences. Before that, she was a colony of the Japanese empire, deprived of economic opportunities in many ways. Her geographical area was small and her natural resources were poor. An overwhelming portion of the population was engaged in agricultural production. However, over the past twenty years or so and particularly in the period between 1965 and 1976 when she quadrupled her industrial output, the nation emerged as a modern, dynamic industrial nation. Today she is enjoying one of the highest rates of economic growth in the world. Part of this may be due to the government's role in resource mobilization for economic development, the success of which would not, however, have been possible without the entrepreneurial ingeneity of Korean businessmen, the diligence of the Korean labor force and, above all, favorable world market conditions.

It could be argued that in the process of such a rapid growth and drastic structural transformation of the Korean economy the government played an important role by formulating and implementing development strategies efficiently. In particular, the government exercised powerful influences in its attempts to direct the flow of economic resources to the industrial areas which were strategic for rapid economic development. The major theme of the development strategies has been industralization through export promotion. In the process the government has resorted to diverse export promotion incentive policies. Out of the policy instruments employed by the government, the most important ones were exchange rate, financial, fiscal, and industrial policies.

The prime role of the exchange rate policy combined with export subsidy schemes was to enhance the competitiveness of Korean export products in foreign countries. The financial policies were to mobilize domestic and foreign savings and to allocate them to export sectors through government control over credit allocation in the financial market. When combined with a low interest rate policy, the control of credit allocation provided the government with extremely effective instruments for stimulating investment in export industries. Fiscal policies were also very important in the development of the Korean economy. Even though the government was severely constrained by the availability of domestic revenue sources through the years, it sought to take advantage of various tax policy instruments in promoting investments which were deemed to be strategic for economic development.

The Korean economy has been basically market-oriented through the years, and one must understand the role of the Korean government in economic development in this context. It has been mainly the businessmen who catch and challenge favorable chances for Korean products in the world market. The government exercised its influences on their activities through the market mechanism with the aid of different policy instruments. The way it did this varied from period to period and from industry to industry. Perhaps one area which can be singled out for demonstrating the whole picture of the government role in economic development would be the industrial policy area, which we will examine prior to the other policies.

II.

Before the 1960s, Korean industrial policy was inward-looking and oriented toward the promotion of import substitution industries, which primarily produced consumer goods. Government economic policy basically emphasized price stabilization and reconstruction rather than growth.

The military takeover in 1961 was the turning point in the development of the Korean economy. The new government began to intervene deeply in the process of resource allocation, and all resource mobilization and investment programs were closely coordinated by the government on the basis of designated priorities in the development plan. Industrial policy shifted from import substitution and stabilization toward export-led industrialization and rapid economic growth.

In the period from 1962 to 1972 the primary objective of industrial policy was to actively promote export, a policy which emphasized industrial development mainly along the lines dictated by the nation's comparative advantage. The government combined a variety of policy instruments such as taxes exchange rate, and financial incentives as a comprehensive supporting package for export-oriented activities. Furthermore, the adoption of an export-import link system was supposed to increase returns to exporters by allowing them to import other products for export production. This incentive regime was also used along with strict protection of domestic markets from foreign competition. Thus, Korea has operated on both fronts on the rationale of securing cheap materials and protecting infant industries. This rationale provided an underlying logic as much for import substitution as for export promotion.

Nevertheless, in a market economy export sectors are likely to expand more rapidly than import substitution sectors when export production is kept more profitable than import substitution. The government export incentive policy was designed to promote export expansion by increasing chances of high profits for exporters in the world market through taxes, financial, tariffs and other incentives. Since the government conducted both fronts, providing incentives for export industries as well as domestic industries, including import substitution industries, a distortion in resources allocation may be conspicuous either in favor of import substitution or of export promotion, depending upon the relative bias in incentives in each sector. Kim et al (1976) reported that greater incentives were given to export production than to import substitution. As a result, export expansion bacame the most influential factor in rapid economic growth. Table 1 shows the rapid rises of export share in total output since 1965.

In favor of export promotion, the government employed a variety of policy instruments. Exchange reforms were cited as a typical example of policy instruments for export promotion. The devaluation in 1961, along with other supporting incentives, was supposed to have a strong initial impact on export growth. From then until the mid-1980s, the exchange rate has been continuously adjusted to stimulate export activities. One my argue that export growth has been sharply elastic to the revisions in exchange rates, and that continued devaluations worked as a primary factor in export expansion. The devaluations are, however, considered to have realigned to capture market equilibrium values more correctly, whereas overvaluations before then were made mainly for other purposes.

Another example equally well cited was a financial reform conducted in 1965 to mobilize domestic savings. This reform has been highly praised as one of the most successful the government has ever made. It has been olaimed that increases in interst rates on time deposits were followed by the most drastic rise of domestic savings. But it may be equally claimed that this reform is also considered to have restored lower interest rates to higher market equilibrium values.

Witness these two episodes we may argue that the government's role was basically to help exporters by eliminating disincentives for their activities. Perhaps the same can be said about different episodes related to other highly discretionary policies for export promotion such as tariff and tax exemptions on imported raw materials for export production, tax reduction on ex-

Table 1. Exports-GNP Ratios

(unit: %)

	EXPORT / GNP
1960	4.12
1961	6.32
1962	5.96
1963	5.43
1964	6.69
1965	9.54
1966	11.90
1967	13.58
1968	14.73
1969	15.39
1970	16.03
1971	17.21
1972	21.94
1973	32.05
1974	29.72
1975	29.53
1976	35.07
1977	38.00
1978	36.69

Source: Bank of Korea, National Income in Korea (1978).

port earnings, preferential export credit, and tax exemptions on domestically supplied intermediate input for export production.

These are incentives provided by the government. In addition to these, many types of policy loans and subsidies were frequently given to exporters at preferential terms. Commercial banks which had been under government control were permitted to operate special funds for export promotion and for the production of intermediate materials for export production. Most of all, bank lending rates were substantially lower than alternative rates in the curb market, and than even equilibrium rates. The average spread between the first two interest rates was usually over 20 percentage points in the 1960s and 1970s, which became another form of export subsidy. Thus, an access to favorable bank credit was extremely important for export activities.

While some measures of industrial policy were practised only for limited periods during the first phase of export-led industralization, other incentives such as tariff exemptions and preferential credit to exporters have been used continuously even in the 1980s. Fundamentally, the aggressive export-orientation adopted in the 1960s still remains an important theme in Korea's industrial policy, even in the mid-1980s.

On the whole, in the period between 1962 to 1972, it was mainly the businessmen who, in the presence of incentives and the absence of disincentives, tried to best exploit the favorable market opportunities for Korean products in foreign countries. The government role was basically to complement these market performances by providing incentives or eliminating disincentives for their activities. Government provision of incentives for export activities in general had the same effect as its eliminating bias against export did (the bias which existed in the past due to the import substitution policy). Kim et al (1976) found that export response to the incentives and disincentives was close to that which can be expected udner a free trade regime. This implies that Korean businessmen in export frontiers conducted their businesses as if they were operating under a free market regime. They also found that the export incentives in their total impact on the value added of exports across industries were by and large uniform. In this sense the industrial policies implemented by the government during this period were basically neutral with respect to particular industries. Leading export industries during this period emerged not through the government's discretionary choice but through the market's selection on the basis of the nation's comparative advantages. The government exerted little influence on promoting the export of specific export items or industries. Thus the period between 1962 and 1972 was a period in which there were few industrialization policies conducted by the government.

The market-oriented policy ended in 1973. In this year, a basic shift in industrial policy from this general export promotion to the development of so-called strategic industries was announced; this new policy was carried out until 1979. It was a major shift from general export-led growth without any special attention to particular industries, to sectoral development focused on the heavy and chemical sectors (HCS). In this period the Korean government selected such HCS as steel and iron, petrochemicals, machinery, electronics, and transportation equipment industries as the key targets.

The government's choice of these particular sectors in this big shift not by comparative advantages but by its discretion had several reasons. First of all, Korea had to reduce her dependence on imported raw materials and machinery to secure stable comparative advantages because they were not as cheap as before due to the deteriorating world market conditions which developed in the early 1970s. Before that time, Korea had enjoyed taking advantage of the importation of low-priced intermediate goods and raw materials. It would be safe to say that the most important strategy for export expansion included exemption of import duties for intermediate goods, parts and components to be used for producing low-priced export products which were mainly consumer goods. In addition, the oil shocks of 1973-74, growing competition with other developing countries in the world market, and Japan's success in the steel, automobile, and electronics industries stimulated Korea to pay greater attention to the development of the HCS industries. Furthermore, the partial withdrawal of US troops in 1971 prompted the government to start an industrial base for its own independent defense.

Besides these primary reasons, many other things also changed so that the policy shift to industrial reshaping with the HCS drive was imminently needed. That is, such things as rapid technological developments, increases in domestic wages, a shift in demand for the products of the HCS with a gradual increase in income levels, and intense competition in the world market called for Korea to reshuffle her industrial structure for further expansion of her economy.

And yet, the new policy for the HCS drive did not depart from the previous strategy of export promotion. Still the export promotion policy was generally practised more than enough to offset other unfavorable elements against export promotion. Korea had to operate on both fronts in this way to overcome its poor position so that the policy shift was rather a policy reshaping for export-led industrial restructuring with a special emphasis on the development of the HCS. It was rather inevitable for Korea to develop the key industries within the HCS for further expansion of exports since the previous export expansion with light industries' products had certain limitations.

Although the course of the industrial policy was quite different from that of the previous export expansion, much the same comprehensive set of trade and financial incentives was provided to mobilize resources to the HCS. Out of a broad range of incentives, the provision of preferential credit was selected with greater expectations to have great impacts on the oromotion of target industries. In addition to existing policy loans provided at favorable terms through commercial banks, the national investment fund was formed in 1974, and almost the two-thirds of the fund flowed toward projects in the heavy and chemical sectors. With this help, the HCS doubled its share in the total credit allocation of all the commercial banking system from 30 to 60 percent during the period of 1973 to 1977.

Several tax incentives were also provided. The tax exemption and reduction control law enacted in 1975 permitted five-year tax holidays, investment tax credits, special depreciation, tax deferral reserves, and income deduction advantages to the key industries. Some of these special incentive measures had been in operation since the 1960s, but the new law integrated previously complicated tax incentives into one simple framework. These measures had given discretionary tax benefits to the HCS and some export-led activities, even up to the 1980s in some cases. As a result, the key industries had better access to a better tax structure and to funding with much lower borrowing costs. Furthermore, wide support for the HCS resulted in the subsequent effect that large firms had more favorable credit access than small firms.

The selective financial and tax measures were very influential in directing resources to key industries such as petrochemicals, steel and iron, machinery, and electronics. As a result, investment in the HCS grew at a rate of 27 percent per annum for 1976-78 and nearly 80 percent of the total manufacturing investment was allocated to those industries during the same period. The share of heavy industries in gross output increased from 12 percent in 1970 to 26 percent in 1980, which is comparable to Japan's 29 percent. Also, the export share of the HCS tripled from 13 percent to 38 percent during this period.

Thus, from 1973 to 1980 the government greatly intervened in resource allocation to promote the development of specific industries. But the result is somewhat dubious. The policy of the HCS drive can be evaluated in several aspects. It may be the government's strong guidance which was responsible for achievement of the policy objectives of the HCS drive with success in most key industries and for the boost of a change in the economic structure. At the same time, it may also be the strong government intervention for the promotion of key industries which was, in developing countries, responsible for some negative outcomes such as misallocation of resources and excess capacity problems. The Korean case may not be exceptional. The way the Korean government directed the flow of the national investment fund reduced credit availability for the private sector, the decrease of which would have caused considerable damage to the private sector's effort to promote exports afterwards. The agricultural sector remained largely underdeveloped with low investment and few incentives, whereas the export-led, key industries and large firms strongly benefitted from a variety of policy incentives. The HCS drive led to such an unequal, imbalanced sectoral development of the Korean economy.

It is also noted that some negative outcomes created by the HCS drive became a cause of structural and economic imbalances during the contraction of the 1979-80 period. Some of these negative results were carried over into the 1980s as unfavorable legacies in the Korean economy.

Of course, Korea's notable export performance for the mid-1980s in some HCSs such as steel and iron, consumer electronics, and shipbuilding was without doubt a result of the strong drive of the HCS in the 1970s. These industries are currently cited as major examples of technical achievement and strong international competitive strength. Recently the automobile industry also has been regarded as another successful example, while its early performance during the 1970s was disappointing. Therefore, combined with the long-run results in the mid-1980s, the second phase of industrialization strategy focusing on the HCS, which has established industrial bases for further expansion with structural change, may be presently evaluated as another notable success.

And yet, this late long term success would be considered unintended. For it is, after all, the new favorable international market conditions developed in the 1980s and again the ability of Korean businessmen to cope with this new development which made the early disappointing outcome turn to the late success. All in all, government intervention in accelerating the HCS while decreasing the role of the market mechanism led the economy to serious troubles in the late 1970s.

In the early 1980s, Korea confronted serious problems in both domestic and external markets.[1] Domestically the promotion of the HCS with huge financial support began to generate imbalances and structural distortions, which resulted in low capacity utilization and weak financial structure for heavy industries. The political crisis following the assassination of President Park was another major source of domestic instability. Externally, the second oil crisis struck the Korean economy. These factors, with an excess money supply generated by the direction of huge funds to capital intensive HCS projects, helped to stimulate high inflation, which in turn led to widespread wage demands. As a result, for the first time in her recent economic history, Korea experienced negative economic growth in 1980. Yet worse, the inflation rate reached 26 percent in the 1980-81 period alone. As the international competitiveness of Korean exports sharply weakened, the deficit in the current account widened to US$5 billion in 1980. Korea faced stagflation on both fronts.

Such adverse internal and external conditions forced the government to end the second phase industrial policy in 1979 and made it turn to new policy directions which were designed to promote a greater role for the market mechanism. These were directed towards macroeconomic stabilization, structural adjustment, and import liberalization. The stabilization program was carried out with such classical instruments as tightening monetary and fiscal expansion. Import liberalization was practised in the traditional pattern with the loosening of controls on import licenses, quotas, and tariffs.

The structural adjustment policy was utilized with particular instruments in the context of Korean development. The basic objectives of the policy were to reduce government intervention, enhance the functioning of the market mechanism in resource allocation, encourage market competition rather than protection, and promote balanced sectoral developments. The new policy directions placed the primary emphasis on market incentives and technology-incentive products rather than industry-specific interventions. Hence, this policy shift was toward the lessening of government intervention in the industrial sector and aimed at enhancing economic efficiency and growth potential in the longer perspective.

A wide array of policy instruments has been adopted for these structural adjustments. To begin with, the government substantially reduced its role in the process of credit allocation and eliminated many types of preferential loans. These measures included increases in real interest rates to eliminate

1. This part is heavily drawn from Dr. Jeong, Kap-Young's recent paper, "Industrial Policy in Korea," mimeo.

interest subsidies for particular beneficiaries, the selling of the commercial banks to private shareholders to reduce government influence, the reduction of suport to the HCS and large firsm, and an increase in financial support to small and medium firms. These policy measures were practised in the context of financial liberalization.

Trade liberalization policy can be also considered in the framework of structural adjustment since that policy was basically aimed at enhancing the competitive strength of domestic firms through import competition. This policy resulted in the increase in the import liberalization ratio from 54 percent to 85 percent in 1984.

The adjustment policy seemed to be a success, even though it is still too early to evaluate it. Returning to the market system was the right choice. The result of this choice enabled the Korean economy to overcome the short contractions in the early 1980s, achieving strong growth again in the 1982-88 period. The average real growth rate per annum reached 9 percent for 1982-85 and 12 percent for 1986-88. Furthermore, this outstanding growth performance was accompanied by a stable price level and a large surplus in the balance of payments. The annual increase rate of consumer prices was only 3.3 percent for 1982-87, and chronic deficits in the trade balance turned into surpluses from 1986, which were unprecedented in Korean history. In fact, the large surpluses have been leading factors in boosting the import liberalization programs, reducing export financing, and more importantly, reversing the exchange rate policy from continued devaluation toward appreciation of the Korean won.

It is difficult to fully evaluate the effects, of the current industrial policy on the economic performance in the 1980s. Since the policy directions in the 1980s were not like those in previous periods, having emphasized industrial neutrality and market mechanisms, the effects of the industrial policy might not be observable in specific sectors. As mentioned, Korean economic performance in the early 1980s was disappointing, but the industrial policy has successfully weathered the structural problems of 1979-81. For 1982-88, with favorable external conditions, combined with the industrial bases for key industries established in the 1970s, the Korean economy once again achieved remarkable growth, which might be called the third phase of industrialization.

Even though the government stabilization and structural policies may have helped to achieve the notable performance, still the favorable external conditions are largely responsible for the remarkable achievement in the 1980s.

Ro (1987) estimated that had there not been low oil prices, low interest rates in the international financial markets, and the low value of the U.S. dollar, the current account surplus would have been as negligible as $0.3 billion. On the basis of this evidence one may say that these three benefits from the world market conditions have greatly contributed to price stability and export expansion.

III.

The previous section gives us an idea of the role of government in Korea's economic development. In sum, in Korea an economic explosion is underway and people are full of hope. Economic development relies extensively on private markets and government's role is to help them. But the explana-

Table 2. Savings Ratios and Investment Ratios

(unit: %)

	Domestic Savings	Investment	Foreign Savings
1960	0.82	10.86	8.57
1961	2.86	13.16	8.60
1962	3.26	12.80	10.69
1963	8.69	18.11	10.42
1964	8.74	14.04	6.85
1965	7.37	15.01	6.39
1966	11.84	21.59	8.45
1967	11.38	21.91	8.81
1968	15.08	25.88	11.15
1969	18.83	28.83	10.63
1970	17.43	26.88	9.33
1971	15.47	25.38	10.78
1972	15.83	21.85	5.28
1973	24.11	26.22	3.89
1974	20.67	31.27	12.51
1975	18.85	29.85	10.61
1976	23.33	25.83	2.46
1977	25.60	27.90	0.61
1978	27.20	31.68	3.27

Source: Bank of Korea: National Income in Korea (1978).

tion was rather descriptive, not analytical. Is there any piece of empirical evidence which may support the above argument? In the following we will seek to evaluate the role of government on the basis of empirical evidence.

In this section we will discuss the effect of the government's financial policy on export promotion. We will not, however, deliver all the details of specific cases since the government has basically implemented the same type of policy instruments for every case such as low interest rates and selective credit control. It is, therefore, useful to discuss the effect of these instruments on export expansion.

In 1965 the government conducted a financial reform through a drastic increase in interest rates on time deposits in commercial banks. This reform was the result of a recommendation made by some economists. The major goal of the increase in the interest rates was to enhance the competitiveness of bank rates with curb market rates with curb market rates. The immediate impact was the most drastic rise of domestic savings in Korean history. Table 2 shows a sudden rise of savings and investments in 1965 and afterwards.

This episode in the reform has been extensively analyzed and cited widely as a successful reform for financial markets. Several other nations even followed the Korean example by implementing a similar reform. The reform also formed high expectations that the high-interest-rate policy would eventually bring about price stabilization, a high savings rate, and output increase. But the long term effect is not immediately clear.

One argument following McKinnon (1973), which is popular, is that in the first phase of developing countries money and real assets are complements, and that an increase in interest rates on real assets raises the demand for financial assets including money. His point is that high time deposit rates are a good thing to establish in a developing country, a necessary precondition for high growth. If short term effects of higher rates are considered at all, they are believed to be favorable, increasing output and reducing inflation in the long run. Despite its popularity, this view has never been tested and confirmed empirically, although the Korean episode seemingly supports it.

Another argument may be possible on the basis of the observation that the reform was followed by an increase in the flow of funds from the curb market to the commercial banks. This would suggest that time deposits are a closer substitute for assets provided by the curb market. If they are, the increase in the bank deposits was created at the expense of the fund of the curb market and then would not represent an increase in savings at all. Along this line, van Wijnbergen (1985) recently tested the substitution hypothesis.

He examined the likely impact of changes in bank deposit rates on economic activities, inflation, and growth. The results are to be contrasted with McKinnon's point of view. He concluded that increases in time deposit rates were shown to be contractionary in the short term, because the portfolio shifts result in a tightening of credit conditions and higher costs of financing working capital. Peopel shift out of the curb market rather than out of cash. The high costs of financing working capital also push up inflation after the change. All together, the increase in time deposit rates ends up with stagflation in the short term.

How then can the performance of the Korean economy after this reform be explained? According to van Wijnbergen, the persistence of this short term loss in output depends upon the commercial banks' role as intermediaries. If credit limits will not prevent the passing through into bank loans of the influx of time deposits caused by the higher rates, substantial and persistent real output gains and increased private investment would result. This may or may not be the Korean case. We still badly need more vigorous empirical studies on this issue. Nevertheless, one thing is clear. Even if van Wijnbergen is right in his claim that bank loans are substitutes for curb market assets so that the rise in bank liabilities would not represent the rise in savings, it is a different matter to say that the government policy was successful in the sense that it was able to direct the flow of funds from the curb market which was out of its control to commercial banks which were under its control so that it could further conduct the flow of funds to the areas it designated. Still van Wijnbergen may insist that even if so, this could not be considered successful either. For all the efforts the government made by directing the flow of funds were an attempt to eliminate the short-term financial market, the curb market, without which many small firms and even large firms would have had difficulties in financing working capital.

The high-interest-rate policy continued until 1971. A year later, the Korean economy witnessed the return of high interest rates in accordance with a Presidential Decree for Economic Stability and Growth. The decree ended the market-oriented policy the government had initiated with the financial reform in 1965, and opened another financial repression. The main goal the government tried to achieve with this decree was to eliminate the curb market, the interest rates of which were so high that they became a big burden on many firms.

One of the distinguishing features of the Korean financial market is its dual structure: the bank loan market and the curb market. The former has played the role of the long term credit market, whereas the latter is the short term credit market. As shown in the 1965 reform, loanable funds in both markets are competitive. This was the main reason why the government tried to suppress and eliminate the curb market even though it had contributed to the provision of short term funds to unprivileged small firms and even big corporations. It was expected that since they were substitutes, the government's administrative fiat would successfully direct the flow of funds to the bank loan market in the face of the financial repression on the unregulated financial market.

Despite the curb market's contributions, interest rates prevalent in this market were high, which became a great burden on those firms that had borrowed from abroad, especially when the major devaluation in 1971, designed to stimulate export, caused a sudden rise in the won cost of foreign debt. Many firms faced a bad situation with deteriorating debt-equity ratios and had difficulties meeting their interest payments. On the eve of the decree the debt-equity ratio of the manufacturing sector was as high as 395 percent, which was fairly high compared to the ratios of other countries. The government had two choices: let the debt-ridden firms go out of sight, or bail them out. The choice made was to alleviate the interest burden of the firms and the policy instrument to achieve this end was the decree. These were the main features of the decree:

1) All the loan agreements between firms and lenders in the curb market were nullified and replaced by new ones. The borrowers would have to repay their curb market loans over a five-year period after a three-year grace period, paying a 1.35 percent monthly interest rate.
2) Some of the short-term high-interest-rate bank loans by firms were replaced by long-term loans at 8 percent annual interest rate payable over a five-year period after a three-year grace period.
3) Banking institutions lowered the time deposit rate from 17.4 percent to 12.6 percent and the general loan rate from 19 percent to 15.5 percent.

The decree was a strong measure inconceivable in a market economy, and marked an outstanding example of excessive government intervention in the market economy. The results were that the total volume of the curb market loans reported by firms amounted to 345.6 billion won, which was around 80 percent of the total money supply at that time.

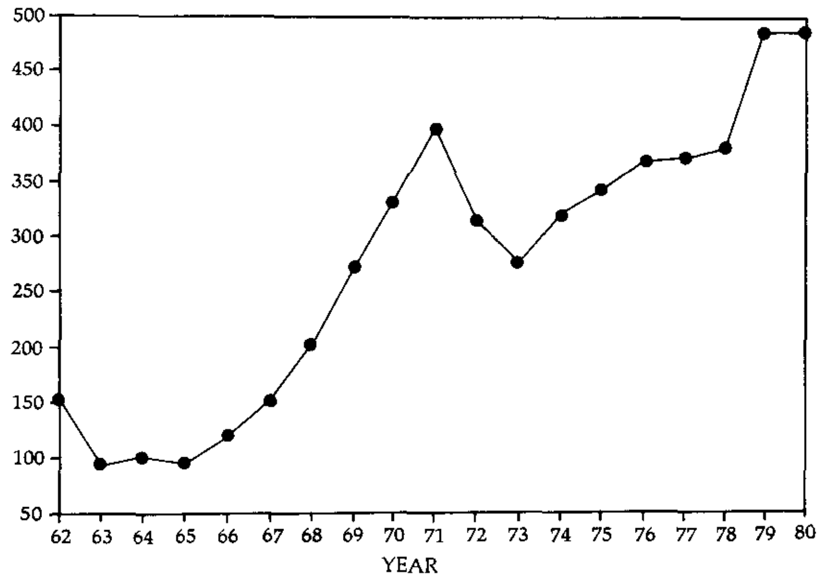
An immediate impact of this measure was the sudden disappearance of the curb market which had supplied the short term funds for working capital to firms. But it was easily anticipated that the curb market would revive in no time. The decree failed to eliminate the market forces which gave life to the market. It also failed to improve the debt-equity ratio of the troubled firms. Right after the decree, the ratio fell dramatically from 395 percent to 313 percent and then to 273 percent. But it went up as high as 488 percent in 1978, when the government needed another similar decree to achieve the same end. Figure 1 shows the trend of the debt-equity ratio of the manufacturing sector.

Cole and Park (1983) evaluated the effects of the decree by saying that "the disorganization of the unorganized financial market could have had more serious repercussions for the economy in the following years, had there not been offsetting factors that precipitated a rapid expansion of the economy.... The sudden increase in exports lifted the economy ....., and more than offset the effects of the disruption of the credit system."

To what extent has the government failed in attaining its goal? The answer to this question requires a close look at empirical data, but no such data are available. One thing is clear. Here we see a failure of government intervention in its attempt to direct the flow of financial sources in the direction where it was intentionally designed to go.

The financial instruments employed by the government have been rather simple. The government always pursued two strategies in its attempt to alter they way in which credit is allocated. The first was to call for changing the cost of credit by the imposition of controls on interest rates. Exporters usually

Figure 1. Debt-Equity Ratios



got credit at the lowest cost. The second strategy for attaining the same end was the direct efforts to change credit flows. The aim was to provide some borrowers with more credit than they would get in the absence of government intervention; the method was to make less credit available to others. Usually the government provided exporters with more credit for export promotion by diverting it from other uses. Whatever the game plan, efforts by the government to change the allocation of credit conflicted with the relentless pursuit of self-interest by both savers and borrowers.

Nevertheless, the government was always able to make excuses such as export promotion to justify credit rationing at rates below market rates. Hong (1986) may be right when he attempted to explain the essense of credit rationing at low interest rates by coining the term "institutionalized monopsonic capital market." He said, "The entrepreneurs tend to surrender without active resistence their decision-making powers in the financial market, accepting the government as the ultimate unit of control in the institutionalized monopsonic financial market. It is because the chosen few would be able to enjoy using very low-cost capital. Unprivileged small entrepreuners will have extra hardship in their investment activities and the workers will have to accept disincentives for their wealth accumulation activities."

Table 3. Equilibrium Rates and Bank Loan Rates

	equilibrium rate	bank loan rate
1971	28.8	22.1
1972	23.6	15.5
1973	24.0	15.5
1974	24.9	15.5
1975	24.5	15.5
1976	27.2	17.0
1977	24.2	15.1
1978	29.2	18.7
1979	31.3	18.7
1980	29.6	20.5
1981	24.6	18.6
1982	15.6	10.0
1983	16.4	10.0
1984	16.0	10.0

Source: Kim (1987).

Although interest rates on bank loans changed from time to time, they were always kept at low levels below the market equilibrium level. It would be safe to say that equilibrium interest rates lie between the interest rates on bank loans and those on curb market loans. As a result,, there was always an excess demand in the bank loan market, which curtailed such investment encourage by low interest rates. Access to bank loans is therefore a great privilege and monetary policy in a low interest rate system takes the form of selective credit control that involves the government's discretion in choosing loan demanders, which have always been exporters.

Loans supplied at interest rates below equilibrium are financial subsidies. Related to these subsidies a question is raised; how much effect did the govern-

Table 4. Interest Subsidy Rates to the Monetary Sector

(unit: %)

	DMB & KDB Loans Subsidy rate
1957	12
1958	13
1959	13
1960	13
1961	13
1962	15
1963	27
1964	40
1965	14
1966	7
1967	13
1968	14
1969	13
1970	19
1971	19
1972	24
1973	21
1974	55
1975	40
1976	26

Source: Hong (1979), p.202.

ment's financial subsidies have on export promotion and hence economic development? Total subsidies may be calculated as the amount of loans times the subsidy rate which is the difference between the market clearing rate and the lower bank interest rates. Kim (1966) estimated a market equilibrium rate in Korea using a Tobin-type portfolio allocation model, specially designed to reflect the curb market explicitly, which shows that bank deposits are closer substitutes to loans outstanding in the curb market than to cash. Table 3 reproduces the results.

While estimated subsidy rates are substantially high, the estimation is, however, confined to the period only after 1971, so that the subsidy rates of this period are not comparable to those of the previous period.

On the contrary, Hong (1979) prepared the subsidy rates in a different

Table 5. Interest Subsidy Rates on Foreign Loans

(unit: %)

	Foreign Loans Subsidy Rate
1957	–
1958	–
1959	9
1960	−10
1961	−80
1962	19
1963	32
1964	−18
1965	−2
1966	19
1967	27
1968	27
1969	23
1970	21
1971	16
1972	21
1973	26
1974	59
1975	27
1976	31

Source: Hong (1979), p.202.

way. He estimated the subsidy rates on deposit banks and Korea Development Bank loans defined as the difference between the rates of return to capital and the loan rates. The rate of return on capital represents the rate of return to all factors but labor. It thus includes the returns to technical progress and etc., and hence is higher than a true estimate of the return only to capital. Thus his estimates on interest subsidies on bank loans are overestimated. Nevertheless, his result are striking. The subsidy rates shown in Table 4 are as high in the 1950s as in the 1960s and 1970s. Financial subsidies in the 1950s were by no means missing.

What then is the role of the financial subsidies provided by the government in the export boom of the mid-1960s? The answer is not clear unless we turn to another source of locans: foreign loans. Table 5 reports the subsidy rates on foreign borrowings. As the Table shows, the subsidy rate made a sudden rise around 1966 and afterwards.

It is remarkably coincidental to the year in which the Korean economy started expanding at a jump. Despite this fact, however, we are still not convinced about the role of the government-controlled subsidies in the sudden export boom in the mid-1960s unless any real difference between the roles

Table 6. Effective Interest Rates and Equilibrium Interest Rates

(unit: %)

	Effective Interest Rate	Equilibrium Interest Rate
1971	35.6	28.8
1972	26.6	23.5
1973	28.4	24.0
1974	29.9	24.9
1975	29.0	24.5
1976	31.2	27.2
1977	27.3	24.2
1978	33.8	29.2
1979	34.8	31.3
1980	32.2	29.6
1981	27.9	24.6
1982	19.7	15.6
1983	18.9	16.4
1984	19.2	16.0

Source: Kim (1986).

of domestic and external loans is clarified. No research results on this issue them, excess demand in the money market is, as a matter of fact, excess supply when it is measured at effective interest rates. This sounds somewhat paradoxical. However, it is true in all financial markets where interest rates are kept below equilibrium rates. Lower interest rates on bank loans create excess demand at those rates. Combining them with higher interest rates on the curb market, we have so-called effective interest rates, which are above equilibrium. Therefore the excess demand in the bank loans market at lower interest rates is truly the excess supply measured at effective rates, and hence the chronic pressure of excess supply in the financial market mounts; this creates price rises. Table 6 provides effective and equilibrium interest rates estimated by Kim (1986).

Credit is fungible because lenders seek to maximize the returns on their investments while borrowers strive to minimize the investment costs of loans.

Table 7. Ratios of Loans by DMB and KDB to Output by Industry, 1955-1978

(unit: %)

	1955	1960	1965	1970	1975	1978
Agriculture, forestry, hunting & fishing	3.3	13.7	6.4	14.1	13.2	14.2
Mining and quarrying	26.2	33.2	17.7	50.5	36.5	29.5
Manufacture	22.0	50.4	33.0	69.0	72.3	71.4
Light industries	17.0	30.0	23.1	51.4	68.3	—
Heavy industries	40.5	109.9	53.2	96.7	76.7	—
Social overhead	13.7	23.0	24.9	35.6	54.9	44.0
Construction	3.4	29.0	14.3	43.0	54.8	33.3
Electricity, water & sanitation	110.3	91.3	112.1	98.4	171.3	137.8
Transport, storage & communication	6.7	7.5	6.9	14.6	30.7	37.1
Services and others[a]	1.6	4.5	6.0	17.4	12.6	15.0
All industry	5.7	16.3	12.8	30.3	34.5	34.8

Source: BOK, Economics Statistics Yearbook (1958-1978); BOK, Montly Economic Statistics (1979), 1, 3; BOK, National Income in Korea.
Cole and Park (1983), 178-179.

Note: [a]Includes wholesale and retail trade, restaurants and hotels, financing, insurance, real estate, ownership of dwellings, public administration and defense, social and personal services, education, and the rest of world.

As long as these principal players in the credit markets be have rationally, efforts by the government to alter the allocation of credit in ways that run counter to the preference of the market place are going to work with only limited success. The extent to which the government succeeds depends upon the fungibility of credit. Unfortunately we have to realize that it is almost impossible to estimate the degree of fungibility in Korea because of the lack of appropriate data. Facing this problem, we find ourselves in a difficult position when we try to evaluate the government's role in credit rationing in Korea's export promotion. The only inference we may make is that financial market segmentation reduces credit fungibility, and that bank loan markets in Korea are said to be segmented in the sense that the government controls, with great success, interest rates and the use of bank credits. This inference may or may not be true for Korea. We still don't know without any concrete evidence. Nevertheless, there has not been any attempt to cope with this difficult problem.

Cole and Park (1983) took a close look at this issue. They first examined the major recipient industries of bank loans and compared their shares of

Table 8. Comparison of Loan Ratios to Capital-Output Ratios

	Marginal Fixed Capital Output Ratio 1956-1974	Ratio of Sectoral to overall Capital-Output Ratio	Ratio of Sectoral to overall Ratio of Loans to Value Added 1970, 1975, 1978	Column 3 divided by Column 2
Agriculture, forestry, and fishing	1.54	0.67	0.42	0.63
Mining and quarrying	1.48	0.64	1.17	1.83
Manufacturing	1.37	0.59	2.14	3.63
Construction	0.61	0.26	1.32	5.08
Electricity, water, and sanitation	7.08	3.06	4.09	1.34
Transport, storage, and communication	7.70	3.33	0.83	0.25
All industries	2.31	1.00	1.00	

Source: Columnl is from Wontack Hong, Factor Supply and Intensity of Trade in Korea (Seoul, 1976)
Column 3 is derived from Table 37.
Cole and Park (1983), p.183.

output in GNP with those shares of loans in total bank loans in the period of 1955-78. Table 7 shows this comparison. They found that the trend of the comparison reflects the relative docline in the size of the nonpreferential sector.

They also made a comparison of the relative loan shares of the industrial sectors with their sectoral capital-output ratios. Their idea was to examine whether the loans were proportional to capital requirements. Table 8 contains this comparison.

To assess these comparisons, we have to first of all take into consideration that financing requirements are different from industry to industry. At the same time we have to recognize the fact that the capital-output ratio reflects only fixed capital while bank loans are used to finance both fixed and working capital.

Despite this fact, the evidence drawn from the Tables may suggest that "a large part of bank loans may in fact have been allocated according to the loan priority" made by the government. But "it is still difficult to determine the extent to which credit rationing was responsible for the changes in industrial structure envisioned by the government."

In sum, the success of the government's financial policy is inconclusive at this moment.

IV.

How much effect the government tax policies had on export promotion

Table 9. Tax Reduction Effect of Tax Credit and Accelerated Depreciation

1. Tax Credit (unit: %)

Rate of ITC	3	6	10
Reduction of Tax Burden	2.85	5.70	9.50

2. Accelerated Depreciation (unit: %)

	Special Depreciation			Free Depreciation	
	30	50	100	30	50
Equipment	1.76	2.60	4.04	3.18	5.38
Structures	2.57	4.13	6.96	6.75	11.30

will not be clear before we quantify the incentive effects of the key tax policy instruments. This section offers such as estimation. We do not, however, model all the details of taxation. It is rather significant to note that since the tax policy for economic development is still resorting to the same types of instruments as accelerated depreciation, tax credits, tax-deferral reserves, and income deduction, we analyze the effect of these instruments on the cost of investment and the effective tax rate on corporate investment, which has in turn played an important role in the export boom.

Tax Credit: Tax credits have been available for various investment and other activities. Panel 1 of Table 9 shows the effects of investment tax credits on the cost of investment when the rates of investment tax credits (ITC) are 3%, 6%, and 10%.

Accelerated Depreciation: Accelerated depreciation takes two forms. One is referred to as the special depreciation (SDP) which increases the rate of depreciation by a fixed fraction of the regular depreciation. The other is free depreciation under which a fixed fraction of the total investment cost is deduced as an expense. The effect of accelerated depreciation on the cost of investment is measured as the decrease in the present value of tax liabili-

Table 10. Tax Reduction Effect of Reserves

(unit: %, year)

	Annual Rate of Accumulation	Grace: Add-Back (years)	Tax Reduction / Reserve	Tax Reduction/ Equip.	Invest. Struct.
Investment Reserves for SMES	15% of equip, value	4:3	13.7	7.3	15.1
Rural income dev.	15% of equip, value	4:3	13.7	7.3	15.1
Mining	2% (4%) of revenues	4:3	13.7		
Relocation	10% of equip, struct.	4:3	13.7	4.9	10.1
Reserve for/against Technology development	Larger of 1.5% (2%) of revenues and 20% (30%) of income	4:3	13.7		
Export loss	less of 1% of revenues and 50% of income	2:3	8.9		
Overseas Marketing	1% of revenues	2:3	8.9		
Overseas invest. loss	15% (20%) of investment	3:4	12.5		
Overseas Business loss	2% of revenues	5:3	15.8		
Price fluctuation	5% of inventory value	1:1	3.2		

Table 11. Tax Reduction/Investment Ratio of Ivestment Reserve in the Presence of Accelerated Depreciation

1. Reserves for SEMs and Rural Income Sources Development

(unit: %)

	Regular Depreciation	Special Depreciation		Free Depreciation	
		30	100	30	50
Equipment	7.3	6.0	4.4	5.0	3.6

2. Reserves for Relocation

(unit: %)

	Regular Depreciation	Special Depreciation		Free Depreciation	
		30	100	30	50
Equipment	4.9	4.0	2.9	3.3	2.4
Structures	10.1	8.9	7.1	7.0	5.0

ties attributable to the acceleration of the depreciation schedule. For the purpose of measuring the effect of accelerated depreciation, we distinguish two categories of depreciable business assets; equipment and structures. Panel 2 of Table 9 summarizes the reduction of investment costs due to accelerated depreciation. We find that accelerated depreciation has stronger cost reduction effects on structures than on equipment. It is useful to recall that, in the past as well as under the current law, the taxpayers are sometimes allowed to choose either accelerated depreciation or investment tax credit.

Tax Deferral Reserves: Reserves may be accumulated for investment in various designated areas. The value of a reserve is the reduction in the present value of tax liabilities due to the deferral of the tax payment. Hence the effects of a tax deferral reserve depends upon the rate of reserve accumulation, the length of grace period and the add-back schedule. Table 10 shows the annual rate of reserve accumulation, grace periods, and the add-back schedule for the various reserves. It shows that the various reserve systems provide substantial tax incentives. In particular, the investment reserve for quipment provides incentives as strong as a 7.6% ITC and is substantially stronger than the 100% special depreciation or the 50% free depreciation. The comparison is even more favorable to the investment reserve for structures. When both accelerated depreciation and the investment reserves are available, the value of the reserves is reduced as the balance of underpreciated assets declines rapidly. Table 11 shows the effect of accelerated depreciation on the value of the investment reserves for different purposes.

Income Deductions: Finally, we examine the effect of income deductions. Income deductions are allowed for various purposes. It is not, however,

Table 12. Effective Tax Rates of Corporate Investment

1. Under Single Tax Preference

(unit: %)

	No tax Preference	SDP			FD		ITC		IR
		30	50	100	30	50	3	10	15
Equipment									
SROR	11.9	11.3	11.0	10.4	10.8	10.0	10.9	8.5	9.3
ETRC	−10.4	−16.5	−19.6	−25.4	−21.9	−31.4	−20.6	−53.8	−40.8
ETRA	12.0	7.2	4.6	0.0	2.8	−4.7	3.9	−22.6	−12.2
Structure									
SROR	12.5	12.0	11.7	11.2	11.2	10.3	11.9	10.7	8.6
ETRC	−5.0	−9.5	−12.1	−17.5	−17.1	−27.0	−9.8	−22.9	−36.4
ETRA	16.3	12.7	10.6	6.3	6.6	−1.2	12.4	2.1	−8.7

2. Under Two Tax Preferences Including Investment Reverse

(unit: %)

	Investment Reserve only	SDP		FD		ITC	
		30	100	30	50	3	10
Equipment							
SROR	9.3	9.1	8.9	9.0	8.7	8.3	6.0
ETRC	−40.8	−43.6	−47.6	−46.0	−50.4	−57.8	−120.0
ETRA	−12.2	−14.5	−17.6	−16.4	−19.9	−25.8	−75.4
Structure							
SROR	8.6	9.4	9.1	9.2	8.9	9.1	7.8
ETRC	−36.4	−39.2	−43.7	−42.6	−47.2	−44.6	−68.0
ETRA	−8.7	−11.0	−14.6	−13.7	−17.3	−15.2	−34.0

straightforward to evaluate the economic effects of these income deductions. We only estimate the present value of the income deduction for new equity issues. The 18% deduction is alowed for small-and medium-sized enterprises of listed corporations and the 15% deduction applies to all the other corporations. With the parameters used above the estimated present values of income deduction for new equity issues are 16.5% and 19.8% of the new equity under the 15% and 18% deductions respectively.

Yun (1989) combined the effects of the various tax policy instruments we just described above with the information on the structure of corporate and individual taxation and estimated the effective tax rate of corporate investment. The following is a summary of his estimation.[2] The effective rates of corporate income taxation is defined as

$$\text{ETRC} = (\text{SROR-CROR})/\text{SROR}$$

where SROR is the social rate of return of the marginal capital input, net of economic depreciation, and CROR is the after-corporate-tax rate of return on corporate capital. Note that SROR is what is widely known as the cost of capital. He also estimated the combined effective rate of corporate and individual income taxation, which is defined as

$$\text{ETRA} = (\text{SROR-PROR})/\text{SROR}$$

where PROR is the private rate of return of the marginal capital input. Table 12 reports the estimated effective tax rates and the social rates of return of marginal capital input.

It shows that, in all of the cases, the effective rate of corporate income taxation is negative and the combined effective rates of corporate and individual income taxation are low and even negative in some cases. There are two reasons for such results. One is that in the calculations, the rates of tax depreciation are substantially higher than the corresponding economic rates. However, it is difficult to prove or disprove that the economic depreciation rates employed in the calculations are too low. The other is that the debt-equity ratio is very high. Since the ratio derived from the financial statements of the business firms are based on the book values of assets and liabilities, it is likely that the estimated debt-equity ratio overstates the actual financial leverage of the business firms. To the extent that the estimated debt-equity ratio overstates the actual leverage of the firms in the manufacturing sector, the resulting effective tax rates understate the actual effective tax rates. With this clue, Yun concluded that the effective tax rates of capital income

2. This part was prepared by Dr. Yun, Kun-Young for this paper.

in Korea are very low.

Panel 1 of Table 12 shows the social rates of return and the effective tax rates when only one incentive applies. Since we fixed the after-corporate-tax rate of return, the higher the effective tax rates are, the higher the social rats of return. For equipment, the social rate of return is the highest when no tax incentive is available, but it is as low as 8.5% when the 10% ITC is appolied. When no incentive is available, the effective corporate tax rates are −10.4% for equipment and −5% for structures. These negative effective tax rates reflect the fact that tax depreciations are faster than economic depreciation and that interest payments are deductible for corporate income tax purposes. Given that the after-coorporate-tax rate of return is fixed at 13.1%,

Table 13. Comparison of Incentives: Export vs. Import Substitution (1965-1978)

	Export Sectors	Import Substitution Sectors
1. Short-term Financing		
a. interest rate differential between the differential loans and commercial	on average ranging from 6% to 12%	none
b. accessibility to credit	automatic upon receipt of L/C	not automatic but subject to a bank examination of credit worthiness and/or to the list industries implicit in the 5-year plan
2. Long-term Financing		
a. interest rate differential	on average ranging from 7% to to 14%	about similar to export sectors subject to the 5-year plan and the list industries
b. accessibility to credit	relatively easy and generally not subject to the 5-year plan	relatively difficult and subject to the 5-year plan and the list industries
3. Income Tax		
a. reduction	50% reduction on income earned from exporting (abolished in 1973)	100% exemption of income tax for the first 3 years and 50% reduction for the next 2 years subject to the 5-year plan and the list industries

the 30% special depreciation lowers the equilibrium SROR only by 0.6% and the ETRC from −10.4% to −16.5% for equipment. For structures, it lowers the SROR by 0.5% and the ETRC from −5.0% to −9.5%. On the other hand, the 10% ITC lowers the SROR by 2.6% for equipment and the investment reserve for the small-and medium-sized enterprises lowers the SROR of structures by as much as 3.9%. The corresponding reductions in the effective tax rates are easily read off the Table.

Panel 2 of Table 12 summarizes the SRORs and the effective tax rates when the investment reserve for the small-and medium-sized enterprises and another tax incentive apply at the same time. As expected, the reduction

Table 13. Comparison of Incentives: Export vs. Import Substitution (1965-1978) (continued)

	Export Sectors	Import Substitution Sectors
b. capital depreciation	an over-generous depreciation rate, i.e., 30% of the	an over-generous depreciation rate, usually ranging from rate but for only a limited time period
c. other tax benefit	1% of total sales allowed to be put to a reserve credit account to compensate for loss in export marketing	none
4. Tariff		
a. on raw materials	100% exemption or draw back system since 1977	none
b. on capital equipment	no exemption but credit is given to installment payment of tariff on certain specified captial goods	similar to export sectors
5. Discounts		
a. railroad transportation	Yes	none
b. electricity rate discount	Yes	none

Source: Suh (1981), II-23-4.

in the SROR and the effective tax rates are substantially lower than in Panel 1, which confirms that the incentive effect of the investment reserve is tempred by the acceleration of tax depreciation. Nevertheless, it is remarkable that all the effective tax rates, even when the taxes at the corporate and individual levels are combined, are negative. When the combined effective tax rates are negative, the private rate of return is higher than the social rate of return, implying that the entire system serves as a subsidy mechanism for capital income at the margin.

We have just seen that overall the tax system provided strong incentives for the allocation of resources into the strategic sectors for economic development. Given the fact that the Korean economy grew successfully out of the misery of the 1950s and the early 1960s, one may argue that the tax policy of the past quarter century contributed partly to the successful economic growth of Korea. The notion of government intervention hinges upon the presumption that the resource allocation by markets can be improved. On the other hand, the tax incentives intrinsically distort the market signals for resource allocation and it is not directly possible to know the right direction and the right amount of government intervention.

So far we have taken a close look at the effect of each specific export promotion policy instrument employed by the government. The result, were somewhat dubious except for the tax policy. Even for the tax policy, the conclusion was critical. In this section we will bring all the elements discussed separately so far into one framework to draw some conclusions. From the outset we all know that the export promotion policy has been around since the mid-1950s. Our question is: What brought about the sudden start of the export boom in the mid-1960s?

One distinguishing feature of the mid-1950s was that the major source of foreign exchange was foreign aid and this was maximized by the overvaluation of domestic currency. This regime typically discourages exporters. It did not, however, completely discourage them since a variety of export subsidy schemes brought them a net profit from a given won yield per dollar. This scheme has continued until recently. Table 13 summarizes export promotion schemes.

Why then did the export boom start in the mid-1960s? Direct comparisons of the incentive policies of export sectors between the mid-1960s and the mid-1950s do not provide any clue as to whether incentives are biased between the two periods. Frank et al (1975) calculated effective subsidies to provide an answer to this difficult question. Their results are given in Table

14. They are somewhat surprising. The effective exchange rate on exports, ports, including subsidies has remained remarkably stable. This may suggest that the export boom was not primarily due to export subsidies. But their study did not incorporate all subsidies, including particularly financial subsidies. In order to analyze the sudden emergence of the export boom in the mid-1960s a further analysis of effective subsidies may be necessary in a different direction in which all the subsidy elements are incorporated. As mentioned, the government's role in the export promotion policies in the '60s was neutral with respect to industries. Export industries emerged as a result of market performance and the neutral policies. As the center of ex-

Table 14. Foreign Exchange Market, 1958-1970

(unit: %)

	Effective Exchange Rate on Exports[a] (1965 won/dollar) (A)	Effective Exchange Rate on Imports[b] (1965 won/dollar) (B)	Ratio (A/B) (C)	Percentage Components of Effective Exchange Rate on Exports: Premia (D)	Subsidies (E)	Official Exchange Rate (F)	Percentage Components of Effective Exchange Rate on Imports: Tariff and Tariff Equivalents (G)	Official Exchange Rate (H)
1958	288.7	160.4	1.80	55.5	1.0	43.5	22.5	77.5
1959	333.3	202.9	1.64	62.2	1.0	36.8	39.6	60.4
1960	326.5	221.6	1.47	56.7	0.8	42.5	37.6	62.4
1961	294.1	287.1	1.02	9.7	5.6	84.7	13.2	86.8
1962	270.5	261.4	1.03	0.0	14.1	85.9	11.2	88.8
1963	280.6	219.4	1.28	21.3	10.3	68.7	12.2	87.8
1964	309.6	271.7	1.14	14.1	9.7	76.2	13.2	86.8
1965	304.6	293.1	1.04	0.0	12.8	87.2	9.4	90.6
1966	296.8	272.4	1.09	0.0	15.9	84.1	8.4	91.6
1967	287.6	255.8	1.12	0.0	18.2	81.8	8.6	91.4
1968	283.0	241.6	1.17	0.0	21.9	78.1	8.5	91.5
1969	271.7	233.4	1.16	0.0	20.6	79.4	7.8	92.2
1970	272.3	230.6	1.18	0.0	21.8	78.2	7.6	92.4

Source: Frank, Kim, and Westphal, pp. 70-75.

Notes: [a]Return to exporter deflated by wholesale price index. Includes official exchange rate, export premia, direct subsidies, tax and tariff exemptions, and interest rate subsidies.
[b]Price to import and deflated by wholesale price index. Include official exchange rate, tariff and FX tax collections and export premia.

port promotion moves from one industry to another in response to world market conditions, the general trend would be the shift from low value-added industries to high value-added ones. Even though the effective exchange rate remains stable through the years in the overall economy, there has been a bias among industries within the economy in the tax, tariff, and financial incentives for some industries relative to another, which may make the former more profitable than the latter. A comparison of the shifts of the center be-

Table 15. Nominal and Real Effective Exchange Rate of Expor, 1965-1979

	1965	1968	1967	1968	1969	1970	1971
Year-average nominal exchange rate (R) (Won per dollar)	266.17	270.25	268.33	276.33	288.42	310.42	350.08
Average incentive (Won per dollar export)	34.2	45.5	63.6	78.0	81.1	88.4	106.2
(1) Interest subsidies	12.6	4.1	7.8	11.2	11.9	13.6	16.0
(2) Direct tax reduction	2.1	2.3	5.2	3.2	3.9	3.6	5.1
(3) Indirect tax exemption	14.1	17.8	18.9	21.2	29.0	28.5	34.1
(4) Tariff exemption	15.4	21.3	31.7	42.3	36.2	42.6	50.9
(5) Electricity & railroad discount				0.1	0.1	0.1	0.1
Gross subsidies per dollar export (1)-(5)	34.2	45.5	63.6	78.0	81.1	88.4	106.1
Net subsidies per dollar export (1), (5)	2.6	4.1	7.8	11.3	12.0	13.7	16.1
Nominal effective exchange rate[1] (won per dollar) R (1+s)	300.37	315.75	331.93	354.33	369.52	398.82	456.28
Dollar Price Inex (1975=100)[2]	51.66	53.15	53.99	55.51	57.30	58.84	61.39
Relative Price Index (percent)[3]	179.38	169.27	161.65	153.77	148.83	139.76	134.33
Modified relative price index[4]	146.43	148.46	130.07	125.22	110.34	96.74	92.11
Real effective exchange rate[5]	538.80	534.47	536.56	544.85	549.96	557.39	612.92
Modified effective exchange rate[6]	439.83	468.76	431.74	443.69	407.73	385.82	420.28
Real exchange rate[7]	477.46	457.45	433.76	424.91	429.26	433.84	470.26

Source: Bank of Korea, Economic Statistics Yearbook, IMF, International Financial Statistics. Suh (1981) p.30

Notes: 1) Equal to the Year-average nominal exchange rate plus the average incentive per dollar exports.

2) Equal to the product of export share of major countries to Korea, WPI's for major countries average exchange rate index for major countries against United States plus the product of the share of U.S.A. to Korea and WPI for U.S.A. (major countries: Japan, United Kingdom, Germany, Belgium).

tween different periods would probably give us a rather clear picture of the effect of the effective subsidies on the export boom in the mid-1960s.

One study by Kim et al (1981) was partially made in this direction, showing that the average effective subsidy rate in the manufacturing sectors was

Table 15. Nominal and Real Effective Exchange Rate of Export, 1965-1979 (continued)

	1972	1973	1974	1975	1976	1977	1978	1979
Year-average nominal exchange rate (Won per dollar)	394.00	398.54	406.00	484.00	484.00	484.00	484.00	484.00
Average incentive (Won per dollar export)	107.9	93.9	84.5	76.2	75.7	76.6	80.2	80.0
(1) Interest subsidies	10.1	5.8	5.9	9.0	8.7	8.8	9.5	11.5
(2) Direct tax reduction	2.0	1.4						
(3) Indirect tax exemption	27.2	21.3	22.8	33.3	33.6	37.1	42.7	42.7
(4) Tariff exemption	68.5	65.4	55.8	33.8	30.7	33.4	30.7	28.0
(5) Electricity & railroad discount	0.1			0.1				
Gross subsidies (1)-(5)	107.9	93.9	84.5	76.2	75.7	76.6	80.2	80.0
Net subsidies (1), (5)	10.2	5.8	5.9	9.1	8.7	8.8	9.5	11.5
Nominal effective exchange rate[1] (won per dollar)	501.9	492.4						
		4	490.5	560.2	559.7	560.6	564.2	564.0
Dollar Price Index[2]	65.97	78.57	93.62	100.0	104.27	112.84	129.88	143.33
Relative Price Index[3]	126.87	141.31	118.51	100.0	93.02	92.34	95.15	88.42
Modified relative price index[4]	91.87	108.78	109.10	100.0	84.02	78.31	77.04	71.45
Real effective exchange rate[5]	636.76	695.87	581.29	560.2	520.63	517.66	536.84	498.69
Modified realeffective exchange rate[6]	461.10	535.68	535.14	560.2	470.26	439.01	434.66	402.98
Real exchange rate[7]	499.87	563.18	481.15	484.0	450.22	446.93	460.53	427.95

Notes: 3) Equal to the dollar price index divided by the WPI for Korea, expressed as a percentage.

4) Equal to the dollar price index divided by Unit Labor Cost Index for Korea.

5) Equal to the product of the nominal effective exchange rate and the relative price index.

6) Equal to the product of the nominal evffective exchange rate and the modified relative price index.

7) Year-average nominal exchange rate x relative price index x 1/100.

−6.5 percent in 1968 while the one in the primary sector was 20.7 percent. This indicates that a higher subsidy was given to the primary sector than to the manufacturing sector in 1968. Similar analyses for the period after and before 1968 would be required for comparison' these are not available now.

While this comparison is not currently possible, Suh (1981) went in a different direction. What he attempted to do was to estimate the effects of export incentives with the help of an econometric method. Unlike Frank et al, he incorporated all of the subsidies, including financial ones. In the following, a summary of his study will be presented.

Table 15 shows nominal and real effective exchange rates for exports for the period between 1965 to 1979. The nominal effective exchange rate is defined as R (1+s) where R represents the average annual nominal exchange rate and s the per dollar export subsidy as a percent of the nominal exchange rate. Note that the nominal effective exchange rate rose from 300.37 in 1965 to 564.0 in 1979. In turn, the real effective exchange rate remained in the range of 538.8 to 695.9. Suh's estimation of the export supply elasticity with respect to the nominal effective exchange rate is 2.2187, which is impressively high. Korean export expansion may thus be explained by the relative attractiveness of export production as revealed by the high elasticity of the effective exchange rate. He concluded that "the nominal exchange rate and the export incentives policy as pursued in Korea were the appropriate policies for high export growth in Korea where the private sector responded sensitively to the export profitability opportunity."

Even though the elasticity is impressively high, it cannot be comparable to the elasticity for the period prior to 1965 since the period Suh dealt with is only the period after that. His results do not give us an equally clear explanation for the export boom in the mid-1960s. ON the basis of this observation, Jones and Sakong (1980) suggested five other factors which were deemed to contribute to the export boom. Those are reduction in opportunity costs, simpler input acquisition, lower variance in export return, field augmentation, and nonpecuniary parameter manipulation, all of which may or may not have anything to do with the government role in economic development. We still badly need more indepth studies on this issue.

References

Cole, D. C. and Y. C. Park *Financial Development in Korea, 1945-1978*, Cam-

bridge: Harvard, 1983.
Hong, Wontack, "Institutionalized Monopsonistic Capital Markets in Developing Countries," *Journal of Development Economics*, 1986, pp. 353-359.
__________, *Trade, Distortions and Employment Growth in Korea*, Seoul: Korea Development Institute, 1979.
Frank Jr. C. R., Kim, K. and L. E. Westphal, *Foreign Trade Regimes and Economic Development: South Korea*, New York, 1975.
Jones, L. P. and I. Sakong, *Government, Business, and Entrepreneurship in Economic Development: The Korean Case*, Cambrdge: Harvard, 1980.
Kim, Hakun, "On Estimation of Equilibrium Interest Rates in Korea (I)," mimeo, 1968.
__________, "On Estimation of Equilibrium Interest Rates in Korea (II)," mimeo, 1987.
Kim, K. and L. E. Westphal, *Korea's Foreign Exchange and Trade Policies*, Seoul: Korea Development Institute, 1976.
__________, "Industrial Policy and Development in Korea," in Bela Balassa (ed), *Development Strategies in Semi-Industrialized Countries*, Baltimore: The Johns Hopkins University Press, 1981.
McKinnon, R., *Money and Capital in Economic Development*, Washington D. C.: The Brookings Institution, 1973.
Ro, S. T., "Favorable External Conditions and the Korean Economy in 1986," Korea Development Institute, 1987.
Suh, Suk Tai, *The Effects of Export Incentives on Korean Export Growth: 1953-79*, Seoul: Korea Development Institute, Working Paper 8107, 1981.
Van Wijnbergen, S., "Macroeconomic Effects of Changes in Bank Interest Rates; Simulation Results for South Korea," *Journal of Development Economics*, 1985, pp. 541-554.
Yoon and Hahn, "On Optimal Money Supply," *Yonsei Business Review*, (in Korean), 1981.
Yun, Kun-Young, "Tax Incentives and Economic Development in Korea," mimeo, 1989.

Korea's Privatization of Public Enterprises: Several Case Studies

Shin Il Kang

I. Introduction

The Republic of Korea (hereafter referred to simply as Korea) has public enterprises which consist of Governemnt departmental enterprises, Government-invested enterprises, Government-backed enterprises, and Subsidiary enterprises of Governemnt-invested enterprise (see Appendix A). Local public enterprises are also controlled by local governments (the City of Seoul, etc.).[1] Government-invested enterprises, whose shares are more than 50 percent held by the Government, are a major element of the public enterprise set. The rationale for establishing public enterprises includes the existence of natural monopolies, merit goods, externalities, and the desire for rapid development. Their provisions of electricity, telecommunication, financial and education services have corrected market inefficiencies which have been caused by the economies of scale, the imperfect capital market, and the nature of public goodness. Public enterprises have played an important role in Korea's rapid economic growth since 1961, particularly in the provision of social infrastructure such as hydro-electric power plants, roads, and so forth. In 1990 the budgets of such enterprises amounted to $29.2 billion, close to the size of the Government budget for 1990. In terms of value ad-

1. Local public enterprises controlled by the city of Seoul are Seoul Metropolitan Subway Corp., Gangnam General Hospital, the Seoul Agriculture and Marine Products Wholesale Market Management Corp., and Seoul Installation Management Corp.

ded, public enterprises contributed 10 percent of total GDP in 1986.

Economic inefficiencies of the public enterprises have revealed themselves increasingly as the enterprises have grown in size. Low profit rate, over-investment, overmanning, and inflexibility in regard to market changes, etc, are types of such inefficiencies. Such failures have been caused by the bureaucratic nature of firms and excessive Government regulation. The goals of public enterprises are to maximize welfare as well as to maximize profits. Sometimes a low profit rate is justified by giving priority to welfare aspects. The ill-defined goals of public enterprise also contribute to poor performance.

Privatization has been suggested as a sound policy for improving the efficiency of public enterprises. It would bar, the Government from paying the costly subsidies it used to pay to keep the inefficient public enterprises afloat. Privatization might be defined as a transfer of assets and service functions from public to private hands. Privatization can take many forms, each of which has different economic effects. The most complete form of privatization is to sell Government-owned assets to private buyers, removing the Government entirely from any involvement in the enterprise. Less complete asset sales, deregulation, and contracting out etc., are included as forms of privatization.

The first large scale privatization program commenced with the privatization of the Korea Express Co. Ltd. It took place from 1968 to 1973. Most public enterprises of the late sixties and early seventies had been established under Japanese colonial rule but were nationalized by the Government after World War II. Some of these public enterprises which had been mismanaged were privatized, while others were reorganized into new enterprises for economic development. Eighteen enterprises are newly established. Eight enterprises were sold off to private firms and financial institutions, which were themselves public enterprises. There was no share limit when they were privatized.

The second privatization program was implemented in the early eighties. Privatization was one component of the general liberalization policy which the Government adopted in 1980. Compared with the real sector of the Korean economy the volume of financial assets and the transaction level of financial intermediaries were considered too low in the late seventies. It was believed that Korea's economy required a more rapid development of the financial sector. Four financial institutions including the Hanil Bank, the Korea First Bank, the Bank of Seoul and Trust Company, and the Cho-Hung Bank were sold to private firms and investors by the asset sale method. Private firms have a share limit of 5 percent, while individual investors have a limit of 5,000 shares to prevent them from monopolizing the financial market. Addressing an increasing problem of inefficiencies within the public enterprise set, the Government passed the Government-Invested Enterprise Management Law in December 1983 which introduced a performance evaluation system for public enterprises. Since 1984 this new evaluation system has been applied to 25 Government-invested firms. Though the performance of Government-invested firms has improved, the new system has had limited effect as it only applies to Government-invested firms and does not cover other public enterprises.

To improve the efficiency of the whole public enterprise set, the Government initiated the third privatization policy in 1987. This initiative was aimed at the development of private enterprise in the industrial and financial sectors. The plan was intended to reduce the inefficiencies of public enterprises, to alleviate the financial burden of the Government, and to enlarge the size of capital in the recent privatization programs. Some public enterprises have been competing with private firms, while others have lost the original goals for which they had been established. The role of these public enterprises has contracted as the private sector grew. The belief that the private sector is more efficient than the public sector may necessitate privatization. Reflecting these needs, the Korea Stock Exchange, the Pohang Iron and Steel, Co. the Citizens National Bank, the Small and Medium Industry Bank, the National Textbook Co., Ltd., the Foreign Exchange Bank, the Korea Appraisal Board, the Korea Technology Development Corp., the Korea Electric Power Corp., and the Korea Telecommunications Authority were chosen for privatization. Among them, the Korea Stock Exchange was sold to the 25 stock brokerage firms, and the Pohang Iron and Steel Co. and the Korea Electric Power Corp. utilized asset sales through a wider share ownership program. The sale of the six other firms, except the Citizens National Bank and the Small and Medium Industry Bank, proceeded step by step. The two Banks' delay was due to the stagnancy of the stock market. Overall, the third privatization program focuses on deregulation of business activities as well as a partial change in ownership.

The main goals of this study are to look at past cases of privatization to identify those factors which have led to success failure and to design a feasible privatization policy with regard to issues such as deregulation, and wider share ownership, etc. Chapter II is to evaluate the first, and second privatization programs by using case studies. Chapter III describes the third privatization program and evaluates the case of the Pohang Iron & Steel Company, and the Korea Electric Power Corp. Finally, an attempt will be made to draw some lessons from the Korean privatization experience.

II. Evaluation of the First and Second Privatization Programs [2]

1. *Overall Views*

Korea began privatization of public enterprises in the late sixties, continued with selling banking firms through an asset sale in the early seventies and accelerated the process in the early eighties. Table 1 lists public enterprises which were sold by the Government to the private sector and the date of the sales. Throughout, the Government used the asset sale method. Buying parties were both private large firms and banking firms which are themselves public enterprises. After 1980, a public tender offer with an ownership share limit was adopted. Firms and individual investors were allocated 50 percent each, with a share limit 5 percent for firms and 5,000 shares for each individual in the first issue. The ownership limit was 8 percent after it circulated. The major shareholder in privatized financial institutions got 7.9 percent of the total shares after four years' circulation. To evaluate the effectiveness of privatization, indicators such as total profit, the average rates of return, and sales per employee were calculated. Indicators at the time of privatization were then compared with indicators after privatization. Table 2 shows indicators calculated for 13 selected privatized firms. The level of profit, the average rate of return, and sales per employee for a five-year average are compared with those at the date of privatization. The privatization of three companies, i.e.: the Korea Shipbuiding and Engineering Corp. and the Korea Dredging Corp. the Korea Line Corp., did not improve performance indicators. The deficit increased and the average rate of return declined though sales, per employee increased due to competition in the market.

In the case of the Korea Salt Co., the Korea Reinsurance Company, and the Hanil Bank the level of profit, the average rate of return, and total sales per employees decreased. The reason why the Korea Dredging Corp. and the Korea Reinsurance Co. have bad performances is that they invested large

2. This chapter is partially quoted from Korea's Privatization Plans and Past Experiences (KDI working paper No. 8823) by Kang Shin Il.

Table 1. Privatized Firms from 1968 to 1983

Name	Year of Establishment	Year of Privatization
Korea Express Co., Ltd.	11/30	7/68
Korea Line Corporation	1/50	11/68
Korea Shipbuilding and Engineering Corp.	1/50	11/68
Inchon Iron & Steel Co., Ltd.	9/64	6/87
Korea Air Lines Co., Ltd.	6/62	3/69
Korea Mining Promotion Corp.	2/62	6/71
Korea Salt Co., Ltd.	10/36	2/71
Commercial Bank of Korea	6/61	2/73
Korea Marine Industry Development Corp.	7/63	11/73
Korea Reinsurance Company	12/62	/78
Yukong Limit	10/62	12/80
Korea Dredging Corporation	8/67	2/82
Hanil Bank	6/61	7/81
Korea First Bank	6/61	9/82
Bank of Seoul & Trust Company	6/61	9/82
Cho-Hung Bank	6/61	3/83

Note: 1/ Those firms actually established before 1945. However, they became public enterprises through law in 61.6.
2/ This firms was partially privatized in 1968. In 1987, the Hyundai group bought this firm when the Government attempted to sell the partial ownership.
Source: Kang (1988).

amounts of money in tangible assets. Compared to the recent data, we can see improvement in managerial performance after privatization. Seven other firms showed good performances: increase in the level of profit, increase in the average rate of return, and increase in the total sales per employee. Especially Yukong Limited became profitable and its average rate of return also turned positive.

2. Case Studies

1) Korea Air Lines Co., Ltd.

This firm was privatized in March 1969 in response to the firm's accumulated deficits and mismanagement. After privatization, the profit-oriented owner enlarged the size of the firm and its market by a large investment in new airplanes and computer systems. Additionally, incentives programs were created for job tenure. In 1986, total capacity in terms of the volume of seats increased to 10,500 seats from only 339 seats available in 1969 and revenues

Table 2. Change in Managerial Performance after Privatization

Variable / Firms	Profit (Million won) 1/ at privatization	Profit average after five years'	Profit differences	Average rate of return (%) 2/ at privatization	Average rate of return average after five years'	Average rate of return differences
Korea Express W., Ltd.	417	757	340	14.4	16.6	2.2
Korea Line Corp.	−73	−126	−53	−3.7	−26.0	−22.3
Korea Shipbuilding & Engineering Corp.	−395	−846	−454	−25.3	−33.4	−8.1
Inchon Iron & Steel Co., Ltd.	695	4,119	3,424	6.3	12.3	6.0
Korea Air Lines Co., Ltd.	−160	113	273	−15.4	4.9	20.3
Korea Mining Promotion Corp.	76	306	230	6.0	17.1	11.1
Korea Salt Co., Ltd.	159	116	−43	70.5	3.8	−3.7
Commercial Bank of Korea	214	5,454	4,740	6.2	18.6	12.4
Korea Reinsurance Company	345	285	−60	12.0	9.1	−2.9
Korea Dredging Corp.	1,038	936	−102	7.2	3.9	−3.3
Hanil Bank	20,780	10,314	−10,475	−14.2	4.5	−9.7
Korea First Bank	6,301	11,436	5,135	4.4	5.0	0.6
Bank of Seoul & Trust Co.	6,079	8,866	2,789	4.2	4.3	0.1
Cho-Hung Bank	5,741	7,477	1,736	2.9	3.3	0.4
Yukong Limited	−34,729	17,344	52,073	−52.6	10.8	63.4

	Total Sales Per Employee (in W million per person)		
	priva- tiza- tion-	at after five years'	average differ- ences
Korea Express W., Ltd.	1.4	2.5	1.1
Korea Line Corp.	3.1	7.4	4.3
Korea Shipbuilding & Engineering Corp.	0.9	1.6	0.7
Inchon Iron & Steel Co., Ltd.	31.9	74.5	42.6
Korea Air Lines Co., Ltd.	2.9	8.7	4.8
Korea Mining Promotion Corp.	3.2	12.1	8.9
Korea Salt Co., Ltd.	3.2	0.9	−2.3
Commercial Bank of Korea	7.7	17.5	9.8
Korea Reinsurance Company	718.3	552.8	−165.5
Korea Dredging Corp.	18.7	39.6	20.9
Hanil Bank	67.4	63.3	−4.1
Korea First Bank	40.1	62.6	22.5
Bank of Seoul & Trust Co.	40.5	57.3	16.8
Cho-Hung Bank	45.9	53.9	8.0
Yukong Limited	975.0	1,196.6	221.6

Note: 1/ Measured in current prices.
2/ Average rate of return is calculated by the ratio of total fixed capital.

rose from $27.2 million to $136.1 billion.[2] Its monopoly position did not account for the increase in revenues, since in 1985 the monopolistic domestic operations contributed only 8 percent to total revenues.

3. Unless otherwise specified, "$" refers to U.S. dollars in 1980 constant prices.

Table 3. The Ratio of Government Provided Freight to Private Freight

(unit: %)

	1965	1975	1986
Government	64.2	20.2	16.2
Private	35.8	79.8	83.9

Source: Korea Express Co., Ltd.

2) Korea Express Co., Ltd.

On the basis of total sales, the Korea Express Co.'s market share decreased every year after privatization due to the increased competition in its market. Though a 74.6 percent market share in 1979 dropped to 29.5 percent in 1985, labor productivity in terms of sales per employee increased compared to the industry average. After privatization, the profit-oriented owner increased equity capital through the stock market and modernized the firm's facilities and equipment. The company also enlarged its markets to handle Government freight as well as private freight (See Table 3) and invested its accumulated reserve in equipment.

3) Korea Salt Co., Ltd.

After privatization, the Korea Salt Co., Ltd.'s market share decreased slowly from 13.1 percent in 1970 to 8.7 percent in 1985, and its operating deficit rose rapidly. The reasons for this poor performance are the following: First, the company's profits are vulnerable to adverse weather conditions, resulting in an unstable price structure. Second, since 70 percent of total costs is from labor input, the migration of labor from rural to urban AREAS has affected costs adversely. Third, the arable land for salt has decreased because of the land reclamation program. Finally, the consumption of natural salt compared to manufactured salt has fallen due to quality and price factors. Recently, the Korea Salt Co. is trying to build a manufactured salt plant to evade these problems.

4) Commercial Banks

Privatization of commercial banks began in 1973 with a transfer of ownership of the Commercial Bank of Korea from Government to private hands. From 1980 to 1983, the major depositing banks (the Hanil Bank, the Korea First Bank, the Cho-Hung Bank, and the Bank of Seoul and Trust Company) were privatized, and there were attempts to liberalize the financial sector by eliminating entry barriers and deregulation on management. The banking sector has been allowed to create new services and financial commodities, and banks have been allowed to diversify their businesses. With privatization, 617 regulated services were reduced to 12. Two banks the (Shin Han Bank and the Han Mi Bank) were allowed to enter the financial market together with other credit unions. All banks are allowed to deal in credit cards, management of bonds and mutual funds Especially banks were allowed to issue CDs bonds and mutual funds Especially banks were allowed to issue CDs during the period of liberalization. Accumulated non-performing loans which resulted from interest rate control and inveterate bureaucratic behavior made liberalization less effective.

Government control of the structure of interest rates and of fund management has diminished imperceptivly. The role of the national investment fund and its specific funds for investment has declined. The outlook for the banking sector after privatization is bright so long as financial institutions are allowed to continue to create new commodities and develop services within a deregulated environment. The major unresolved issues are the state of the outstanding non-performing loans which resulted from the Government lending policy and fund management control. Outstanding non-performing loans amounted to about 4 billion dollars in 1988. Five percent of the loans will be written off and the rest of them can be gradually written off against banking reserves as the level of profit increases. However, it will take many years to solve this problem.

3. Lessons

Several lessons can be drawn from Korea's experience with the first and second privatization. Most of the buying groups were confined to a few firms. They could become large firms, which aggravates the relationship between large firms and SMFs. However profit-motivated owners have an incentive to manage firms efficiently by implementing changes in organization and accountablity. Private firms typically provide incentive systems (promotion) for their workers, ultimately saving on production costs, improving their financial structure and diversifying their general risks with management of an expanded market area.

There are a few firms, however, which have not shown significant improvement after privatization. In the case of the line and shipbuilding busineses, the unregulated entry of new participants has led to overcompetition which has resulted in deficits. The Government has ignored the fact that these businesses operate under economies of scales with alrge sunk costs. in the case of banks, the Government has continued to impose regulations on the term structures and on fund management which have had harmful effects for profit-oriented managers. Broad deregulation along with privatization is needed. Finally, there are many business risks: general risk and firm specific risk. General risks might be more efficiently borne by a risk neutral agency such as the Government. The salt business, for example, is ectremely vulnerable to weather conditions.

III. The Current Privatization Program

1. Data from Selected Firms.

The current privatization program was initiated on April 2, 1987, by the Privatization Proceeding Committee (PPC) which consists of thirteen government officials and six civilians and is chaired by the Vice Minister of the Economic Planning Board (EPB).[4] PPC selected seventeen Government-Invested Enterprises for privatization among twenty-five firms. Table 4 provides data on the selected firms, seven selected for total privatization, four for partial privatization and seven for functional privatization, transferring some of the public tasks to the private sector selectively. Inefficiencies of those firms revel themselves as time passes. Those firms chosen for total privatization had already been competing with private firms. Those firms chosen for partial privatization are large scale firms which still have a large impact on Korea's economy. Though they will be completely privatized in the long

4. The Economic Planning Board (EPB) was organized in 1961. The EPB is responsible for price policy, fair trade administration, investment project appraisal, and performance monitoring and evaluation, in addition to the initial functions of development planning, budgeting and statistical work. Since the minister of the EPB is a deputy prime minister and has the important instruments of budgetary control over the ministries, the planning ministry is considered to have the appropriate institutional power to carry out the functions of economic planning and policy coordination.

run, the Government remains a large shareholder until the capital market is mature. Firms choson for functional pivatization still have some public functions though they compete with private firms. Some functions still need to be under the guidance of the Government.

Table 4. Current Privatization Schedule
(Firms Selected for Privatization)

	Firms	Government Holding	Primary Service/Product	Date of Privatization
Total Privatization	Korea Stock Exchange	68.1	Regulation of securities, sales, review of new stock offerings	2 Feb 1988
	Citizens National Bank	72.6	Promoting household saving, expanding finance of small enterprises and low-income groups	1989 c/
	Small & Medium Industry Bank	99.9	Providing credit guarantees, loans and discounts to small and medium industries	1989 c/
	National Textbook Co., Ltd.	50.0	Publishing and supplying elementary and middle school textbooks	1989 c/
	Foreign Exchange Bank	2.5 a/	Dealing with foreign exchange	1991
	Korea Appraisal Board	49.4	Appraisal of banks' collateral, firms' assets	1989
	Korea Technology Development Corporation	20.8	Providing credit guarantees, loans for technology development	1989
Partial Privatization	Korea Monopoly of Tobacco	100.0	Production and distribution of tobacco and ginseng	1989 c/
	Korea Electric Power Corp.	100.0	Electrical source development and electricity generation	1989
	Korea Telecommunications Authority	100.0	Telegram and telephone facility development and maintenance	1989 c/
	Pohang Iron & Steel Co.	34.1 b/	Production of steel	April 1988
	Korea Overseas Development Corporation	100.0	Overseas labor supply service	1989
	Industrial Sites and Water Res. Development Corp.	97.3	Industry site and special regional development	1988 d/
	Agricultural Promotion	100.0	Irrigation development and	1989

Functional	Corporation		land reclamation	
Privatization	Korea Development Bank	100.0	Long-term loans, investment guarangees, international banking	1989 d/
	Korea Housing Bank	96.4	Financing for both public and private housing sectors	1989 d/
	Korea Trade Promotion Corporation	100.0	Overseas marketing and information service	1988 d/
	Korea General Chemical Industry Corporation	5.0	Chemical fertilizer production	1988

a/ The remaining 97.5 percent is held by the Bank of Korea.
b/ KDB holds 38.0 percent; the remainder is held by commercial banks.
c/ Privatization has been delayed because of the stagnancy of the stock market and reforms of related laws.
d/ Functional privatization has been proceeding slowly by changing the organizations, etc.

2. Method of Privatization

Privatization has been mostly carried out through asset sales, either with public tender offers or people's share[5] with fixed prices. The primary purchasers were employees, individual investors and firms. Twenty percent of total shares at the initial sale of each public enterprises was assigned to employees who showed strong resistance to the privatization. The "Employees" ownership program overcame this severe barrier. Most firms have used people's shares programs with the rest of shares: the Pohang Iron an Steel Co., for example, was privatized with a people's share program in May 1988. Purchasers consist of three groups: low-income (75 percent), employees (20 percent), and individual investors (5 percent). The Government adopted a discount price (30 percent) for shareholders who were willing to hold the stock for three years. Otherwise, qualified investors had to pay the market price. The Same method apolied to the Korea Electric Power Corp. (KEPC) in 1989. The success of the asset sale method depends on the size of the stock market. Privatization cannot take place unless there is enough capital in the private sector for divesture.

Table 5 privides information onthe development of the stock market. Since 1986 the stock market has advanced both qualitatively and quantita-

5. The people's share program increases the number of stockholders, which prevents major stockholdings. In Korea, this program is used for income redistribution purposes to qualifying low-income people.

Table 5. Table V. The Development of the Stock Market

(unit: %)

Year	No. of Listed Companies	No. of Share-holders	No. of Shares (in '000)	Par Value (Wmilion)	Total (A) Market Value (Wmilion)	GNP (B) (Wbillion)	A/B (%)
'63	15	14,823	31,973	16,971	10,025	488.0	2.05
'70	48	76,276	158,965	134,292	97,923	2,776.9	3.53
'75	189	290,628	824,983	643,405	916,054	10,064.6	9.10
'80	352	753,290	3,875,642	2,421,417	2,526,553	36,672.3	6.89
'83	328	70,510	5,444,062	3,238,872	3,489,654	58,985.8	5.92
'86	355	1,410,507	1,125,592	5,649,718	11,994,233	83,833.0	14.31
'87	389	3,102,303	1,518,976	7,594,879	26,172,174	97,531.7	26.8
'88	502	4,600,000 a/	2,511,384	12,560,367	64,543,684	111,574.8	57.8
'90	609	1,731,265	4,796,327	22,268,772	79,109,675	168,438.0	46.9
92.1	688	N. A.	5,163,756	2,639,852	82,073,095		

a/ Approximate. Additional 150 million stockholders which have people's shares in the Pohang Iron & Steel Co. are included.
Source: Korea Stock Exchange, 1988.

tively The ratio of total stock market value to GNP increased from 6.9 percent in 1980 to 57.8 percent in 1988. Since then the stock market has been stagnant. The number of shares trade increased rapidly because of the people's share program which was first applied to the Pohang Iron and steel Co. in March 1988 and the Korea Electric Power Plant Corp. in May1989. Qualitatively, stock-issuing companies flourished with the increase in technical personnel to evaluate stock issuing companies and computerized systems to provide information.

Government policies to foster the stock market were implemented in the seventies. There are incentives for firms to offer shares to the Public by providing preferential tax benefits and to improve the efficiency of the stock market system. Recent policies for the stock market have been implemented to help diversify supply sources of investable funds and to alow the current privatization program to proceed without friction.

6. The ratio of total stock market value to GNP in U.S. is 52.2 percent and in Japan 86.5 percent (as of March 1987)

3. *Privatization in Progress*

There are three firms which did not adopt the peoples' share program. The Korea Stock Exchange, the Korea Appraisal Board and the Korea Technology Development Corporation were sold to the current stockholders. Table 6 shows the size and method of asset sales for selected firms. The Korea Telecomunications Authority, the Citizens National Bank, and the Small & Medium Bank will be privatized by using the peoples' share program after their related laws are revised. The National Textbook Co, and the Korea Monopoly of Tobacco have already decided how much the government will sell However, the method of privatization has not been decided yet. These firms

Table 6. Asset Sales Methodology of Selected Firms

	Firms	Method	Size of	Government Shares after Privatization
Total Privatization	Korea Stock Exchange	Sales to member firms	100%	0
	Citizens National Bank	People's share	21.6%	78.4% a/
	Small & Medium Industry Bank	People's share	48.9%	51.1% a/
	National Textbook Co., Ltd.	Public tender other	100%	0
	Foreign Exchange Bank	People's share and public tender to others	100%	0
	Korea Appraisal Board	Sales to current stockholders	100%	0
	Korea Technology Development Corporation	Sales to current stockholders	100%	0
Partial Privatization	Korea Monopoly of Tobacco	People's share	49%	51% a/
	Korea Electric Power Corp.	People's share	30%	70%
	Korea Telecommunications Authority	People's share	49%	51% a/
	Pohang Iron & Steel Company	People's share	34.1 of total share	35%

a/ Those shares are currently held by the Government because a selling policy has not yet been determined.

plan to sell out in 1992.

Seven firms have been choson for functional privatization which will proceed as follows: The Korean Development Bank (KDB) and the Korea Housing Bank will be reorganized according to a banking sector restructuring program which has not as yet been formulated. The Government will first sell firms which have been invested in by the KDB. The Korea General Chemical Industry Corp. (KGC) is a holding company of five firms, four of which have already been sold. The KCC took control of the remaining firm, the Namhae Chemical Corp. The Korea Trade Promotion Corp. (KTPC) overlaps the Korea Trade Association (KTA) and is financed by the KTA. Both firms are to be reorganized. The Industrial Sites and Water Resource Development Corp. was changed to the Water Resource Development Corp in December 1982, focusing on the development of water resources. The agriculture and Fishery Development Corp. has been encouraged to stabilize prices through demand and supply management of agricultural products, rather than having a storage function. Finally, the Korea Overseas Development Corp. will retain its travelling services and be transferred to private firms. However, capital exportation for investment and information on labor immigration in domestic and foreign markets will be retained by the Government.

4. Case Study of the Pohang Iron & Steel Co.

The Pohang Iron & Steel Company (POSCO) was established in 1968. New investment has been carried out by the Government. It's production capacity per year amounts to 11.6 million ton which is seventh in the world. The Government sold 34.1% of total shares via the People's Share program in 1988. With the asset sale, the Government revised the law of security exchange, the act of promoting the capital market, and the statute on national property to prevent large scale firms from being owned by one firm, in order to carry out the privatization program smoothly.

The value of assets was evaluated by the Korea Appraisal Board and the Korea Credit Evaluation Ltd. They offered the suggested price to the Advisory Committee for Calculating Asset Price which is controlled by the Ministry of Finance. The Committee recommended 15,000 won per share to the Ministry of Finance, which was the actual sale price. The starting price of POSCO was 43,000 Won in June 1988 on the stock market. It lowered to 26,200 in June 1991. The trend of POSCO's stock prices is shown in Table 7. The revenue which the Government got after the privatization of POSCO was

Table 7. The Trend of Stock Prices of the Pohang Iron & Steel Co.

	Maximum Price per Month	Minimum Price per Month
'88. 6.	43,000	30,600
7.	32,300	28,700
8.	30,000	26,200
9.	28,200	26,600
10.	31,500	26,300
11.	33,005	29,000
12.	39,900	31,500
'89. 1.	38,000	35,500
12.	37,400	29,400
'90. 1.	34,100	29,600
6.	28,300	23,400
12.	24,100	22,100
'91. 1.	24,600	22,200
6.	20,200	18,200
12.	23,600	21,700
'92, 1.	25,500	20,200

Source: Stock, Korea Stock Exchange, various issues.

149.1 billion which will be used via a special account in the Government budget.

After divesture, employees and individual investors were added to the share holders of the MOF, KDB, etc. After divesture, POSCO increased it's equity capital through the stock market. The number of shareholders increased to eight million at the end of 1988. (See Table 8.)

Three problems encountered have been since the privatization of the Pohang Iron and Steel Co.: equal distribution, long-term holding and deregulation. Since only low-income people are entitled to seven or sixteen shares per person, general investors had to purchase the shares at a premium. The premium has been two times that of the initial market price, which distorted the market. As for the seond problem, 83 percent of qualified investors had not chosen the discount price but preferred short term windfall profits even when the Government granted a discount price and a higher share limit for long-term holders. Windfall profiteering distorts the equity market. In order to stabilize the equity market and to protect low-income groups, some

Table 8. Distribution of Share Holders by Groups

%

	Before Privatization	After Privatization
Government	33.4	20.0
Korea Development Bank	38.0	15.0
Commercial Banks		
(Cho-Hung, Han Il, Korea First Bank, Bank of Seoul & Trust Company)	28.6	25.3
Korea Tungsten Mining Company	2.5	2.4
Employees' share	—	10.0
People's share	—	27.3

benefits are provided to long-term holders. Thsoe are free shares, discount price, and the establishment of a "mutual fund" which gives depositors, mostly low-income groups, higher returns than market transaction costs. Finally, deregulation has to be followed by total privatization to get market efficiency. Entry barriers are to be lifted. For example, POSCO has two establishments in Korea: Pohang and Kwang Yang. The two establishments can be divided for real competition in the market in the long run. In the case of partial privatization, the privatized firm is treated as equivalent to firms in the private sector. These firms face tight regulatory methods in public enterprises and the private sector. Some regulatory methods which create economic inefficiencies are to be lifted.

IV. Conclusion

This review of past and current privatization provides a guide for current privatization. Even though past privatization was merely a transfer of ownership from the Government to the private sector without any accompanying policy change, profit-oriented new owners were able to improve the firms' financial status. There are several lessons to be learned from this survey. First, risky businesses and regulated businesses have not shown any improvement following privatization. In the future, deregulation should accompany privatization.

A second lesson is that past privatization has been open to some interested investors though it later limits ownership rights in terms of shares. Some groups such as SMFs were completely alienated from privatization programs. It was hard for the past Government to find buyers due to the underdevelopment of the stock market and the firms' unsound financial structures. Confinement to some investors aggravates the relationship between large firms and SMFs. The current economic conditions are much more favorable than those in the past. Large numbers of investors together with the development of the stock market seem to help privatization to proceed well and also generate enough interest among investors. The Government intends to use the wider share ownership program with a discount price to distribute economic rents resulting from privatization. The Pohang Iron and Steel co., a with large excess surplus, was recently privatized by using the wider share ownership program. Investors below the middle income class were eligible. Most of them resold their shares for short-term windfall gains rather than holding the shares for the long term. In the future, the Government should provide more benefits for long-term holders who hold shares for at least three years.

A third lesson is that during past privatizations, it was difficult to find buyers for the assets of public enterprises. The sale of public enterprises with large deficits and the small size of the equity market were important restraints. Not allowing foreign investors to participate in the privatization might also, have been a contributory restraint. The current situation is much better, Enterprises have overcome chronic deficit problems and participation in the program has lessened as the equity market grows. However, their participation should be allowed in the privatization programs to the extent that foreign investors' participation increases technology transfer.

A final lesson is that partial privatization makes concerned firms have more government regulations, together with the regulations which the private sector has; until concerned public enterprises are totally privatized, some regulations in the private sector which create economic inefficiencies should be withheld.

PUBLIC ENTERPRISES BY TYPE

(As of 1990)

(1) Summary Table

Type	Features	Number
Government Enterprises	Government Branch	4
Government-Invested Enterprises	More than 50% of the shares held by the Government	24
Government-Backed Enterprises	Less than 50% of the shares held by Government	6
Subsidiary Companies of Government-Invested Enterprises		85
Total		119

(2) Government Enterprises

(Unit: person, Won in billions)

Branch	Employment (1990)	Budget (1990)
Korea Ministry of Communications	30,431	799.6
Korea National Railroad Communications	36,862	799.6
Korea National Railroad	36,862	1,477.4
Korea Administrator of Supply	1,193	31.4
Grains Management	1,144	20.4
Total	69,630	2,328.8

(3) Government-Backed Enterprises

(Unit: Won in billions)

	Equity (1985)			Year of Establishment
	Government	Private	Total	
Pohang Iron and Steel Company	91.8	367.1	458.9	1968
Korea Exchange Bank	10	395	405	1967
Korea Appraisal Board	1.5	1.5	3	1969
Korea National Roilraod	7.8	23.4	31.2	1952
Export and Import Bank of Korea	177.9	360	537.9	1976
Korea Technology Development Corporation	9.3	32.7	42	1981
Total	298.3	1,179.7	1,478	

(4) Government-Invested Enterprises

	Year of Establish-ment	Equity (Won in billion)	Government Stock (Won in billion)	Government Share (%)	No. of Subsid-iaries
Korea Development Bank	1954	1,059.4	1,059.4	100.0	28
Small & Medium Industry Bank	1961	217.1	217	99.9	6
Citizens National Bank	1963	96	69.7	72.6	15
Korea Housing Bank	1967	69	64	92.8	5
Korea Monopoly of Tobacco	1980	1,380	1,380	100.0	1
Government Mint	1590	6.6	6.6	100.0	
Korea Electric Power Corp.	1981	3,041.7	2,367.4	77.8	5
Korea Coal Corp.	1950	119	113.8	95.6	5
Korea Mining Promotion Corp.	1967	105	102	97.1	
Petroleum Development Corp.	1979	42	22	52.4	2
Korea Integrated Chemical Stock Company	1973	87.8	4.4	5	6
Korea Trade Promotion Corp.	1962	0.5	0.5	100.0	
Korea Highway Corp.	1969	637.8	625.3	98.0	4
Korea Housing Corp.	1962	868.5	803.8	92.6	2

Industrial Sites and Water Resources Development Corp.	1974	684	639.9	93.6	3
Korea Land Promotion Corp.	1979	370	343.4	92.8	
Agriculture Promotion Corp.	1970	14.4	14.4	100.0	
Agriculture & Fishery Development Corp.	1967	21	21	100.0	3
Korea Telecommunications Authority	1981	1,978.4	1,978.4	100.0	7
Korea Tourism Corp.	1962	30.9	16.7	54.0	3
Government Printing Office	1952	8.2	4.1	50.0	
Overseas Development Office	1976	1	1	100.0	
Labor Welfare Corp.	1977	87.9	87.9	100.0	
Korea Gas Corp.	1983	82.6	48.8	59.1	
Total		11,107.8	89.9	85	

PART III
Transformation of Socialist Economy to Market Economy in East-Central Europe

The Subtleties of Post-Communist Transformations in Eastern Europe

Laszlo Lang

I. Introduction

Much has been written about the "transitions" in Eastern Europe. At first, Western kremlinologists attempted to lend intellectual support to reforming communist elites in the erstwhile socialist countries. They sought ways of making East European economic systems slightly more open and efficient, without raising the risk of enraging the Soviets or the local ruling elites and setting back the prospect of further economic and political reform for another decade.

After a long period of stagnation, Sovietology had come alive once again. Perestroika induced some of the best minds of Western economic though, in addition to numerous prematurely optimistic intellectuals, to engage in the struggle to "reconstruct' Soviet communism. But, the Soviet economy continued to function according to the unassailable logic of bureaucratic coordination; only the "efficiency" of central planning deteriorated.

In the end, these efforts did not amount to much. Such concepts as "socialism with a human face" and "market socialism," eagerly coined in the second half of the eighties, have disappeared into the annals of perestroika history. Recent experience has shown that communist economies are "unreformable" and halfway houses are at best utopian dreams or rather nightmares: It is not a matter of some kind of convergence, rather of unilateral systemic transformation. Even the decades-long Hungarian experimentation with reformed socialism offers little help to Hungary in the 1990s.

In recent times it has become increasingly clear that Gorbachev's greatest achievement was not so much his much lauded perestroika, as his policy of glasnost, that is, the cautious and inevitably imperfect democratization of the Soviet media and urban society. Whereas perestroika resulted in economic catastrophe, glasnost kindled a social awakening, leading to the opening up of communist societies to the world and the stirrings of an urban civil society.

The present time calls for facing up to harsh realities and adopting pragmatic policies rather than the grand intellectual designs which were so prevalent in the early days of Soviet reform. An understanding of Eastern Europe's most recent transition might explain why this is so and it would be unfortunate if this experience goes unnoticed in the melee of post-Soviet fever in the West.

Recent political and economic changes in Central Europe provide some, albeit limited, experiences of post-communist transitions. The evolving delicate and controversial interrelationships between crisis and transition; politics and economics; the role of the state and the free market; moral and psychological attitudes to the past and present; self-determination and nationalism etc. may point to immediate risks and dangers as well as opportunities in the future. I believe that these early lessons of Central European change should serve as a guide to the West and the Far East as they fashion their policies towards the former Soviet Union and its successor states. I also believe that these interrelationships may help to demonstrate that it is not the inevitable hardship of East European economic transition that will play the most decisive role in engendering the much feared new wave of population movements in Europe, but their political, national and security repercussions.

II. Transition versus Crisis

Each country in the region, Russia and the post-Soviet republics included, shares in a varied mixture of crisis and transition. In some countries, transition and the reform steps this implies, are the cause of the exacerbation of inherited crises. In others, crisis handicaps transition for political and economic reasons. The elements of crisis handicaps transition for political and economic reasons. The elements of crisis are only too well-known: inefficient and insurmountable economic structures; huge hard-currency debts, ecological catastrophes, and wrecked social welfare structures, etc. The notion of transition has also become commonplace: privatization of state ownership; the dismantling of pervasive controls over prices and exchange rates and the reconstruction of social welfare facilities, etc.

Once upon a time, it was presumed that pro-market economic transition was the best way to cope with the economic crisis left behined by communism. The American stance towards the achievements or failures of this post-communist region is still characterized by such wishful thinking: privatization, deregulation and decentralization will allow the free market to take care of Eastern Europe's problems. And no doubt, there is, in the long run, a harmony between crisis management and pro-market transition.

However, politically and socially, it is the short run that matters. We, individuals live in the short run and so too do our politicians, they probably to an even greater extent.

Thus, they may favor immediate crisis management (with state intervention, subsidies, institutional stability and protectionism, etc) to accelerated pro-market transition.

After all, in the communist years, crisis were dreaded as the inevitable precondition to change; had it not been for the crisis, change would have been unnecessary. The new, evolving, democratic governments of Eastern Europe could adopt a similar stance: crisis would be a threat to democracy. Legal and structural economic transformations are necessary and inevitable, yet such reforms may strengthen anti-democratic forces. Better to contain the crisis and social unrest, this line of argumentation may go on, before venturing wholeheartedly into the market. Unwanted political forces, such as the ex-communists, may exploit the social volatility caused by the simultaneity of crisis and transition. Therefore, strong state power is indispensable for taking the right steps with the appropriate time schedules to secure crisis-management and transition. Democracy would be sacrificed in the short run for the long-term goal of stable and consolidated democracy.

Undoubtedly, there is a certain truth to these arguments. If structural transition goes hand in hand with increased social hardship and at the same time, a grave recession is plaguing that economy, the government may feel bound to contain at least one of them.

Of course, such debate can lead to all sorts of questions about the means and the ends. It would be only too easy for the long-term goal of stable democracy to be defiled with the adoption of seemingly essential short-term policy options and all under the banner of "one day we will have a democratic society with a functioning market economy..." Hopefully, the realization that there is no solution to this problem other than a continuous fine-tuning of the balance between crisis and transition will probably hit home in Eastern Europe soon enough. In the meantime, politics may have its say.

III. Politics versus Economics

Eastern Europe's economists dream of a quiet period to introduce and institutionalize change. No doubt, they will have to keep on dreaming. The economists' desired time frame is the politicians' nightmare. From their point of view, sound economic policies may have to be modified or delayed to secure the political support to continue the reform process.

Hopefully, political and economic change will, in the long run, unite in a virtuous circle. At present, the circle seems to be more of a vicious one. The new democracies will find it difficult to overcome this controversy.

In each country in the region, political pluralism has preceded meaningful economic change. This could not be otherwise: the reforming communist regimes could not overcome their ideological and structural bias to launch far-reaching changes. Those who argue that "ideally what the East European countries needed was for their economic strategies to have two years unthreatened change to work. After that, unfettered political pluralism could have been introduced..."[1] betray a grave misunderstanding of the aspirations and limitations of East European reform communisms or anti-communist authoritarianisms.

In the current East European context, pluralism is inevitably translated into political struggles and competing sides seeking to capitalize on the social hardship which economic change entails. In Poland, a pro-transition President desperately wants to rule by decree against his country's allegedly foot-dragging legislature. The unity of the Czech and Slovak Republic may be wrecked as much by national ambitions as the differential impact of crisis and ambition on the different ethnic groups. Haungary's economic gradualism might appear exemplary to foreign observers in terms of finding the most effective interaction between economic remedy and political cohesion, yet for the Hungarian people, this remedy and this cohesion are less apparent. I do not propose to discuss Bulgaria, Romania and Yugoslavia in this paper, but in each of these case political and economic uncertainty are feeding on each other.

1. J. F. Brown, "Evolving Agendas and the Task Ahead', paper presented at the Council on Foreign Relations Symposium on "The U.S. and Eastern Europe," September 10-11, 1991, p. 7.

IV. State versus Free Market

The collapse of communism resulted in a proliferation of "transition theories." After all, this was the first time transition from a centrally planned economic mechanism to a market economy had been attempted. Initially, free marketeers had the upper hand. The superiority of the private sector over the public sector in the management of the economy had long been accepted as common wisdom in the West.

East European political rhetoric continues to laud private ownership and profess anti-statism. But in their daily practice, many of Eastern Europe's democratic governments seem to be sick and tired of maintaining this Thatcherite posture. For a start, they are now looking at the state and the government from the inside, rather than the old outsider (opposition, dissident) perspective. It is easier to be an ideologue when you have an overarching intractable enemy (the communist party and government machine), especially when you are not faced with the nitty-gritty of running a country. Moreover, for the first time the new politicians have tasted the fruits of power and found them savory. A dismantling of state power necessarily implies a weakening of their own power. Furthermore, the governments seek to stabilize the economy in the face of economic shocks. In that effort, they are bound to find that at least in the inevitably short-run of their existence, state intervention is more effective than the free play of the market, imperfect and semi-developed as the latter is.

A recent editorial in The Times sought to justify this mild pro-statist change in attitude. Firstly, it argued that it would still be justified in the short run, if there were investment projects yielding social returns greater than the cost of borrowing. Secondly, it would be foolish to rule out increased government borrowing if it were used for economic stabilisation (whatever that might mean). "The problem should dictate the solution, not ideology. That after all, is what the West has spent decades telling the communist world."[2]

Anglosaxon advice aside, mounting economic hardships may indeed tempt East European political elites to look to the East rather than the West for salvation. Inevitably, the question will be raised of whether market and foreign direct investment should be the sole arbiters of industrial rise or decline or whether national "industrial strategies," involving competition and a degree of protection, exchange rates, price controls and export subsidies, would be

2. Colin Narbrough, *The Times*, August 27, 1991, p. 21.

better harbingers of change, just as in the East Asian NICs. This discussion was raised and faded rather quickly prior to and during the political showdowns of 1989. Now that social hardships are beginning to goad local populaces, this subject is likely to return to the political agenda. "Englightened intellectuals" are well aware of that the "mild authoritarianism" accompanying this option would be a dangerous choice: it would be hard to keep it mild. Nevertheless, they will not be the ones who reinvent and guide this shift in approach.

V. Moral and Psychological Attitudes to the Past and Present

Each country needs time to come to terms with its past, but as is so often the case, people want answers tomorrow. Germans have been struggling for decades to come to terms with their past collaboration with or acquiescence in Hitler's regime. Nazism, however, was in power for "only" 12 years; the communisms of Eastern Europe endured 40 years. Even in the last hours of its existence, communism seemed to be everlasting and undefeatable. Small wonder that people found whatever way they could to get round the system, practicing deceit, hypocrisy, pretense and double-thinking, etc. right up to the last minute. The work ethic was also ravaged: legal, prime-time jobs were devalued in comparison with secondary and tertiary employment in the shadow economy. Individual success came to be regarded with suspicion. Not as so often argued by Western observers that East Europeans lack the entrepreneurial spirit and are so poisoned by egalitarian indoctrination that they cannot stand others' good luck. Rather, East Europeans simply wonder where and how did the private capital, which is now being so conspicuously invested and consumed, come from? They rarely relate it to individual skills and merit, remembering only too well how private enterprise flourished between the gaps and niches of central planning.

Suspicions and acusations are now spreading a kind of moral pollution throughout the region. Most of the Czechoslovak MPs could not help walking out of Parliament last year when several of their fellow-MPs were publicly exposed as former members of the security apparatus: it was not sympathy for the guilty but the ruin of some of the innocent that could not be borne. Can the files drawn up and held by a systemically deceptive regime be regarded as reliable? Where does accountability begin and end? The questions of collaboration, accountability and punishment cannot be solved overnight.

The answers are open to interpretation. People want justice; they also seek revenge. Often, it is the loudest who carry the day. And the loudest are rarely totally clean or among the handful of true dissidents belonging to Eastern Europe's communist past. New/old nomenclatures are emerging; career stories are being built not on individual moral and professional merits, but on real or, more often, fabricated and embellished facts of "resistance" against past regimes. Surely, this phenomenon reached its pinnacle with careers, made and broken and pasts pushed aside on the basis of what side were you on in those brief hours of the August coup!?

The moral burden that plagues whole societies also interacts with ethnic nationalism. "With the demise of communist dictatorships," the Czech sociologist, Jirina Siklova argues," ..all social values, all [past] actions and fortunes are stained by the suspicion of collaboration with the [old] political regime. Therefore, people can face only their primary ... social status without feeling ... Should their people their age, their sex ..., their ethnic and national belonging ... Should their people acquire a social prestige without ... collaboration, through their own acts and skills, then ... they will differentiate among each other on the basis of merits and quality and their nationalism will subside"[3] This reckoning is, however, some way down the road.

Social solidarity has been shattered. Role models go back to early 19th century capitalism, i.e. a period of primary capital accumulation with all the repercussions it imposed on the unfortunate majority of societies. People fear for their own jobs, but care less about those of others. The newly rich care only for their own social and increasingly political status, disregarding that of their present or future employees. Until recently, they sought to imitage what they perceived to be Western lifestyles; now the new elites are also seeking to acquire political influence. Tyminski's appearance in Poland is one startling case in point. The support some powerful elements of the new Hungarian rich lend to the conservative-populist Smallholders' Partyl a junior member of the ruling coalition, is another. Others will follow. Despite President Vaclav Havel's declaration that he intends to run again for reelection to back further economic reform and defend human rights, the time for benevolent historians, writers, philosophers and human rights activists to be in power may soon be over.

3. Jirina Siklova, "Who Killed the Goose That Golden Eggs," *Beszelo*, April 13, 1991, p. 17.

VI. Privatization versus Restitution

The dilemma over whether to and how far to privatize or reinstate land and assets to former owners has surfaced in all the post-communist countries of Eastern Europe. Political responses to this problem cover a wide spectrum.

In principle, it is hard to repudiate on moral and legal terms the restitution of land and property confiscated by the communists. However, the problem is not as straightforward as it may seem. Land was seized in all the countries concerned for reasons which go far beyond the communist cloak. Should other cases of confiscation (the seizure of Jewish property, the mass deportation of ethnic groups and ensuing property losses in the aftermath the World War II) be remedied by reparation, compensation or restitution? The line which necessarily has to be drawn is sure to be an arbitrary one.

Moreover, populaces might easily arrive at the question of why only those lucky few who or whose parents and grandparents happened to have some assets right after the war are entitled to reparation. Don't "we, the people" who have also suffered a great deal deserve some form of compensation? Schemes for nationwide "voucher privatization," that is, the free allotment of state-owned shares to the whole population, are being considered in all East European countries partly with this aim in mind.[4]

The only "rational solution" to this dilemma, to declare a clean slate/tabula rasa in property relations following democratic elections, has been rejected by all East European countries. Whether they seek to reinstate the property confiscated by the communists or to provide partial financial compensation, not only will the moral, legal and political dilemmas continue to plague the governments and peoples of Eastern Europe, but it will necessarily prolong the already painful process of privatisation.

VII. Economic Nationalism versus Liberalism

Nationalism, and economic nationalism in particular, cannot be linked to either of the major ideological schools of modern times. It crops up everywhere on the political spectrum from Christian democracy through social democracy to promarket neo-conservatism. Economic nationalism is not a

4. Other reasons for the attraction of these schemes lie in its appearance as a quick-fix to the problems of an otherwise lengthy privatization process and in the fallacy that in this way "oversized" foreign takeovers of "national assets" could and should be prevented.

blueprint for right-wing economic policy, more often it appears in the guise of pro-welfare and pro-independence policies of the right, center and left.

Pre-modern political values of the nation, tradition, the family and religion figure high on the political agendas of right-wing and centrist parties in the West, but so too do the principles of individualism and the free market. This is hardly the case with the emerging populisms in Eastern and Central Europe, which rely largely on the constituency of the emotions and are therefore not suited to rational governance, except perhaps in some form of authoritarian rule.

East and Central European populisms use and abuse nationalist tunes and attitudes which are inherent in the current government policies of the region. Arguably, the coals that stoke the nationalist tunes and as such nourish the appeal of populism are going to increase. Firstly, all the countries of the region will have to live through the purgatory of crisis before the second stage of their transition to democracy and the market is completed.

Secondly, new state formations are bound to emerge in the wake of both the collapse of Yalta, Paris and Versailles, not to mention the Soviet Empire. Thirdly, as true civil societies emerge, interest groups will be increasingly well-organized and increasingly capable of articulating their demands. These groups, including reorganized labor, will seek to use the state to advance their interests. And just like in Western Europe, the increased power of producer goods will become a major force for economic nationalism. Fourthly, the external factors, (intra-and extraregional), which are provoking nationalist responses in the countries of Eastern and Central Europe are likely to increase rather than decrease in numbers.

Therefore, one would be mistaken to presume that a large number of new states are entering the world stage joining in Fukuyama's vision of liberal universalism. Due to the problems and controversies mentioned above, these countries, including parts of the former Soviet Union, are likely to have large propensities towards interventionist, populist, nationalist attitudes, i.e., a set of characteristics which was supposed to be extinct in modern Europe. Some would even argue that the restoration of this ethnoregional nation-state system, with all its unsavory qualities, is a necessary precondition to European integration at some point in the 21st century.[5]

Obviously, some can take comfort by contending that this historical "return to the past" will be confined to Central and Eastern Europe. However, among

5. Peter Hanak, "Crises and Roots," *Heti Vilaggaszdasag*, September 7, 1991, p. 74.

other things, population movements in and out of the region will serve to remind these observers how wrong they have been.

VIII. Population Movements versus Old/New Xenophobias

Population movements in and out of Eastern and Central Europe are being depicted as one of the major dangers looming on European horizons. Recent election results in France, Germany and Belgium have only highlighted the respective fears. Although these fears are not without foundation, I am convinced that they are exaggerated, even smacking of "cataclysm." If we have learned anything from this period of Soviet and East European change, surely it is that both experts and politicians alike must avoid the extremes of complacency and cataclysm. An examination of the predictable and more unpredictable elements of these much-feared population movements might shed some light on a middle path.

1. The Results of a Survey

Apart from Poland and Czechoslovakia, emigration experience in the region appears to be rather limited. According to a May 1991 survey by Szonda-Ipsos, a Budapest-based public opinion agency[6], two-thirds of the Poles questioned had an acquaintance who moved abroad in recent years, and half of the Czechs and Slovaks knew of such a person in their neighborhood. In contrast, only one-third of the Russians surveyed and one-fifth of the Hungarians knew personally of people who had emigrated.

Paradoxically, the Poles, and Polish intellectuals in particular, harbor the most harsh sentiments against countrymen who did, or wish to, leave the "motherland" for good. Only? of those questioned said they approved of such a life plan. In contrast, two-thirds of Hungarians, and three-quarters of Czechs, Slovaks and Russian condone the emigration choices of their fellow countrymen.

Emigration int he course of the next three years is definitely not being considered by 88% of Hungarians, 69% and 67% of Poles and Russians respectively. A further 7%, 20% and 19% of those questioned in their respective countries found it most unlikely that they would make such a decision. However, 9% of Russians seem to be flirting with the idea as against 3-4%

6. The results were published in major Budapest dailies between august 23 and 27, 1991.

in Poland and Hungary. The proportion of those who allegedly want to emigrate in the next three years is confined to 1-2% in all three countries.

Strangely enough, it seems that, in relative terms, the largest number of emigrants would flock to the West from Czechoslovakia. Only 59% and 23% of Czechs and Slovaks surveyed denied harboring any intention to emigrate "firmly" or "with sufficient resoluteness." Conversely, 4% and 14% of those surveyed said they would definitely emigrate or were considering doing so over the course of the next three years. In most of the countries in Eastern Europe, there would seem to be a class correlation among the various people contemplating emigration. Like their Russian counterparts, it is mostly the young Czech and Slovak intellectuals who are flirting with this idea. In Poland, it is the middle classes who are more willing to leave; whereas in Hungary no such correlation was to be found.

Motivations do not vary substantially from one country to the other. Expectations of higher living standards and a better quality of life as well as a safer future for their children appear to be the motivations driving people abroad.

In terms of potential target countries, Germany figures high on people's agendas, except for the Russians, 40% of would-be Czech and Slvak emigrants, 33% of Hungarians and 25% of Poles would choose Germany as their new homeland. In contrast, the Russians think of the U.S. (37%), France (23%) and Scandinavia (21%). Canada appears high on Polish and Hungarian agendas with 37% and 25% respectively. Geographical proximity attracts the Hungarians to Austria (28%) just as the Russians are attracted to Scandinavia.

This survey leads to several conclusions:

One is that the more recent the possibility to travel freely, the more willing the populace is to entertain the idea of emigration. A lifting of the constraints on travel after decades of prohibition gives rise to a kind of restlessness, ("the grass is always greener..."), emigration included.

Secondly, national inclination to emigrate conversely relates to recent national experience with massive emigration. Small wonder. Emigration is a learning process; new emigrants convey messages to relatives and acquaintances at home which might discourage those considering emigration.

Thirdly, illusions run high in the emigration drive. A lack of information may influence choices of target-countries, such is Canada for not only the Czechs and Slovaks but also the Poles and Hungarians. Others, such as the Russians, rely on history when they name France as their second most preferred target. Clearly, more information about the immigration policies and procedures of these countries will discourage or slacken the claimed resoluteness to emigrate. Despite its rather liberal policies on immigration, Germany, which is among the first three choices of all East European nations, (except the Russians), is also the state which is the most uncomfortable with the concept of a multi-cultural society which such large-scale immigration implies. The success of the far right in elections earlier this month in Baden Wurtemberg and Schleswig Holstein reflect, among others, the anger and frustration some German citizens feel about Bonn's inability to stem the tide of immigratns. Germany notwithstanding, it seems clear that institutions which not were designed for this new Europe will either have to be substantially reshaped or be supplemented or replaced by new institutions.

Fourthly, domestic politics and political psychologies also account for the notable country-specific differences. Until recently, Czech and Slovak citizens were active participants in their country's transition processes. Unlike, for example, their Hungarian counterparts, they could even consider themselves the harbingers of systemic change. The professional politicians inevitably supersede the role of "the people" and so their life plans shift from the political to the individual sphere; they focus on individual welfare and readily consider the emigration option as a means of achieving that end. In Russia, in light of the still relatively fresh developments, this shift in attitude is yet to come. However, with the rude awakening of the freeing of prices and the persistence of familiar problems, the belief that finally the Russian people have history firmly in their hands is already fading fast.

Finally, the upsurge in nationalist attitudes and emigration might also be conversely related. The survey does not shed light on the differences between Czech and Slovak inclinations to emigrate. However, one might presume that the "get-away" drive in Bohemia might be stronger than in Slovakia, where the populace is not only less open to the lures of the outside world but it is also engaged in the adventure of national self-realization. This factor might also impose a temporary constraint on emigration from Russia, the Ukraine and perhaps the Baltics. Moreover, rural societies or countries in which the rural communities outnumber the urban population, are less prone to mass emigration.

2. Emigres versus Refugees

A further examination of this problem would shed light on the conceptual difference between emigree and refugee flows. Refugee decisions are not affected by the lack or abundance of information, social learning, rural or urban or nationalist affiliation etc. Refugees flow across borders whenever they fear for their own physical survival and that of their nearest and dearest. They might be endangered national minorities (Romanian Hungarians or Germans, Hungarians from Slovakia and Voivodina, or at a later stage Poles from Lithuania and the Baltics, and Russians from the non-Russian republics of the former Soviet Union) or simply endangered individuals from Croatia, Slovenia, Kosovo and Albania not to mention the Ukraine, Russia and the Baltics. Refugee flows, unlike planned emigration are geographically limited: Refugees cross the nearest "safe" borders' Albanians to Greece and Italy; Romanians and Croatians to Hungary; people from the Baltic Republics, Ukrainians and Russians to Poland, Slovakia and Hungary. Not that once they are safe, they might not have second-thoughts about going to the West. However, the majority of refugees, especially those who have no ethnic links to the country providing temporary or more lasting refuge, are willing to return home when circumstances permit.

Therefore, in terms of population movements and from and within Eastern Europe, it is the unforeseeable flows of refugees rather than the more or less forecastable emigration that will cause the most trouble for the target countries. Western countries will tighten their immigration policies, even though it will be hard to argue why nations which had been such ardent advocates of the free movement of peoples constrain the free movement of people from Eastern Europe, for example. Whereas emigration can be constrained and would-be emigrants discouraged, the flow of refugees cannot be arrested by the same methods (such as laws, information or border controls). Refugee flows will cause higher social expenditures in host countries, thus enhancing nationalistic and xenophobic political parties and polarizing domestic politics. Moreover, the front countries of this "undesired" and unplanned immigration, such as Austria, Hungary, Poland, Slovakia and Germany, etc., may be tempted to pre-empt this potential burden by intervening into the domestic affairs of their neighbors. If this is the case, the conflicts and animosities in Eastern Europe will proliferate and may take on international dimensions.

If it is in the West's security interests to prevent i) Germany from being forced to shoulder too heavy a political burden in the region and ii) the trouble and strife caused by the hardship of economic crisis and change, and the resurgence, however temporary, of the East European nation-state system, from culminating in international conflict, the United States, together with the European community should accept that the emerging refugee problems will cost money at home and abroad, in the form of aid to the chosen refugee havens, and respond accordingly. The eloquent words of political support for the new democracies oft-stated by Western politicians and representatives of international organisations will not make these problems go away. Taking steps to partially mitigate some of the inevitable problems and security threats is the most that money can buy.

IX. Conclusions

Conclusions to this outline of thoughts will inevitably be short. What has been said boils down to the simple fat that post-communist transitions will, by definition, be long and tardy processes with several predictable and unforeseen risks and dangers looming down the road. The controversies that surround these transformations do not yield to easy solutions. Vicious circles rarely do.

Moreover, the developed "free world" has limited means at its disposal to positively influence the outcome of the ongoing Eastern and Central European change. Not only because its means, ie.e. the taxpayers' money, are physically and politically limited. But also because money can buy a lot but not everything, and it definitely cannot cure the internal pains and plagues of shifting from one distinct system to another. This is not to say that outside efforts of "assistance" to Eastern Europe would be useless or in vain. Nevertheless, the directions and emphases of such assistance should be very carefully considered. Local circumstances and political risks permitting, FDI will come to the region, largely irrespective of governmental spurs and encouragement. So too will voluntary financial lending, provided that country-specific debt servicing and economic policy performance will permit it to do so. In either case, governmental willingness and readiness can do little to turn the tide.

However, outside governments can do a lot to forge East European transitions by

- investing "soft money" into infrastructural development throughout the region;
- promoting dialogue with and support of the pro-market, anti-statist

political forces of the region, be they right, liberal or center according to West European standards;

- lessening external influences that might call for "reactive nationalisms" throughout the region;
- presenting a "role model" for feasible intra-regional cooperation and an attractive perspective for the desperate East Europeans by achieving and deepening West European integration.

Poland's Experiences with Transition to the Market Economy

Josef Soldaczuk

I. Introduction

Poland started her program of structural and institutional reforms with the aim of the radical transformation of her economic system on January 1, 1990. The program, initiated by the new government formed by the "Solidarity Movement" in September 1989 (after parliamentarian victory in June 1989), assumed the transition from a centrally planned economy dominated by the state property, into a market economy based on the institution of private property. The program was announced under the extremely difficult internal and external conditions of late 1989. The new government inherited, as did the other centrally planned economies of Eastern Europe, the ineffective, highly bureaucratic and monopolized "economy of shortages" (Kornai).

The industrial sector, dominated by heavy industry, with undeveloped consumer branches was obsolete and internationally non-competitive. Agriculture, though never collectivized in Poland and 80% in private hands, mainly of small farmers, with the rest in large state farms, was under invested and partly backward. It was unable to provide a sufficient food supply at the domestic market at low, relatively to world standards, administratively controlled prices. With wages growing under trade union pressure at a higher rate than both the productivity of labour and supply of consumer goods, inflation "hidden" under administrative price control, intensified with the lapse of time. The internal market remained in a more or less permanent state of disequilibrium. The long-term "inward-looking" approach to economic growth resulted in the insufficient pro-export orientation of production as well as in the low competitiveness of exports: the primary reasons for Poland's long-term balance of payments problems. Moreover, Poland was overburdened with a very high foreign debt in convertible currencies. Due to the low level and slow growth of her exports she was unable to service her foreign debt from 1981. The unpaid part of the principal was periodically rescheduled under agreements with creditors. The interest arrears were capitalized, increasing the total amount of foreign indebtedness.

All those problems were greatly change in the intensified in 1989. When the Solidarity-led government overtook the political power, the economic situation was dramatic. The declining (since July 1989) industrial output insufficiently supplied, the market with manufactures, while the food supply decreased due to lower deliveries by farmers expecting higher prices in autumn, after the moval of administrative control of food prices. With accumulated purchasing power in the hands of the population, a panic buying of everything depleted shops.

The rapidly growing inflation at the rate of 30-40% a month and the sky-rocketing unofficial exchange rate of Polish zloty to US dollar led to a complete disruption of the internal market. The deficit on current accounts increased threefold from 580 million dollars in 1988 to nearly 1.9 billion dollars, increasing foreign debt in convertible currencies to 40.8 billion dollars, the debt-export ratio to 5.3, and the debt-service ratio to 86%.

II. Assumptions of Poland's Short and Long-Term Transformation Program

The economic program announced under such conditions had to deal, first of all, with intensifying hyper-inflation. In agreement with the IMF which supported Poland with "Stand-by" credit, with promised longer-term credit by "World Bank and with the Stabilization Funds set up for Poland by western governments, a radical anti-inflationary stabilization program was adopted as a precondition of the transition to a market economy. That program applied from the beginning of 1990 a so-called "shock therapy." It provided for the immediate freeing of most of commodity prices from administrative control and adoption at the same time of a very rigid fiscal, income and monetary policy. State spending on investment, subsidies for industry as well as subsidies for consumers, were drastically cut. Rates of interest were raised to a real level and adjusted for inflation. The Polish zloty was deeply devalued (six times in comparison with the official rate prevailing in October 1989 and by 45% in relation to the December rate). At the same time a partial, so-called "internal" convertibility of Polish zloty to convertibel currencies was introduced. The new rate of exchange, set up at the level of 9500 zlotys to one dollar, was to be stable for at least six months. It was treated as an "anchor" for further "market-oriented" changes.

The longer-term program connected with the transition to a market economy provided for a gradual privatization of Poland's economy in such a way as to make the private sector dominant in the economy. The program envisaged the creation of modern commodity, financial and capital markets, a modern banking and financial system and a real labour market, as well as deconcentration and demonopolization of over-concentrated and monopolized industry, trade, transport and, to some extent, the sector of public services. The critical element of the program consists of a wide opening of Poland's economy and its gradual integration with the world economy, particularly with the European Economic Community. The "State Monopoly" of foreign trade has been denounced, and a gradual liberalization of foreign trade policy and a policy attracting foreign capital investment to Poland are envisaged. Foreign investments are looked upon as an indispensable factor of long-term growth, modernization and restructuring of the Polish economy.

In this context, the convertibility of Polish currency and the stability of the exchange rate are treated as important, indispensable conditions for attracting foreign capital to Poland. The rigid fiscal and tight monetary policy, support of the IMF and of the Stabilization Fund should assure both of them. It was assumed and believed in government circles that the implementation of that program should relatively quickly, i.e. within few months, restore the equilibrium in the domestic market and bring to an end the "economy of shortages." In the longer-term perspective of a few years, the re-created market economy should, according to the program, lead to a deep structural transformation and modernization of all sectors of the national economy, increasing their efficiency and competitiveness. In consequence, it should also improve Poland's export performance, balance of payments situation and the debt-servicing capacity.

III. Results of the First Two Years of Implementation of the Stabilization Program

The radical stabilization program resulted undoubtedly in some achievements; however, at the same time it produced undesirable effects, unexpected or not expected on such a scale. The deep devaluation of the zloty and freeing of most of commodity prices (except energy and energy raw materials and prices of public services), accelerated the rate of inflation to 79% in one month, January 1990. In these devastated market conditions, with highly monopolized production and sales of most commodities, prices of consumer goods were increased promptly by 80% or more. That was to a large extent a result of sales and price policies of many enterprises with a strong monopolistic position in the domestic market. Most of those state-owned and cooperative enterprises discounted not only the devaluation rate but also 20% customs duties and 20% turnover tax, as well as the new, high interest rate (45%) on deposits required by banks in an ammoung of 10% of the value of all imported products. All those costs were immediately passed to consumers, increasing prices of consumer goods. Being certain that the competitive imports would not be able to show up in the Polish market for three or four months, many enterprises raised their prices often even above one hundred percent. That caused a "shock" to consumers, affected at the same time by a very strict fiscal and income policy. Heavy taxes on wage increases, imposed on all enterprises, public or private alike, and the considerable lowering of wage and salary indexation to 0.2 of inflation rate, caused in the situation of rapidly growing prices a substantial drop in the real income of the population.

The "shock" to consumers caused by the very steep and sudden rise of prices resulted in turn in a sort of "consumer's boycott" and a rapid drop in demand. However, monopolistic producers reacted not by lowering prices but by cuts of production to maintain high prices. As a result, the big drop of aggregate demand caused an even bigger decrease of industrial production. During the first quarter of 1990 industrial production declined by 24% in comparison with the fourth quarter of 1989 and by 30% in relation to the first quarter of the year before. Enterprises affected by the drop in demand at the domestic market tried to export as much as possible both to convertible currency countries as to the CMEA countries of Eastern Europe.

The deep devaluation of the zloty both to the US dollar and to the "transferable ruble" created during the first half of 1990 a high profitability of exports. It must be pointed out that external conditions for Polish exports were in 1990 fairly favourable, both in the West as well as in the "Eastern Market" of the USSR and other CMEA countries. Western countries not only supported Poland financially, but extended also to Poland the System of General Preferences for developing countries. This facilitated the access to Western Markets for Polish export. In trade with the USSR and other CMEA countries export deliveries proceeded in accordance with, or even over, the quotas agreed to in 5-year commercial agreements and protocols for 1990, which had been signed before the "events of 1989." As settlements in trade between these countries were made in "transferable rubles,," both the USSR and other East European countries which had not yet started the transformation process in their economies, and which retained rigid, administrative control over their foreign trade transactions, were interested in 1990 in an import surplus in trade with other CMEA countries. Such a surplus mitigated, partly, supply deficiencies in their internal markets. So they willingly accepted additional imports from Poland, while delaying at the same time the own exports to her, as to other CMEA partners.

In contrast, Poland, engaged fully in the transformation process, with the formal abolition of the State Monopoly of Foreign Trade and with a far-reaching liberalization of foreign trade policy, especially for exports, experienced a completely different situation. As already stated, Polish enterprises were deeply interested in export expansion because of the recession. It has to be added that due to the system of settlements in "transferable rubles" and the collateral internal financial provisions, accounts of enterprises exporting to CMEA countries were immediately credited with presentation of the export decuments in the Bank Handlowy. So the exporting enterprises received immediately the full amount of the value of their exports in zlotys. Together with high prices on domestic sales, state enterprises realized in 1990 fairly high profits, on the average-30%, despite the intensifying economic recession.

The devaluation of the zloty and the mentioned-above 20% customs duty and 20% turnover tax imposed on imports made the imported products initially rather expensive. That together with the big drop in industrial production and in investment activity diminished together with the big drop in industrial production and in investment activity diminished total imports. As a result a big unexpected and, in fact, undesired by the government export surplus was generated in 1990 both in trade with the West as well as with the USSR and other Eastern European countries. According to the balance of payments data, the surplus of export earnings over import expenditures in convertible currencies, amounted to 2.2 billion dollars, while the IMF guidelines provided for 800 million dollars of deficit on the trade account in 1990. The trade surplus with CMEA countries reached at the same time 6.6 billion transferable rubles, surpassing Poland's total accumulated debt with the CMEA, amounting at the end of 1989 to 5.8 billion transferable rubles.

Such export surpluses created an important relief to "exporters," allowing them to maintain, or even slightly increase, their production. Nevertheless, the total Polish industrial output declined in 1990 by 24%. With the drop in investment activity of 10% and in construction of 13%, the GDP declined by 12%. The unemployment rate rose in 1990 from only 0.3% in January to 3.1% in June and 6.1% in December, surpassing 1.1 million people. High profits realized by state enterprises in 1990 allowed them to pay taxes regularly and the so-called "dividends" (in fact a tax on capital assets) to the state budget. Together with substantial cuts in subsidies and government spending on investments, the state budget registered an unexpected surplus, which at the end of 1990 reached 0.5% of the GDP (IMF guidelines allowed a deficit of such magnitude in 1990. The state budget surplus was achieved by means of drastic fiscal measures that undoubtedly intensified the recession. On the other hand, it helped to lower the monthly rate of inflation, which dropped from 79.6% in January, through 23.8% in February to 4.0% on average in March-June 1990 to only 1.8% in August. However, during the final four months of 1990 the rate of inflation advanced again to 4.5-5.9% a month, mainly due to the rapid increase in oil prices in the world market following the Persian Gulf conflict. The increase in monthly inflation rates since September might also be attributed to some relaxation of income policy. In August the wage and salay indexation temporarily kept in line with the growth in prices. However, for the rest of the year it was set at 0.6 of the inflation rate.

The biggest achievement of the stabilization policy of 1990 was undoubtedly the elimination of the burdensome supply deficiencies and the restoration of a real equilibrium on the domestic market since the middle of the year. Liberalization of the import policy (undertaken in the situation of a growing export surplus) significantly contributed to this achievement.

Custom duties on the majority of import items were suspended from July till December 1990, and turnover taxes on imports were substantially lowered. That move on the part of policy-makers was intended to increase competition to domestic producers to counteract their monopolistic practices and enforce a reduction of prices of home-produced goods. In practice, the strong and growing import competition diminished further demand for domestic production and deepened the recession. Particularly affected were food-processing, textiles and other light-industry products, consumer electronics and the automobile industry.

The recession passed to 1991, affecting most severely the producer goods sector. Metallurgy, the machinery industry and basic chemicals were among the msot affected. It was to a large extent caused by the adverse changes in 1991 in external conditions, particularly by the disintegration of the CMEA and the deep economic and political crises in USSR. The radical change in the settlment system in mutual trade among former CMEA members, i.e. the change to payments in convertible currencies, considerably depressed mutual trade. All former CMEA members were interested mainly in imports from and exports to Western countries. Such developments drastically reduced Poland's exports to the Eastern market. Especially affected were heavy and machinery industries, which were closely linked to the Soviet market, particularly to the military-industrial complex of the USSR. Also, the light and chemical industries suffered serious losses. Similar effects but on a smaller scale resulted from the unification of East and West Germany. All together during 1991 Poland's exports to the USSR and other former members of the CMEA dropped by 41.5% in volume, which deepened the crises in Poland's industry, mainly in the state sector.

The change of the payments system and the change to world market prices in mutual trade of former CMEA partners increased considerably prices ot oil, gas and other raw materials imported from the USSR. That significantly deteriorated Poland's terms of trade, intensified the current account deficit in convertible currencies and added to "cost push" inflation. In January 1991, the rate of inflation increased to 12%, dropping to 6.7% in February and to 4.5% in March. Nevertheless, the steady growth of inflation, together with the constant rate of exchange of the zloty at 9.500 zloty per US dollar kept from January 1990 to May 1991, significantly decreased the profitability of exports and increased the competitiveness of imports. As a result, the balance of trade in convertible currencies after five months 1991 turned to a deficit amounting to 370 million dollars. In 1990 during the same period a surplus of about 1.7 billion dollars was recorded (Balance of Payments data). Such dramatic change in trade balance depressed the whole economy and particularly the state industry. Zloty devaluation of 17% to the dollar conducted in May 1991 and the increase in customs duties and in turnover tax on most imported items introduced in June helped to gradually improve the balance of trade. After October 1991 the foreign exchange rate policy was based on a "crawling-peg" to assure a gradual adjustment to the rate of inflation.

These measures improved the export performance and corrected the balance of trade account. At the end of 1991 the balance of trade in convertible currencies showed a deficit of 43 million dollars, i.e. much less than during the first five months of 1991. In fact, during the last seven months of 1991 the balance of trade achieved the aggregate surplus in the amount of 327 million dollars, contributing to a certain extent to improvements in the situation in industry.

During the period June-September 1991, industrial production stabilized at a level 40% lower than achieved in September 1989. During September-December industrial production increased slightly and closed by the of 1991 at the level lower by 37.5% than recorded in September 1989.

The unemployment rate doubled in 1991 to nearly 2.2 million people or 12% of the total work force. Th monthly rate of inflation declined to 3.2% in the final quarter of 1991, but for the whole year, the inflation rate amounted to 70%. As the average monthly wages increased by 53%, real wages for the majority of people employed in main sectors of the economy outside agriculture decreased. Growing unemployment and the decline of real income of most of the strata of the population have awakened growing public discontent, manifested in organized strikes and demonstrations.

Similarly, in agriculture the situation of most farms (both private and state owned) deteriorated considerably, being affected by the adverse movement of the prices of agricultural produce relative to manufactures on the domestic market. On the one hand, such developments were a consequence of the monopoly position of industries supplying the agricultural sector with machinery and chemical products. On the other hand, they resulted from a growing competition of cheaper imported food. High level interest rates, on the growing farm debt added to their difficulties, provoking serious discontent among farmers. Organized strikes and demonstrations were led with demands for minimal prices for agricultural products guaranteed by the state, debt relief and higher protective tariffs against food imports.

In consequence of the falling profits in state enterprises (on the average a drop of 5%-6%), decreasing income and the growing indebtedness of the agricultural sector, budget revenues in the form of taxes and "dividends" diminished. At the same time unemployment allowances, pensions and other social security expenditures, as well as subsidies, increased government spending. As a result, the state budget turned into deficit, amounting at the end of 1991 to 3.4% of the GDP.

The prolonged economic crisis and growing public discontent intensified the rivalries among numerous political parties both before the parliamentary elections in October 1991 as well as in the newly elected parliament; the strong criticism of the economic policy of the two former Solidarity governments, as well as the lack of a more permanent, working parliamentary majority, considerably increased economic uncertainty.

Nevertheless, at the end of the first quarter of 1991 there are some signs that the economy is emerging slowly out of the recession. The official statistical data of industrial output for the last eight months, i.e. from September 1991 till the end of April 1991, indicate a positive average rate of growth of 1.5% per month. A significant acceleration of industrial output was recorded in March 1992 with the growth of 17.0% over the February level. The growth of this magnitude was on the large part a result of a 17.3% rise in exports and 5.1% drop in imports. In April production declined in comparison with March by 4.2% when counted in real working time, but was maintained on the March level if expressed per number of work days. The level of industrial output recorded in April was higher by 4.5% than in April of the previous year and was higher than in any single month since March 1991. It was still lower, however, by about 35% against the level of output generated in September 1989.

It is worth mentioning that a significant increase in activity was recorded in construction, which in the first quarter of 1992 was higher by 11% with respect to the first quarter of 1991. The increase in construction in turn contributed to the industrial performance recorded in March 1992. Further progress, to a large extent, will depend on political factors. If in the parliament a working majority for the realization of the reform program is formed and program consequently realized there will be a chance for the economy to show a positive, though rather a slow rate of growth in GDP of about 1-2% in real terms in 1992.

IV. Results of Institutional and Structural Transformation

The process of privatization, fundamental to the whole process of transition to market economy is proceeding in Poland at different pace in particular branches and lines of economic activity. Generally, in the economy as a whole, the private sector increased its share in comparison with 1989, both by creation of new private enterprises domestic or foreign through privatization of a number of state-owned enterprises and by joint-ventures between state and foreign enterprises. Some of the enterprises which previously were included in the "public sector," like cooperatives, associations and entities established by political, social and trade union organizations were reclassified in 1990 and included in the private sector.

At the end of 1989, before the start of the transformation process, the private sector outside agriculture employed about 1.6 million people 9.0% of the total working population, equal at that time to 17.1 million. In agriculture the total employment amounted to 4.5 million people, of which 3.6 million were employed on private farms (the figure includes the owners). Together with employment in private agriculture, the total employment in the private sector at the end of 1989 amounged to 5.2 million people or 30% of the total employment in the national economy. At the end of 1991 the total number of employees in the national economy decreased to 15.9 milion but employment in the private sector grew to about 6.0 million i.e. 38%. During the first quarter of 1992 the ratio of employment in the private sector to total employment in outside agriculture increased to 40%. Together with employment in private agriculture, the share of the private sector in total employment increased during that time to about 55%.

The number of individual private enterprises (mainly in small businesses and handicrafts) increased since the end of 1989 till the end of March of 1992 from over 770,000 to 1,430,000. At the same time the number of private companies increased from 11,900 to 51,260. Cooperatives, formerly treated as public enterprises but after a radical change in their statute reclassified to private sector, increased in numbers from 16,165 units in 1989 to 17,300 at the end of March 1992. The number of foreign enterprises, both the wholly-owned small business enterprises (operating in Poland since 1976) as well as joint-ventures, (set up under the legal Act of 1986 novelized in 1990), rose from 1,200 units in 1989 to 6942 at the end of March 1992. The number of joint-ventures increased during that period from 436 to 6,185. It must be noted that during only the first quarter of 1992 the number of joint-ventures increased by 1,390 units. Actually registered are 2,481 joint-ventures in industry, 1,741 in trade, 442 in construction, 236 in transport and 1,258 in all other types of economic activity.

The share of all foreign enterprises in Poland's total industrial production reached 7.0% in 1991. It must be added that in 1989 the whole former private sector produced 7.4% of the total industrial output. Altogether, the share of the private sector in Poland's industrial production increased from 7.4% in 1989 to 24% in 1991 and to nearly 27% at the end of March 1992.

Despite the recession which affected mainly the public sector, the industrial production of the private sector increased in 1990 by 17% and in 1991 by 25%. After the first quarter of 1992 production in private industry was 36% higher than in the first quarter of 1991. Such results were, of course, achieved both by the increase of production in the "old" private sector, as well as by the entrance of newcomers, the privatization of some state enterprises and by the "reclasification" mentioned above.

In construction, the share of the private sector in output increased from 22% in 1989 to 55% in 1991 and 73% at the end of March 1992. Similarly, in transport, the share of the private sector rose from about 6% to nearly 24% and 31%, respectively. In internal trade, the share of the private sector increased during this time from 14.5% to about 80%. In foreign trade, the private sector exports were in 1991 about 2.9 billion dollars, accounting for 20% of total Poland's exports in convertible currencies. In imports, the rold of the private sector has became much bigger since it imports in 1991 were about 6.8 billion dollars or 47% of Poland's total imports in that year. It is worth mentioning that in 1989 the total Polish exports in convertible currencies amounted to 7.6 billion dollars and the total convertible currency imports to 7.3 billion dollars.

Generally, the share of the private sector in Poland's GDP approximate in 1991, 45%. That figure, together with the 55% share of the private sector in total employment, points out that the whole process of privatization of Poland's economy during the two-year periody, 1990-91, is more advanced and not as slow and insignificant as complained about by so many critics at home and abroad.

Nevertheless, the procedure of privatization of state-owned enterprises based on the parliamentarian Act of July 1990 is rather overcentralized and burdensome. According to the law, the state enterprises first have to be selected for privatization byt eh appropriate branch Ministry and approved by the Ministry of Privatization. Then, they have to be transformed into corporations with 100% of shares in the hand of the State Treasury. These shares are then offered for sale in part to the employees of the enterprise on preferential terms, in part to the general public in public auction and in part to foreign capital. Privatization might also be effectuated through the liquidation of selected state-owned enterprises and their sale to private capital, domestic or foreign. The sale of shares of state-owned enterprises to foreign capital in excess of 10% requires the approval of the special governmental agency.

As domestic private capital is very scarce and foreign capital is rather reluctants till to invest in Poland on a larger scale, the whole process is going on rather slowly. Since July 1990 till the end of March 1992 of the total 8,450 state-owned enterprises 1,554 were selected for privatization both through transformation as well as through liquidation.

The achieved results are not looked upon in Poland as unsatisfactory and the pressure is mounting both from professional business organizations as well as from different political sources for speeding up the process. In political discussions the stress is laid on the so-called "general privatization." There are two different concepts of that type of privatization. Both are based on the idea of distribution or sale (on credit terms) of ownership titles to citizens. Some progress in this respect might be expected during 1992.

The demonopolization process is more advanced as a result of the increase in the number of private companies and joint-ventures operating in industry, construction, trade and transport. Nevertheless, the concentration of production in industry is still rather high. In 1989 at the start to the transformation process, production of 32% of all products was concentrated in one or two big enterprises. Most heavily concentrated were and still are mining (coal, sulphur and copper), metallurgy, production of railway tracks and equipment, heavy transport and road building machines, tractors, ship building, automobile, aircraft, television and telecommunication industries. Highly concentrated also was production of crude chemicals and fertilizers. In addition, most of the industrial branches were organized in obligatory associations controlling up to 100% of production and sales in the domestic market and in export. All those associations were compulsorily dissolved in 1990. A special Anti-Monopolistic Agency was also set up in 1990 for speeding up the process of deconcentration and counteracting monopolistic practices of big enterprises and their organizations.

The process of the division of big industrial combines into a greater number of independent enterprises is still going on. The further privatization as well as the creation of new joint-ventures with foreign capital which often undertake production competitive to existing big state enterprises has been the most effective way of demonopolization and enhancement of competition in the internal market. The liberalization of foreign trade policy in the middle of 1990 was also aimed at counteracting the monopolistic practices of big domestic enterprises. However, under very strong pressure from domestic producers and trade unions complaining that foreign competition is deepening the recession and increasing unemployment in domestic industries, protective tariffs were reimposed in the middle of 1991.

In other words, the results achieved in industry in this field are rather mixed. Similarly, efforts undertaken by the Anti-Monopolstic Agency are also rather limited. Bigger results were achieved and more competitive conditions were created in construction, trade and other services, where a much greater number of new enterprises operate. In foreign trade, after the abolition of the State Monopoly over 100,000 enterprises registered their foreign trade activity. In 1980 only 72 specialized Foreign Trade Organizations operated in this field. After the economic reform of 1981 which partly decentralized foreign trade activity at the end 1989 nearly 3,000 enterprises directly carried out foreign trade operations.

Significant results, though not yet sufficient, were achieved also in the reconstruction of the banking system in Poland. Under the centrally planned economy the banking system was highly centralized, with the dominant role of the State National Bank, acting not only as a Central Bank but also as a main credit institution and cashier of the whole public sector of the economy, public administration, public utilities and services including health, education and cultural activities. Financing of agriculture and cooperatives including those operating outside the agricultural sector was concentrated in the specialized Bank of Food Economy.

Private savings were deposited in the specialized Public Savings Bank, affiliated from 1975 till 1988 with the National Bank of Poland. Foreign financial activities were concentrated partly in the National Bank of Poland and in the Bank Handlowy S. A., a bank for foreign trade financing. The Bank Handlowy financed and settled the accounts of all commercial transactions of foreign trade enterprises. It arranged foreign credits for domestic state enterprises and performed all financial services connected with the co-operation arrangements, joint-ventures with foreign capital, leasing operations etc. The Bank PKO S. A. financed foreign operations of small businesses, extending credits to finance small business operations and opened deposit accounts in convertible currencies for Polish citizens, as well as accounts of foreign small business enterprises "Polonia firms" operating in Poland since 1976.

The reconstruction and decentralization of the banking system in Poland was already initiated under the economic reform of 1981. The banking law of 1988 transformed the National Bank of Poland into a Central Bank responsible for the issue of "proper money," control of the aggregate money suply in the economy, conduct of refinancing operations and running the policy of the rate of interest and the rate of interest and the rate of exchange. At the same time it was freed of direct financing activity. The Public Savings Bank was separated from the National Bank and started operation as a fully independent financial intermediary, collecting private savings and granting credits mainly to private enterprises and to individuals, especially for performing financing operations in the field of foreign trade activity, competing to some extent with the Bank Handlowy.

Since the beginning of 1989 nine new commercial banks were created with the right to finance economic activity in the domestic market and in foreign trade operations. The real banking reform adjusting the whole banking system to the needs and requirements of the market economy was started with the beginning of the transformation program of 1990. Since that time till the end of 1991, besides 9 state commercial banks, 68 new commercial banks organized as joint-stock entities entered into operation and moreover, 7 banks with participation of foreign capital started their activity. In addition 1,665 local cooperative banks were created or transformed into independent entities from existing former local branch units of the Bank of Food Economy. Generally, within the period of two years, 1990-1991, a completely new, diversified banking system has been created in Poland with perspectives of its further development and evolution to the genuine modern banking system performing all types of financial services required in the market economy.

The industrial restructuring policy of the two previous governments was based on their liberal economic philosophy. It was assumed that the deliberate government restructuring policy in industry is not only unnecessary but even undesirable. They generally believed that the privatization and demonopolization of the national economy as well as the liberalization of foreign trade and promotion of competition should automatically lead to a most effective allocation of resources and to the most rational production pattern in accordance with the principle of comparative advantage. Only under the pressure of a severe recession and particularly, especially big losses in industries linked to the market of the former Soviet Union, the discussions on the need for a clear, positive "industrial policy" aiming at restructuring were most branches of industry, started late in 1991. The third "Solidarity" government formed in December of 1991 declared the need for such a policy, but it did not manage to go beyond the declarations.

The restructuring has been to some extent enforced by external factors, namely by the breakdown of the USSR and CMEA and the big drop in foreign trade within that Area. It induced attempts to divert trade to the West, mainly to the EEC region. Those efforts succeeded to a large extent in 1991, with an increase in exports to the West by 16% and to the EEC alone by 20%. Imports from Western countries increased during this time by 77%. At the same time exports to and imports from the former Soviet Union dropped in volume by 57% and by 48% respectively.

Another positive signal that the restructuring process is to some, extent taking place in Poland's industry is connected with the 43% increase "in real terms" in imports of machinery and equipment from the West recorded in 1991. This points out a tendency to replace a part of the old equipment by new, imported from the West. Nevertheless, that process of transformation is rather at its initial phase and there is a need for a more energetic, deliberate government economic policy in this field.

V. Conclusions

Summarizing the results of the stabilization and transformation policies carried out in Poland's economy during 1990-1991 it must be pointed out that some unquestionable, positive results were achieved. The most important are,

- the restoration of a real equilibrium in the domestic market,
- ending the permanent state of supply shortages,
- lowering the rate of inflation to manageable levels,
- assurance of stability of Polish currency and the introduction of its partial convertibility to convertible currencies,
- conclusion of agreements with the IMF and with the World Bank and assurance of their support and the support of Western governments to the stabilization and transformation programs,
- conclusion of agreements with "Paris Club" and western governments provided for real, substantial debt-relief (50% writen off the official debt)
- conclusion of the Agreement on Association with the European Economic Community,
- reorientation of a large part of foreign trade to the West after the breakdown of the Eastern Market.

Achievements are unquestionable, though not yet has sufficient progress been made in the privatization and demonopolization of Poland's economy.

As to the evaluation of the results of the so-called "shock therapy" applied in Poland in 1990, it must be pointed out that it contributed largely to most of these achievements. On the other hand, this therapy considerably deepened and prolonged a very severe economic recession. In consequence, it provoked serious public discontent and frustrations as well as very deep contradictions and rivalries among political parties.

Transformation of Central European Economies and Cooperation with Asian NICs: The Case of Slovenia

Marjan Svetlicic

I. International Environment

We are all living history today. Some are more active participants then others, however. It is not just the collapse of the socialist model but more than that. What makes this moment historical is the co-incidence of the end of the Cold War, transformation of socialist economies into market-driven democracies, unprecedented technological changes in the world, intensive economic integration and political disintegration (or better to say, emancipation) processes and general emergence of new players in international relations.

Is the Cold War over; has the whole political and military map of the world changed forever? Yes, certainly there is no way back to non-market systems and also to undemocratic political systems, at least for the long term duration. But the political systems in those countries are far from being stabilized. The war in Bosnia and Hercegovina and Croatia, formerly republics of Yugoslavia, is, unfortunately, not the last military conflict in this part of the world.

Although former Soviet republics seem to be successfully resolving the dissolution of the empire, it would be too optimistic to see only peaceful ways there in the years to come, particularly in some Asian parts of it. Disintegration tendencies are expected also in some other countries. CSF as the first example.

The Epoch of the Cold War and the balance of fear is certainly over in its old form. Nevertheless, we still have two strong military powers, defined as ones with "second striking capacity. "The USA is indisputably one while it is hard to say who is the other. It is the Community of Independent States of is it more likely Russia? Realistically speaking, it is Russia with its 1,035 intercontinental ballistic missiles as against 1,000 US ICBM carrying nuclear warheads. Ukraine has 176, Kazakhstan 104 and Byelorussia 72 ICBMs.

Even in military technologies' relevance the CIS is not to be neglected. In terms of scientific-technological potential, the CIS record is mpressive, having twice as many resear chers and almost three times as many engineers as the USA (Hatibovic, 1992, p. 9 and 10).

Not forgetting this military power is important in spite of the fact that the weak economies of the former Soviet republics make the use of this military power less probable. Nevertheless, it is there and the deepening of the economic crisis make it a threat. Resolving the economic crisis is threrfore to a large extent also a way to lessen military danger.

Perhaps the most important factor brought about by the globalization processes together with the liberalization of international trade his changed role of the large national market. The advantages of a large domestic market have been reduced parallel with the increasing importance of access to the world market. The disadvantages of small internal markets have been offset by trade pacts among independent states and growing trade among them.

Economic turbulences have reached an unprecedented degree in the last decade of the "separation of the real economy of the production of goods and services and the symbol economy of financial flows and transactions (P. Drucker, 1986). Second are changes in Eastern Europe, third, developments in the Middle East and fourth, the source of volatility and uncertainty is a threat to the global environment created by global warming (See, Dicken, 1992, p. 3).

International trade has boomed since 1960 as a response, in part, to much lower costs of transportion cheap and fast methods of communication, and multilateral reductions in tariffs. We are witnessing the transformation of the selling of products into the providing of solutions. Such changes demand the formation of world wide communication networks which enable close interconnections between clients and producers. They consist also of rules and principles (infostructures) allowing actors with access to mobilize the network's resources in the pursuit of their own objectives resources in the pursuit of their own objectives (Bressand, 1991, p. 10). Outsiders could not mobilize them.

1. M. Itaki and M. Waterson, 1990.

Contemporary flexible technology made it possible to combine economies of scale and individualization. Technological and globalization tendencies also brought about a radical change in terms of international competition and comparative advantage. The relative role of different production factors within regions, states and in the world has changed. This leads to the changed distribution of costs and benefits of the integration in national states, regions, ethnical communities or nations within multi-national states.

Human capital has become a crucial comparative advantage. Therefore, such technological trends could also destroy the traditional comparative advantages of countries with high illiteracy rates and low skill levels. Those having such advantages are getting into a position which facilitates their integration into the centers of gravity of the global economy.

Post-socialist economies are human capital rich and, therefore, would be in a position to be integrated into the global economy provided that existing barriers don't prevent them from this (lack of infrastructure and infostructures).

Traditionally, the Europe 1992 project, is frequently seen only as a step forward in the internationalization processes. Contrary to such expectations, M. Itaki and M. Waterson claim that the formation of an internal market of more than 300 million customers will bring about a move away from multinationalism. Instead of having plants in several member countries, firms could reduce the number of their existing plants within the EEC (or reduce their plans to establish them, addition by SM). They could rely on only one factory and exports from there to all other EC members, provided there would, not be other trade barriers to such export any more.

Implications of all these are manifold. Gradual integration of Eastern and Central Europe in the European (world) market would, provided that they soon get out of the deep economic crises, contribute to certain shifts in the centers of gravity of some economic activities. Resource-rich countries would attract foreign direct investment. Before that, vast resources would be needed for the development of their infrastructure which would be necessary for commercial exploitation of these resources. Opening up of their markets will bring about the more intensive functional integration of at least some of the more advanced companies which will enter into long-term collaboration agreements with Western companies in world multinational companies networks. As Dunning has put it, Western and Japanese MNEs are unlikely to treat their East European affiliates as stand-along ventures, but treat them as part and parcel of a Pan-European or even an international network of activities" (Dunning, 1991, p. 11).

All countries which are not able to connect to the modern spread of international communication networks are today practically brought in the delinking situation. If you are not part of modern infostructures, your goods are not known to the customers. The best illustration for the importance of such networks is airline and hotel reservation systems. If you are not in such a network, customers could not fly your planes or stay in your hotels.

Finally, we are witnessing today two, at first sight contradictory, mutually interdependent and interconnected processes. On the one side, international economic integration, transformation, and regionalization and on the other, political democratization, disintegration[2] of multinational states and individualization of societies. Global changes made such changes possible. These tendencies are particularly relevant for former socialist countries with strong centrifugal tendencies; first demonstrated in former Yugoslavia, then in what used to be the Soviet Union or recently in CSF.

It is imperative today to realize this historical development as soon as possible. Wanting it or not, today's processes of political disintegration are showing the way of similar processes to come in all parts of the world. The number of nationalisms which have already claimed their rights and therefore got our attention is several times smaller of those which are still silent. The number of languages in the world is app. 8,000 and with are still silent. plifications we could say that we have a similar number of ethnic groups. It was add to this app. 600 claims of ethnic groups which have already said that they don't have their national states, we get the ratio 8,000 against 800 (including the app. 200 existing states). E. Geller claims that we have one effective nationalism on 10 potential ones on such a basis (R. Rizman, 1991). The sooner we realize it the better we could prepare politically and economically for the peaceful transformation of the political map of the world.

II. General Characteristics of Transformation in Central European Countries

Let us start with Malinvaud words that it is quite obvious that "the faster

2. I am using this term since it is frequently stated in different analyzes of contemporary tendencies, as contra courant, as anachronistic to integration processes. Substantively it would be more appropriate to brand such processes national (ethnical) emancipation. The second reason is to demonstrate its inadequacy in light the of real processes, although on the surface, it is the political disintegration of existing states.

reconstruction is in Eastern Europe, the fastest reconstruction will be in Western Europe (benefits from a larger and quickly increasing demand and exposure of traditional industries to more and more competition." This is important to keep in mind since the interdependence of these two processes is usually neglected. Interrelation is certainly asymmetrical but, nevertheless, it exists.

Two possible scenarios, both assuming a high degree of integration between the two parts of Europe, have been put forward by E. Malinvaud (1991, p. 36) in this regard:

a) a rapid reconstruction of competitive economies of Eastern Europe and
b) integration of the part of Eastern Europe with the West on the basis of the Southern Italy or French Departments d'Outremer formula. The implication of the scenario[2] is that part of Eastern Europe would remain outside the integrated area.

First reconstruction model would be similar to the one for Western Europe after the War. It would include, however; only those economies which are less "wrecked but have lived longer with a low productivity" (Malinvaud, 1991, p. 36). It has been assumed that growth in this scenario of "competitive reconstruction" will be even faster than it was in Western Europe forty years ago. The developed human capital base and geographical and cultural proximity are the most important bases for such an optimistic scenario. For quite some time such a scenario would assume that these economies would have to outweight their poor technological competitiveness by lower cost advantages. Although quite an appealing scenario it would also mean that, provided these economies would not transform their competitiveness from low cost to one based more on technological and non-price factors, they would risk lagging behind again. Low cost labour advantages should be considered more as buying the time for real reconstruction in the modern economy.

There is, today, much too much of oversimplification around transformation processes in Eastern and Central Europe. Too many believe that all these countries are undergoing the same processes. Yes, in all of them, we have processes of democratization and economic transformation. But at the same time their starting positions are very different.

Differentiation among post socialist economies could be made on the basis of different criteria. One could be a type of inherited economic system. The second could be ethnical: one or multinational states and related problems (peaceful or military transition-disintegration). The third is the role of FDI.

One could have, according to Dunning (1991), three models of development for these countries regarding the role of FDI:

a) developing a country model, characterized by certain trajectory from an initially less to later more important role of FDI.
b) reconstruction model, named by the experiences with the reconstruction of West Germany and Japan after the Second World War (resource richness but many institutional and attitudinal impediments) and
c) systemic model which claims that the willingness and ability of foreign investors will depend on the speed and extent to which these countries can later their economic and legal systems.

Former socialist countries (FSCs) are fundamentally different. They differ widely in development level but more in terms of economic structures and finally, of course in the type of economic system. Yes, they are all implementing market—oriented reforms but some of them have already many years tradition in such an implementation while others are really taking their first steps.

Some post socialist countries initiated at least modest economic reforms decades ago; some are only now taking first steps toward a market economy. The role of economic entities, companies, has been in the past very different in Yugoslavia, which abandoned a centrally-planned economy already in the 1950s, or in Hungary, which started its first market—oriented economic reforms two decades ago. The state monopoly in foreign trade was abandoned in Yugoslavia already four decades ago.

The role of managers in a centrally-planned economy was completely different from those in "half" market economies. Slovenia and Croatia for instance, which mastered market—driven reforms in Yugoslavia most efficiently. Managers have behaved, in many cases, almost as owners of the companies although they were not. They had to follow market signals, salaries depended on the performance of the company, etc. Companies were almost in a position of private companies on the market with similar responsibilities. Therefore, they have developed nucleuses of marketing and managerial techniques which make their transformation into the real market economy easier. The situation in the banking sector was similar Centrally planned economies didn't develop a commercial banking sector at all while it was, in spite of many deficiencies, developed anyhow in Yugoslavia.

The situation in centrally — planned economies was completely different. Managers were in the position to follow central plan orders. Therefore they have first to transform their mentality and develop managerial techniques from scratch.

A differentiated approach is, there fore very much needed in order to adapt todays policies to the existing economic, cultural, organizational setup and tradition. The same instruments produce in different societies different results. Almost identical recipes so frequently given to these countries by outside consultants are therefore frequently missing the target.

The second important element is different the material bases of all these countries. Their development levels and factor endowments are very different. Countries have also different histories, democratic traditions and entrepreneurship ethos. While some have experienced in the past for some it is totally new. Some democracy of them have been quite open for decades, others were almost completely closed to the world. Slovenia, as a part of Yugoslavia, has followed a very open door policy, eliminating visas three decades ago for instance. Hungary was much more open than any other centrally-planned economy.

The share of export going to the West was also very different. In Slovenia, for instance, more than 85% of its exports are going to Western countries. By far the largest share of foreign trade of other post socialist countries have been traditionally accounted by their fellow members of COMECON (around 70%).

This is important in terms of the level of costumization of their products to the needs of the world market, in terms of the level of mastering of modern managerial and marketing techniques, etc. It is not surprising that for instance, Slovenia[3] Croatia and Hungary are the most advanced in terms of attracting foreign capital. They have a tradition in doing business with foreign capital.

Although the early reformers' position is advantageous it also has disadvantages. Socially-owned companies are more difficult to be privatized than state-owned. It certainly takes much more time and makes transfor-

3. Per capita FDI in Slovenia in the period 1989 to 1991 is much higher a in any other post-socialist country (app. 200 dollars compared to app. 130 in the case of Hungary or 26 in the case of CAF. data refer to the registered capital until April 1991.

mation more complicated. Therefore, it is not surprising that we are witnessing, in a way, a move towards state ownership as a midstep first and then the private one. All these developments make the transformation processes of the countries concerned very country specific.

Not only the "World" but also we from post socialist countries tend to forget all these national specificities. To certain extent, it is a consequence of a prevailing attitude that everything in the socialist past was bad, that all FSCs are starting a new history from the very beginning. It is, therefore, not surprising that one could see tendencies of the replacement of one ideology of the 19th century with another of the same century. A market economy is being introduced which is far from the ones which exist in market economies themselves. Profound changes in market economies in the last decade are not recognized.

Another danger which, together with the above-mentioned one, brings some instability into these transformation processes is the replacement of one (political, ideological) voluntarism with another. All revolutionary periods have revolutionaries and it seems that all of them believe in the power of their will, in the power of their goals. Therefore, they tend to neglect the role of economic laws, although they all proclaim the market as the main regulator.[4]

Sometimes it is hard not to get the impression that the new state is somehow not willing to give away the economic role of the predecessor. New democracies still don't feel strong enough to leave the economy to economic actors. One of the reasons is that, in Slovenia for instance, many of the managers of the large companies are still from the old elite. New democracies want to build their economic power by entering the field of economics in a way which is not what a market role of the state should be. Noneconomic criteria are forced upon the economy or economic ones in the field of culture and similar areas. There are strong aspirations to build economic power in order to strengthen political power. Similar aspirations are also found in political parties. They all would like to strengthen their economic role in order to strengthen their political position.

---

4. Illustration: a few days ago I had a very "hot" debate with one of the high officials of a green party who neglected the role of profit criteria. In spite of my argument that, in fact, the neglect of the profit criteria destroyed socialist economies and in spite of my consent that profit criteria has to be amended in terms of the achieving sustainable development today, he insisted on the complete neglect of profit criteria.

Althouth such developments were to be expected, it could be dangerous for the development of a real market economy. One could get a strange combination of interventionist role of the state and very liberal capitalist market system.

Such profound changes are very difficult to make over night. Some transition period is needed even in countries like Slovenia which was the most open economy, traditionally Western-oriented in terms of culture and tradition, with the strongest economic ties with Western companies etc., but still having similar problems.

Lastly, transformation processes in multinational or one-nation states are very different, they can not be measured by the same yardstick. In mul- In multinational states they are paralleled with severe political crises and even wars. Yugoslavia is certainly a good example of what could happen in similar cases elsewhere.

There are some grounds for the critiques of the "public choice" theory approach in Eastern Europe. Politicians namely spread lots of short-term slogans which have no material base; they promise very fast changes which are impossible to achieve. FDIs are given a role which they could not perform, or at least without parallel internal changes etc.

III. The Case of Slovenia

After declaring independence on June 25, 1991, 5, Slovenia was attacked on June 27 by the so-called Yugoslav army. The declaration of independence was the result of a long period of negotiations and efforts within the federal state. All proposals for changing relations put forward have not been taken seriously and have been rejected by the Serbs as the main opponents to changes in the Yugoslav federation. After many efforts, Slovenia proposed a kind of asymmetrical federation with other parts of the federation. Later, together with Croatia, it offered the transformation of Yugoslavia in confederation. All these proposals were not only rejected, the Serbs did not want even to start a debate about them. Therefore a decision to secede from the federation could not be regarded as a sudden, secessionist move of the

5. The Slovene Parliament adopted the Peclaration of Independence and Sovereignty, its own laws on foreign exchange, and citizenship. The validity of federal laws were declared until corresponding Slovene laws are adopted. Slovenia also agreed to act as a successor to all international agreements signed by the former Yugoslavia.

most developed republic of Yugoslavia.

It was a ten-days war in which Slovenians demonstrated in the battle field their determination for independence. The Yugoslav army was defeated. On July 8, 1991, the Slovene territorial defence regained control over the territory of Slovenia and its international borders. But the destruction of roads, airports, planes, TV and radio transmission towers, houses etc. remained. Indirect damage is even much greater[6]. Although the transformation process started in Slovenia the well before, the costs of reconstruction made the transformation process much more difficult and costly.

The implementation of further steps towards independence were postponed for three months by the Brioni peace agreement among the republics and the EC mission. On July 15, the Yugoslav army began its withdrawal from Slovene territory. After this three month period, precisely on the day of the expiration of the moratorium, Slovenia introduced its own currency tolar (provisionally in the form of coupons). Slovenia's new Constitution as a basis for a new legal system was adopted in December 23, 1991. On January 15, 1992, Slovenia was, together with Croatia, recognized by the EC as an independent state. By June 23, 88 states had recognized it. Slovenia was accepted as a member of the United Nations on May 22. Succession with the ex-Yugoslav states is not yet resolved. The costs of a new state (including the establishment of its own defence system) are enormous. Limited financial resources are driven away from narrowly defined economic use.

Negative growth rates have been persisting for three years already. Nevertheless, the trade deficit has been narrowed. After the introduction of its own currency coupons (real new currency is about to be introduced) Slovenia has accumulated over $600 million in foreign exchange reserves. Slovenia started its independence with app. a 24% monthly inflation rate. After the introduction of its own coupons, it jumped to 26% but then gradually slowed down to 5.6% (May 1992). Unemployment has increased to 12%. It is expected to increase further if disguised employment is eliminated.

Privatization legislation has not been yet been passed. Several concepts of legislation have been prepared with no general consensus. The contradiction seems to be that Slovenia, having certainly the best educated and ex-

6. The Airport of Ljubljana was closed for a number of months. This fact alone introduced an additional barrier to the export — oriented Slovene economy and additional costs for keeping international trade going, not to mention other similar indirect costs.

perienced managerial "class" is not able to resolve this issue. One explanation is in the fact that the denationalization law was accepted. It complicates the issue of privatization and makes it more a political than an economic issues.

After two years of its first democratic government the Slovene parliament elected a new prime minister[7] and a new, more technocratic, government. The new president was the former president of the Presidency of Yugoslavia. He is known to be economically minded. This change demonstrates a public wish that economic issues should become priority ones. The first democratic government was very much political, even ideologically minded, although in a different way than in the socialist era.

These highlights are important in order to see the different starting points on the road to economic transformation of states like Slovenia compared to other post-socialist economies. Transition from the 23, million inhabitants' economy of Yugoslavia to the 2 million inhabitants economy of Slovenia is a big change. Economic, transportation and communication interconnections are disconnected because of the war in Croatia and Bosnia and Hercegovina. Economic structure geared towards the Yugoslav economy has had to accommodate to the new situation almost overnight. The transformation process in Slovenia is, therefore, going on parallel to the dramatic changes in the economic strategy and structure.

In spite of the relatively high development level 8 and the fact that Slovenia has started reforms well before other republics in Yugoslavia[9], today's tasks are formidable. The economy has to be reoriented from a more Yugoslav market-oriented one to a world market-oriented one.

The Slovene economy was already before very much internationalized (even more than neighboring regions in Austria and Italy). The fact remains that 25% of Slovene production was sold on the Yugoslav market, 57% on the local Slovene market and 18% in exports. With the war in Croatia where 12% of goods were sold, the economic blockade in Serbia (7% of goods

---

7. It was a result of a confidence vote in which the former prime minister lost.
8. With app. 12 bil. dollars of GDP, nearly 6,000 dollars of per capita income, Slovenia's place is somewhere among the upper middle income countries. According to GNP it is tied for 70 place in the world, according to the World Development Report 1991. Its economy is rather internationalized since Slovenia accounts, according to exports, 45th in the world and 55th according to imports. In terms of number of population it is a small state (116th in the world).
9. The door to multi-party parliamentary democracy system was opened already within one-party system.

sold), almost nonexisting transportation links with Bosnia and Hercegovina and Macedonia (4%), imposed sanctions by the EEC on Yugoslavia last year affecting for a time also Slovenia, and recent sanctions towards Serbia and Montenegro (which declared themselves recently a new Yugoslavia) the market reorientation became extremely difficult.

Althouth Slovene companies want to remain in the market of ex-Yugoslavia the fact is that the war makes it almost impossible. The result is a 72% slowdown of exchange with other republics and 42%[10] drop in the Slovene international trade in 1992 (data for first two months). The Slovene economy has lost almost half of its foreign markets. Export in the first two months of 1992 was almost 25% smaller than in the previous year. Even in the medium run, companies have to realize that their goods could be sold to former Yugoslav republics provided they are world market competitive.

It is very difficult to develop a clear long term development strategy for Slovenia in such a period of profound changes. It is, nevertheless, becoming more and more a must, precisely because of these ramatic changes. An inherited economic structure should not be the main determining factor since the options of a 2 million population economy are substantially different from a 23 million population economy. A new economic structure should be developed, a new competitive position in the world market found.

The Slovene economy has always been very much European-oriented. In 1991, the EEC absorbed 64% of Slovene exports the EFTA 9% and other industrially developed countries 7%. Post socialist countries took only 14%. The share of developing countries was very modest, 6%. Similar was the share also in the case of imports.

In 1991, major export items were textile products (12.5%), transport equipment (11.6%), machinery and equipment (11.2%), electrical machinery and appliances (10%) and furniture (6.1%). Slovenia imported machinery and equipment (14.8%), transport equipment (11.4%), electrical machinery (7.2%), mineral fuels (6.8%), and cotton (6.6%), etc.

A new international economic strategy for Slovenia should be based on the following elements:

10. This data is somewhat exaggerated due to abnormal conditions in the market. War has destroyed normal business channels but business ingenuity finds ways and means in keeping some of the necessary and mutually beneficial trade in spite of this because of "alternative" channels, such trade is not normally registered as trade among republics; it could be international trade or not, being registered as either. Therefore, one expects that the slowdown is not as dramatic as the statistics show but still exists.

1) as a small economy Slovenia has to strengthen even the already high internationalization of its economy.
2) high flexibility of the economy to the world market conditions. Too high specialization in terms of sectoral orientation would be dangerous in so turbulent an international environment,
3) integration in European space, parallel to general world wide integration. It is not regional factors which determine international economic relations but substantive ones. One should cooperate with technological leaders irrespective of their location.
4) niche market orientation is the sptimal stretegy. The small size of the economy make maximization of the world market share impossible as the main strategic orientation.
5) human capital (precisely high skills) should become the basic competitive advantage of Slovenia,
6) potential for export of goods made completely in Slovenia is limited. Orientation to exclusive production of goods as partners / subcontractors to dominant producers is a more viable orientation,
7) development of its own firm specific advantages ia a must not only for export but also for inflow of foreign capital.

Such goals could not be achieved overnight. A certain transitory period is necessary. The most important issue in this domain is to set the right time span for such a transition. It should not be too long but long enough for the necessary adaptation of local industry.

The war, emancipation from Yugoslavia, unresolved succession issues, and economic and political instability, make such a transformation a very complex process. Tourism and the general service economy which are rather important in Slovenia are, because of the war in former Yugoslavia and political instability, in a severe crisis. Nevertheless, export has increased in 1991 and the foreign trade deficit reduced to only 281 mil. dollars. Slovene debt is not too high, 1.7 billion dollars.

Appropriate analysis has not yet been undertaken but it is believed that in 8-10 years the Slovene economy could come out of such a transformation. What is crucial is to set a precise plan of gradual (annual) reduction of preferential treatment sought for a Sloven economy in this transition period.[11]

11. Perhaps the best way would be to have a two or three year "grace period" and later reduction of tariffs for on the average 20% annually. In such a system companies would get two clear

What is of crucial importance is confidence in the Slovene economy and political system in spite of the hectic ongoing criticisms of all "colors," being built.[12]

1. Foreign Direct Investment in Slovenia

Yugoslavia was the first socialist country which already in 1968 allowed joint ventures with foreign partners. The position of Slovenia, as one among sit republics and two autonomous provinces in Yugoslavia, was therefore predominantly determined by the Yugoslav legal and political system. Very few, although growing, aspects related to the regulations of FDI were in the jurisdiction of the republics (part of taxes, for instance).

The first Yugoslav FDI code in 1967 aloowed only a very specific form of joint ventures, quasi equity JVs which could be perhaps the best described as contractual joint venturs. It means that the foreign investor was not the owner of invested resources. In fact, it was more a long term credit arrangement than real FDI. Such a legal framework was also one of the explanations why FDI have not mushroomed in spite of frequent efforts to accommodate that law in line with the suggestions of foreign investors. Gradually it was liberalized (although there were also periods of more restrictive attitudes towards foreign investors).

By the beginning of 1989 a completely new type of internationally competitive FDI code, based on the principle of national treatment, was introduced. The quasi Yugoslav type of JVs was eliminated and all forms of companies known in market economies introduced. The number of FDI projects started to increase at an unprecedented pace.

General characteristics:

- FDI in Slovenia were until 1989 very modest. After new legislation the

---

messages: first, that infant industry protection would not last more than a certain time, and second, they would know in advance by what time they would have to become worldwide competitive.

12. One illustration: banks have allowed the public to with draw part of their foreign exchange deposits which have been frozen. Over 50% of them have been, "unexpectedly" left in the banks which illustrates the building up of minimum confidence. But it will take much more time before full confidence will — return.

Table 1. Foreign Direct Investment in Slovenia in the Period: 1968-1991 (until May 9, 1991) and Its Share in Yugoslavia.

	Number.	Share in Yug. in %	Value. in mil. $	Share in Yug. in %
1968-1985[13]		33		20
1985	5	19	3,7	16
1986	3	11	1,5	3
1987	6	16	11,4	5
1988	4	15	17,8	26
1989[14]	174	30	96,7	29
1990	616	21	333,2	24
1991 (May 9)	85	n.a.	141,6	n.a.
1989/1990	790	22	429,9	25
1989/91 (May 9)	875		571,5	

Source: Center for International Cooperation and Development, Ljubljana.

number of FDI projects has tremendously increased but not som much in terms of disbursed foreign capital.

- increase was more intensive in terms of registered capital since not necessarily all registered capital has been really invested. There was still no differentiation between subscribed and paid in capital. At the same time in not so few cases, additional capital was subscribed after initial registration. Available information leads to the conclusion that less than 50% of registered foreign capital has been really invested. Out of it there was a large part of capitalized equipment.
- 1991 has witnessed a relative slowdown of FDI which was a consequence of the crises in Yugoslavia, and the aggression of the Yugoslav army on Slovenia in June and the war in Croatia.
- in spite of oscillations, Slovenia's share in all FDI in Yugoslavia has (with two years of exception) always been very important and has been in-

13. Data refer to 1985, i.e. active joint ventures that year. Other data refer to annual registered new FDI projects.
14. Original data are in DM (1 US$=1.68 DM in 1989 1.50 DM 1990).

Table 2. Structure of FDI in Slovenia by Type of Companies in the Period 1989-1990

	Number	Share in %	Value in mil. $	Share in %
1. Mixed comp.	578	73	149	34
2. 100% owned comp.	102	13	10	2
3. Contractual joint vent.	110	13	270	63
Total	790	100	430	100

Source: Center for International Cooperation and Development, Ljubljana.

creasing. In terms of invested funds Slovenia's share was the second largest, only a few points behind the share of Serbia although its population is almost five times higher,

- but in terms of per capita FDI, as a more realistic approach, the role of Slovenia in the whole of Yugoslavia was predominant. In 1989 and 1990 the value of per capita FDI in Slovenia was more than two times that of Montenegro, assuming second place,[15] 2.7 times higher of that of Serbia (without autonomous provinces) and more than four times that of Croatia as the second most developed republic in Yugoslavia. Spearman rank of correlation between the rank of the republic (province) in terms of per capita social product and per capita registered foreign capital in 1989/1990 (average) was positive (0.52).

Data clearly indicate the domination of the old form in terms of registered capital but new forms in terms of number of projects.

The share of mixed and 100% owned foreign companies with minimal registered capital is the highest. FDI has a "wait and see" character. Explanation: a higher level of local financial and legal expertize being able to "make" investors invest just the minimum required capital. Why? Foreign capital was, according to the legislation, supposed to be immediately converted in local currency which has destimulated above the minimum required initial investments in the periods of high inflation.

Such a domination of the old form of contractual investment is a result

15. It was the result of one large FDI in a tourims resort.

of a continuing lack of confidence in the new FDI regime, general political and economic instability and a lack of transparency in the new system. Investments in the old form of contractual joint ventures are, in a way, a continuation of the already made contracts as additional investments. Their average value was, in the period 1989-May 1991, almost 5 mil. DM and for 100% owned foreign companies only 129,839 DM (Rojec, 1991).

A large number of other types of investments are, in fact, "wait and see" investments or "sleeping partner" investments. Foreign investors consider the new legislation liberal; therefore they tend to establish a foothold in a local market. When a political and economic situation gets stabilized they could activate such investments and invest real capital on top of the legally required minimum which they have invested initially.

Small FDI are obviously dominant. Those below 20,000 DM account for more than 64%. Large investments are very fewi only 10% larger than 1 billion DM.

The domination of the most important economic partners of Slovenia also among foreign investors demonstrates that proximity and consequently familiarity with the market conditions. These are very important determinants

Table 3. Distribution of FDI in Slovenia by Value of Invested Foreign Funds in 1989 Until 9. 5. 1991.

Foreign inv. funds in 1,000 DEM	Number of companies	Structure in %
−5	467	53,4
6 to 10	46	5,3
11 to 20	32	5,9
21 to 50	78	8,9
51 to 100	42	4,8
101 to 500	66	7,6
501 to 1,000	27	3,1
1,001 to 5,000	51	5,9
over 5,000	38	4,3
unknown	8	0,9
Total	875	100,0

Source: Center for International Cooperation and Development, Ljubljana.

of such a structure. Seventy percent of registered foreign capital originated in two countries. The share for three would increase to 88%. Spearman rank correlation between the share of foreign trade and share of the volume of FDI (eight partners) is as much as 0.81. The origin of foreign partners has also influenced the allocation of FDI. It is most obvious in the case of Italian FDI located predominantly in the border regions. Quite a number of such "foreign" investors are basically of Slovene (Yugoslav) origin (app. one-third). They invest in their homeland (region). Slovene companies established in Germany, for instance, are investing, back in Slovenia and in such a way take the advantage of the tariff free import of machinery as an incentive for FDI.

Approximately 20% of foreign investment projects are undertaken by Slovenes working abroad. According to M. Rojec, additional character of these funds is questionable. He is of the opinion that they would bring these funds home anyhow and invest them as local investors. Therefore, such investments do not represent a net increase in the inflow of FDI (Rojec, 1991 p. 15).

Table 4. FDI in Slovenia by States of Origin of Foreign Capital (ranked by value of foreign invested funds) 1989-May 9, 1991.

Country of origin	Number	Struct. in %	Value mil $	Struct. in %
Germany	174	20	228	41
Austria	245	28	158	29
Italy	291	33	99	18
Australia	4	0.5	24	4
France	3	0.3	22	4
USA	18	2	5	1
Switzerland	39	6	4	1
Liechtenstein	8	1	4	1
Netherlands	19	2	1	..
Others	77	9	12	2
EEC total	507	58	350	63
EFTA total	301	34	166	30
Total	875	100	455	100

Source: Center for International Cooperation and Development, Ljubljana.

IV. Bilateral Cooperation with Selected South-East Asian Countries

In spite of the fact that by far the major economic partners of Slovenia are EC member countries, economic cooperation with Asian NICs is growing in importance in recent years. Slovenis has among the different republics in ex-Yugoslavia. The share of Slovenia in Yugoslav exports to the ROK was in 19910 38%, to Taiwan 73% and HongKong 26%. Shares were similar also in imports from those countries.

In absolute terms trade was very modest. Even lower also are shares of Slovenia in foreign trade of these Asian countries. In the case of Thailand, Slovenia exports represent only 0.03% of its total import bill or similarly only 0.06% of its total exports.

Import-export structures differ from country to country. In the case of some countries (Hongkong, Taiwan, Singapore) it is more an intra industry trade with the domination of industrial goods on both sides. In the case of Thailand the structure is more traditional; primary products on the Thai export side and manufactured products on the import from Slovenia side. The case of the ROK is very specific. Automobiles are by far the dominating import of Slovenia from the ROK.

The Slovene trade balance in all countries is negative. Obviously, Slovenia is more familiar with the economic potentials of those countries than vice versa. If cooperation is to be successfully developed in the future, more balanced trade is to be achieved in, at least, the medium term.

It is, therefore, not an exaggeration to state that in view of the fast-growing

Table 5. Foreign Trade of Slovenia with Selected Asian Countries 1991 (mil. dollars and shares in total SLO trade).

	Export		Import	
	mil. $	share	mil. $	share
Hongkong	3.7	0.1	14.1	0.3
Taiwan	3.7	0.1	20.8	0.5
ROK	7.3	0.2	49.3	1.2
Malaysia	7.1	0.2	7.8	0.2
Singapore	4.6	0.1	8.1	0.2
Thailand	4.7	0.1	12.9	0.3
Total	31.1	0.8	113.0	2.7

economies of most of the Asian countries the potential of mutual economic cooperation is far from even being really started.

A number of factors have prevented such cooperation in the past (political[16] the non-existence of double taxation agreements, etc.)

The political crisis and the war are the second most important barrier the way of strengthening mutual economic cooperation. It is still not overcome in spite of the fact that the war in Slovenia is over.

Among narrowly defined economic factors the lack of proper up-to-date information is certainly the most important one. In order to overcome such an information gap Slovenia has established representative offices in some of these countries (Singapore, Thailand, the ROK). The small Slovenia market has also become a barrier to traditional cooperation oriented towards the Yugoslav market as a whole.

According to the new development strategy of Slovenia, moving in the direction of a service economy and even further strengthening of its export orientation, new types of cooperation have to be built. Slovenia could offer to Asian countries the closest way to Europe.

In its port Koper, processing facilities for bulky goods could be established and transported further as final goods to Central and some Western European destinations. With its skilled labour and relatively developed infrastructure, Slovenia could become a springboard for Asian countries to Central and parts of Western Europe.

There is a vast potential for a kind of triangular cooperation between Asian and Central European partners and Slovenia. They all seek stronger links with the EC or European space. Post-socialist economies have a strong need for towards integration also with other parts of the world. Therefore, they need the access to the sea which Slovenia has.

Perhaps the basic precondition for strengthening such a cooperation is the assertion of Slovenia as an new entity in the world, separate from the negative Balkan picture of Yugoslavia branded with the war. All negative effects of developments in other parts of former Yugoslavia are tremendously affecting Slovenia, in spite of the fact that Slovenia offers, after the so-called Yugoslav army left in 1991, a perfectly stable business and living environment.

16. Slovenia has still an image as being part of Yugoslavia with all its negative implications.

References

Bressand, Albert, *International Governance: Trade in a Globalizing Economy.* June 1991.

Dicken, Peter, *Global Shift*, Paul Chapman Publ. Ltd. London, 1992, sec. ed. p. 1.

Drucker, P, *Roaches Outlive Elephants*, Forbes, 19 August 1991, p. 74.

Dunning, John, "The Prospects for Foreign Direct Investment in Eastern Europe," *Development & International Cooperation*, Vol. VII. No. 12, CICD, Ljubijana, June 1991.

Hatibovic, Dzemal, "New Structure of Global Power," *International Affairs*, Belgrade. VOl. XLIII, No 1003. 1.4. 1992, p. 9 and 10.

M., Itaki and M. Waterson, *European Multinationals and 1992*, University of Reading discussion Papers, No. 141, August 1990, pp. 22.

Malinvaud, E., *Macroeconomic Research and European Policy Formation*, J. Monnet Chair Papers, European University Institute, Florence, 1991, p. 36.

Rizman, R., *Nacionalizem ante portas*, Delo, Dec. 1991, p. 20.

Matija, Rojec, *FDI in Slovenia after the New Legislation: Experiences, Perspectives and Possible Orientation*, CICD, Ljubljana, 1991.

Problems of Transition in the War-Torn Economy of Croatia

Mate Balic

I. Introduction

Since Croatia is one of the most recent newcomers to the world of independent states, let me introduce her by giving few facts:

The Republic of Croatia is situated along the eastern coast of the Adriatic Sea and its Hinterland then streches up to the last slopes of the Alps and deep into the Pannonian valley to the banks of the Drava and Danube Rivers. Croatia has an area of 56,538 square kilometers. According to the census of 1991, Croatia's population was 4.8 millions. Coatia is one of few countries (like Israel and Ireland) that has more of her natives living outside than inside the country. There are more than 3.5 million Croats in the USA and Canada. In Western Europe there are about 1 million Croats. Many Croats live also in Australia and South America.

The Adriatic coast that belongs to Croatia is 1,778 km long. With 1,185 islands and the clean intense blue of the water with an average temperature of the surface layer of 25 to 27°C in the summer, the Adriatic Sea is generally considered one of the most beautiful seas in the world. It represents the base for the development of tourism in Croatia.

In the division of labor between the republics in socialist Yugoslavia, Croatia was assigned the role of foreign exchange, hard currency earner. For this reason it developed mostly export-oriented industries. The most important exporting industry has been the shipbuilding industry which exported 97% of its production on average over the last 30 years. The Yugoslav shipbuilding industry is located in Croatia and, according to the Lloyd's Register of Shipping in 1989, it occupied third place in the world after Japan and South Korea.

The Croatian economy is relatively open. The share of foreign trade (exports + imports) in GDP of Croatia in 1989 amounted to more than 96%.

According to the role of Croatia inside socialist Yugoslavia, Croatia was earning about 60% of the total hard currency receipts of Yugoslavia. The share of Croatia in the merchandise exports was only 26%, but the share of Croatia in the export of services (tourism and transportation) amounted to more than 80%. The share of Croatia in the receipts of hard currency from remittances was very high since most of Yugoslav "guest workers" in Europe are Croats.

This was situation until 1989, the last year of the communist-led government in Croatia and Yugoslavia.

After the first democratic elections in Croatia in spring 1990, the communists lost power, and a new democratic government was sworn in on 30 May 1990. But soon after that, in-mid August, the Yugoslav army whose officers are Serbian communists started to make problems, disturbing the free circulation of goods and serices. All-out war with the Yugoslav army started in summer 1991. We have always feared that people's armies in communist countries were armed and trained to fight their own people (or peoples of their allies in the former Warsaw pact). The Yugoslav people's army has unfortunately proved this.

The economic consequences of the aggression of the Yugoslav army dominated by Serbians have been catastrophic. The following figures show the amounts of the economic damage done to Croatia by the Serbian-dominated Yugoslav army from the start of their aggression till mid February 1992.

Among the types of massive destruction included above are 265,000 apartment units and single houses, over 300 churches, 286 historic monuments, 21 major bridges, hundreds of miles of roads while one-third of the farmland could not be harvested. Over 10,000 people were killed, 36,000 wounded, and 650,000 displaced. Over 3,100 children have lost one or both parents. Of Croatia's 1,650,000 aggregate employment in early 1990, 550,000 presently stand unemployed. The nation's production capacity has been reduced by 45 percent, and over 2,000,000 people of its 4,765,000 population qualify for welfare.

The process of transition of the economy from socialist into market in Croatia has been slowed down or even postponed due to the war. Hopeful-

Economic Sector	Amount of Damage $ U.S. in 000s	
Mining and Manufacturing	1,950.000	
Agriculture & Live Stock	1,000.000	
Forestry & Woodwork	800.000	
Water & Sewer	220.000	
Transportation & Communication	1,362.000	
Stores, Shope & Restaurants	970.000	
Tourism	1,500.000	
Resid. & Commercial Construction	5,300.000	
Total		13,102.000
Public Service		
Social Welfare/Refugee Shelter	750.000	
Schools	1,258.000	
Sports/Recreation Centers	85.000	
Cultural Centers/Museums	1,000.000	
Health Care Institutions	850.000	
Administrative Institutions	250.000	
Special Funds	800.000	
Total		4,993.000
Grand total		18,095.000

Source: Ministry of Information of the Republic of Croatia, April 1992.

ly, the war will soon be over and we have to prepare for the peace. After winning the war, we should not lose the peace. We have to start the process of building a new democratic society with both political and economic democracy. There is no political democracy without economic democracy. There is no economic democracy without a market economy. Therefore, we have to start immediately the process of transition to a market economy in Croatia despite the enormous economic difficulties caused by thr war.

1. Present status and fundamental determinants of the Croation Economy

As the previous figures show, Croatia's economy is in very severe conditions. Most of manufacture has been demolished by the war. By its structure it is still a socialist self-management economy. This means that the basic reasons for inefficiency have not yet been eliminated. The situation for her healthy, rapid and stable development has not yet been created.

The economy of Croatia is now characterized by a large decrease in production, an increase in unemployment, galloping price inflation and a decreasing living standard.

Industrial production in Croatia was 44.7% smaller in 1991 than in 1990. Consumer prices rose by 123 percent in 1991. Real wages fell by 40 percent.

These negative tends continued in the first three months of 1992. Prices continued to rise so that the consumer prices index for the first three months of 1992 was 417 compared to the same period in 1991. Real wages in the first quarter of 1992 fell to 51% of the level of real wages in the same period 1991. However, industrial production stopped falling and actually increased in January, February and March due to the truce.

The most urgent need in this situation is to set in motion an economic mechanism aimed at puting a halt to these trends. A necessary condition for propelling economic development is the restoration of peace. However, this is not the only condition; we also have to work out a program for Croatia's postwar economic development which would guarantee Croatia's rapid, stable and balanced growth. Croatia's postwar development conception has to be based on a market economy but an export-oriented one. For a small country like Croatia only export-oriented economic growth guarantees a long-term balanced development. An export-oriented economy would mean her complete openness. Since Croatia is a small country she can not influence the conditions that prevail on the world market. Instead, she has to accept them. This implies a need for maximum production efficiency of Croatia's economy in order to be competitive on the world market.

The economy's maximum efficiency can be achieved only in a market economy with the highest possible degree of competition. Therefore, the growth of a market, export-oriented Croatian economy is conditio sine qua non for her long-term development and stability which means a long-term increase in production and employment along with a preserved internal and external balance. However, Coatia is faced with one very severe problem, due to the war and to a great deal of occupied territory whose resolution can not be postponed. It is the problem of the return of 700,000 refugees, 15% of the total population, to their homes and their placement into a normal economic life.

The problem of the returning refugees has the highest priority and has to be solved immediately. That is why programs for their return and their inclusion in normal economic life essentially determine the short-term economic policy. The programs to rebuild houses for the refugees, restore their estates and revitalize their economic activity have to be carried out in the shortest possible time. Financing these programs has to be done, above all, with the help of public and private foreign institutions and international organizations. Foreign aid should be supplemented by national resources from the budget as well as with favourable credits, especially mortgages.

Together with solving economic problems and the problems of the refugees, we have to think about the growth of Croatia's economy. Development policy has to be based upon two principles: building of 1) market economy and 2) export-oriented growth. Therefore, the reconstruction of destroyed economic facilities that would re-establish the old prewar structure is out of question. We have to build new facilities from economic and technical standpoints in accordance with the above-mentioned principles.

The realization of these goals in the present conditions in the Croatian economy is not easy nor can it be quickly realized because it assumes a radical change in her structure. This includes changes in the sphere of production, organization, technology and ownership. Also, there is a need to change the behaviour of all economic subjects, institutions and organizations. The economic structure which has been constructed over the last 45 years can not easily nor quickly be changed. That kind of change will take time and resources because we are dealing with a complete change of the whole economic system, not with a change in economic policy in the realm of the existing system. A partial, uncomplete change of the economic structure could be worse than no change at all. Therefore, the fundamental task of the new program is the development of Croatia's economy and the change from a self-managing socialist, technologically underdeveloped, autarkic economy, chiefly based upon public ownership, to an open, market, modern economy based predominantly upon private ownership. This is a very complicated task, because it asks for considerable changes in the economy's structure.

The changes in Croatia's economy should start with the change of the objective function of the firms. The company's objective in Croatia's economy should be maximization of profits as in all other modern market economies. Thus, the precisly defined firm's objective becomes a criterion for efficiency evaluation.

The realization of that objective assumes specific environmental characteristics in which the company does business. Above all, this means the freedom of movement of factors of production in and out of every industry and enterprise. That implies the non-existence of monopoly agreements, either open or collusive, so that businessmen an organize production in such a way as to achieve maximum efficiency of the factors of production. In a socialist economy these assumptions were not realized. That is why it had to be less efficient than a market economy. In a socialist economy the freedom of movement of the factors of production did not exist so enterpreneurs were not able to achieve an optimum combination of production factors in order to achieve their maximum efficiency. Not only was capital not mobile, but also labour was not mobile. Unlike a market economy, the labour factor was a fixed production factor. That made substitution impossible so production was suboptimal. The price system was arbitrary so the prices were not carrying out their function which they otherwise do in a market economy. The degree of monopolization was very high because the authorities in socialism preferred to develop large systems. That is why monopolies were very often institutionalized into various forms of public cartel agreements (recall the self-managed agreements in socialist Yugoslavia). In socialism, the state favoured large system and protected their monopoly positions with legal regulations. This is exactly the opposite of a market economy where laws endeavour to prevent the development of monopolies and to insure the highest possible degree of competition. The result was reduced production and higher prices, in socialism because of the non-existing freedom of movements of factors of production in and out of production. A company was very difficult to liquidate even when a firm was a lossmaker. Therefore, there was no "creative destruction" in Schumpeter's sense which is an essential characteristic of every healthy economic development. In the human organism some cells die and new ones are born, this is one of the conditions for a healthy human organism some cells die and new ones are born, this is one of the nies is a condition for the nomral life end growth of an economic organism.

2. *The Role of the State*

The role of the state in the process of economic development is considerable. The states task is to insure the necessary assumptions for the process of economic development. That means that the state has to ensure stable and precise laws insure law and order, personal protection, ownership law, fundamental infrastructure, education and medical and social security, and proper economic policy for the maintenance of internal and external balance. All these are well-known functions of the government. However, in our specific condition of transition from socialist into market economy the state has to subordinate its functions to insure a greater market influence on the functioning of Croatia's economy. Taking into consideration the difficulties of transforming a socialist economy to a market one, we could say that in our present condition the most important role of the state is to insure the functioning of a free market in all Croatian segments of economic life. A free market does not mean a laissez-faire market but a market where the government participates actively in the process of the elimination of market failures (imperfect competition and externalities) for achieving a greater degree of competition which would insure a maximum effiency of the allocation of scarce resources. That is why the Croatian government's duty (the same as the duty of governments in market economies) is to ensure a greater degree of competition in Croatia's economy and to establish properly defined antimonopoly laws. The government should clearly define the legal framework with in the realm of which every entrepreneur would act completdy freely in order to maximize his business objectives. That means laws have to be simple, clear and stable. It would essentially reduce uncertainties in business. In this way, a greater degree of confidence would be created. This is necessary to achieve a favorable investment climate which is necessary for increasing investments (foreign and domestic) and the start of the process of economic development. Since Croatia has to develop an export-oriented market economy and her main export market is the EC whose member Croatia has to become, it is best that Croatia immediately adopt company law (and other laws) which the EC has already standardized. Croatia's entrepreneurs will thus be oinsured, but also forced to accept the same economic conditions which exit in the EC. In this way they will be in an equal position with their European competitors.

3. *A Necessity of Management Changes*

Since man is a fundamental factor of every activity, a radical change in an economic structure from a socialist to a market economy is not possible without a change in personnel structure.

New policy can not be conducted with "old" personnel who are not capable of thinking in a new way. Christ expressed this as: "Do not put new wine in an old goatskin." If we did, the new wine would tear the goatskin and the would leak. This means that if we tried to conduct a new policy with "old" personnel who think in old ways, irrespective of the new phrases they use, it is very likely that from the new policy the only thing that would be left would be its new package.

In the socialist system, the communist party which was in power, appointed the managers of the firms. An unclear, undefined objective function of the enterprises and property system enabled the party in power to appoint managers who had to be more obedient than capable. These managers were more responsible for political than for economic mistakes. After all, their economic mistakes were attributed to "objective, difficulties" while their successes were attributed to the appointing manager's capability, his political party and/or political leaders. Initiative and entrepreneurship were drowned and kept back, especially when it was understood that they could lead to an increase in the manager's prestige which could shade the credit of the party in power or even the leader himself. That is how one of the greatest problems in Croatia's economy came to be and this is why she is facing a lack of qualified and courageous managers. The success of every firm depends on the ingenuity, creativitiy, flexibility and hard work of, above all, top management. Therefore, the greatest problem in this transitional process from a social ist economy into a market economy is to insure a sufficient number of managers, that is, persons who know their jobs, have the ideas and courage to enter into risks, and who think in a new way.

A manager is a person who organizes production, introduces new ideas and processes, carries out business decisions and is accountable for their results. That is why the government has to approach immediately the making of a sufficient number of managers without which there would be no economic restructuring.

This problem can be solved in the short-term by hiring a sufficient number of manager teams from abroad, but in the longterm it has to be insured by our own resources.

It is possible to get help for the education of managers from various international government and non-government institutions. Even without help from international institutions for Croatia's economy it pays off to hire and pay teams of managers from abroad because it is an investment in the scarcest knowledge in that economy. After all, when investing in knowledge the law of decreasing returns does not hold so these investments are profitable.

4. The Change of Ownership Structure

Changing the structure of an organization and management in the process of production (and exchange) requires a change in ownership structure which would result in a change of responsibility of all subjects in the economy for their business results. In this way irresponsibility for business failures would be eliminated and it would take way the possibility for the party in power to appoint managers who are obedient but neither fit nor capable.

Because of this, the change in ownership structure is a necessary condition for the change of the whole structure of the Croatian economy and her rapid development. That would mean an improvement in the living standard of the Croatian people. The change in ownership structure should not be spontaneous but well-organized and managed. A spontaneous change in property structure may lead to a community wealth pursuit which can be by various machinations, turned into private. This will not be beneficial to Croatia's society. That is why the state has to determine precisely the rules of the game that change ownership structures which would ensure as increase not only in the economy's efficiency, but also a just distribution of accumulated national wealth. Existing laws of privatization are very deficient in this respect. The change in ownership structure should realize these two objectives:
1) An increase in efficiency of Croatia's economy;
2) A Setting in motion and acceleration of Croatia's economy growth.

The realization of the goal of increasing Croatia's economic efficiency depends upon the making of an environment for the optimal allocation of disposable, natural, financial and human resources. That includes stimulating not only the quantity but also the quality of these resources. Since social ownership turned out to be inefficient it had to be changed. That means it has to be transformed into public or private ownership.

The development of socialist countries showed that complete nationalization of the means of production resulted in very poor efficiency of their use. The state showed itself an inefficient producer as a "self-managed interprise" which was subject in the social ownership system. It remains that social ownership should be transformed into private property in the largest possible degree. This should be set as an objective which to be achieved as soon as possible. Of course, there is no need to completely eliminate other forms of ownership such as state, mixed or co-operative, where these forms of ownership are more efficient.

In orde to achieve the second goal "setting in motion and accelerating the growth of Croatia's economy," the transformation of social ownership into private should be done by selling firms', assets, not distributing them without charge. Selling shares should create the financial funds needed for the take-off of the process of development. These funds should be used for financing investments for economic growth which would result in the creation of new jobs needed to solve the problems not only of existing unemployment but also expected unemployment due to the economy's restructuring. In the process of selling social assets to private individuals (foreign and domestic, the state should perform, above all a control function. This will prevent "spontaneous" privatization which can result in the wrongful claiming of social ownership on behalf of individuals or organized groups.

The process of privatization should begin immediately and be conducted as quickly as possible. However, we have to keep in mind that the process of transforming the entire economy will not be realized overnight; it will take some time. In privatizing social enterprises we have to make en effort to protect public interest and to obtain the best possible price in order to get a greater amount of funds that can be used for development financing. The higher price of socially-owned firms could be achieved through their restructuring. This could be achieved by hiring teams of capable managers to increase efficiency. Theprocess of restructuring can be concentrated in only a hundred of the biggest firms which have in the year 1989 participated in Croatia's GNP with about 60% (exactly 59.4%). The price that would be paid to engage such teams would be a lot smaller than the direct benefits measured by the increase of value of these large firms. If we addto direct benefits the indirect ones, like the education of domestic managers who would work with these teams and a spontaneous adaptation of smaller more flexible firms and the improvement of the efficiency of the Croatian economy, then the total benefits outweigh by far the costs of engaging these teams of managers.

In numerous and often interesting dicussions in the last two year about the transformation of Croatia's economy from a socialist economy into a market one, the process of transforming the economy was simplified and reduced to the problems of privatization. The idea of privatization has become just as popular, even fashionable, as was the idea of nationalization after World War II or the idea of self-management organization after the enactment LOAL (Law of Associated Labor) in 1976.

Sometimes privatization is taken as a panacea which will solve all structural problems of East European countries. Very frequently privatization is suggested as the most efficient way of transforming a socialist into a market economy.

There is no disagreement among economists that the Yugoslav and other East European economies were less efficient than the West European market economies due to the differences in political and economic systems. The disagreements begin about the ways and means of how to transform the former into the latter.

Privatization without demonoplization will not increase the efficiency of the economy. The economic behavior of the monopoly does not differ whether it is private or public. The monopolistic produces less and charges higher prices than the non-monopolistic enterprise.

The privatization of enterprises is animportant aspect, but no the only one, and not even the most important one in the transition from a socialist to a market economy. In other words, privatization matters, and matters very much, but not only privatization.

We cannot expect that the problems of the Croatian and other East European economies will disappear simply by handing enterprises over to the private sector. In these countries the private sector is undeveloped and when it exists, it is very imperfect. So we have the choice between an imperfect public sector and an imperfect private sector, not between an economically inefficient public and an economically efficient private sector.

The simplified reduction of the problem of transformation from a socialist economy to market economy to the problems of privatization is unjustified. Privatization is not only a legal problem but also an economic one. I would even dare to say that it is, above all, an economic problem. That is why the present privatization law in Croatia is not good because it simply neglects the complexity of the economic privatization problems, concentrating only on the legal aspects of the process of privatization. If the solution of Croatia's structural problems is reduced to only a legal act of her privatization then ther is a high degree of probability that again it will be just a change in form. The economic structure will not be changed and Croatia's economic efficiency will not be increased. That is why privatization should be just one (however very important) in a consistent set of measures of economic policy for her transition from a socialist to a market economy. Privatization then there is a high degree of probability that again it will be just a A monopoly, whether private or public, follows the same logic of economic behaviour. A monopolist produces less, and sells at higher prices than oes a competitive firm. That is why the process of privatization should be followed by the process of demonopolization by restructuring large systems as well as by stimulating competition (foreign and local). That means that privatization should go hand in hand with the liberalization of imports. That is why the domestic market should be immediatly opened up in order to increase the degree of competition on the domestic market. In this way relative prices on the domestic market will adjust to relative prices on the world market. For those reasons (and for others) the process of restructuring of companies should precede their privatization. Restructuring firms (first of all, a change in management and organization) can be achieved in a considerably shorter period of time than privatization.

The process of privatization faces a number of problems which can not be solved in a very short period of time. The first problem is the finding of buyers. For a buyer to buy a company he has to believe that with a different management appoach the company will be profitable. This is especially true for the lossmakers. A private individual will buy such a company only if he believes that the restructuring of such a firm (a change in management, a change in the factors of production, freely forming prices, etc). Will be able to make a profitable company out of a loser and that the discounted value of future profits will be able to make a profitable company out of a loser and that the discounted value of future profits will be greater than the price which he will pay for the company.

The second problem is determining the price of a social firm. Namely, the book value of the firm in Croatis does not reflect its real value. That is why it is necessary to estimate the value. In the situation where the capital market is non-existent every evalution of the firm is necessarily arbitrary.

The final problem with privatization is political. Privatization entails change which is often seen as a source of increased uncertainty. The workers and managers often oppose privatization because they are afraid that they may lose their jobs. Some political leaders oppose it because of the lose of their direct influence over part of the economy. Consumers might oppose the process of privatization because they believe that prices might rise. Some political leaders point out that privatization might result in the creation of a new class of capitalists with the "exploitation" and the unjust distribution of national income as a consequence.

There are many proposals concerning the techniques privatization: the selling of shares; the distribution of shares to every citizen or to the employees; the combination of the two, etc. Each has its advantages and disadvantages.

The solution distributing shares to the workers and so make them private owners aims primarily at the creation of ownership incentives. But, due to the difference in capital intensity in different industries, workers would receive very different capital values. Those working in factories would receive more than those in agriculture and services. What about the unemployed and those employed abroad? Besides, experience shows that the workers try to sell the shares for cash. This is why in Yugoslavia the federal government attempted to compel workers by law to purchase shares by deducting their value from wages. That provoked furious reactions on the part of workers and this system simply did not work.

The diffusion of stock ownership among a large number of people tends to protect entrenched management, because it is difficult or impossible for such a large group of investors to organize a majority to force such managers out of business.

Besides, there is the question of whether the workers in the system of self-management who (at least in theory) menage the enterprises and distribute the profits, would behave differently when they become small owners. The question boils down to the question of whether this transformation will improve the efficiency of the enterprises.

Another approach is that all firms ought to be transformed into state enterprises in order to sell them gradually to domestic and foreign private investors. Due to the inferior results of state-owned enterprises compared to comparable private enterprises, this approach looses ground. What has to be done is to transform the state firms into independent decision-makers, to create an environment for entrepreneurship.

Lastly, the approach of privatizing all enterprises has become very attractive. The privatization should be done as soon as possible. But the process of overall privatization should be controlled and conducted very carefully. The process of "guided" privatization has less unfavorable side effects than the process of "spontaneous" privatization.

A great number of small establishments (shops, restaurants, repairshops, service establishments, appartments), often unprofitable parts of larger firms, could be sold immediately to individuals and cooperatives, perhaps on the basis of installment credits and mortgages. The rest of the firms may be controled by a certain amount of holding companies owned mostly by banks. For this reason and for the reasons of extremely bad performances of the banks in Yugoslavia, the most urgent need is for good bank managers. The countries with developed financial systems could help in this respect.

The main goals that the process of privatization should achieve are to increase the officiency of enterprises and to get fresh investment funds in order to create new job opportunities, especially for workers that will lose their jobs-due to the process of privatization. These goals suggest that the increase of efficiency through the process of the restructuring of enterprises should precede privatization and that privatization should take the form of selling the enterprise to private businessmen. The proceeds should be used to genernate new jobs to replace those which are being phased out.

In conclusion, I would like to draw attention to one very important matter that has often been neglected in the discussions on privatization. Namely, in the process of transition from a socialist to a market economy in Croatia it is important not only to promote privatization of socialist firms but also to promote the development of the already existing private sector by stimulating measures of tax and credit policies.

References

Babić, M. "The Problems of Transition from a Socialist to a Market Economy in Yugoslavia," *Rivista di Politica Economica*, June 1991, pp. 331-344.

McCracken, P. W. *Thoughts on Marketizing State-managed Economies*, Hudson Institute, Jan. 1990.

Kim, Dalchoong, Ku-Hyun Jung, Kap-Young Jeong, *The Role of Market and State: Economic and Social Reforms in East Asia and East-Central Europe*, Yonsei University, 1991.

F. A. von Hayek, "The Use of Knowledge in Society," *American Economic Review*, Vol. 35, 1945, pp. 519-30.

Primorac, E. & Babić, M. "Systemic Changes and Unemployment Growth in Yugoslavia 1965-1984," *Slavic Review* 48, No 2, 1989, pp. 195-213.

Ramanurti, Ron. "Controlling State-owned Enterprises" *Public Enterprise*, Feb. 1987., pp. 99-177.

Schumpeter, Joseph A., *Theory of Economic Development*, Oxford Univ. Press 1961.

Schumpeter, Joseph A., *Capitalism, Socialism and Democracy*, George Allen Unwin, 1976.

Vernon, R. *The Promise of Privatization*, The Council on Foreign Relations, Washington, D. C., 1988.

PART IV
Global Economic Restructuring and the Asia-Pacific Region

Global Economic Restructuring: Its Impact on the Asian-Pacific Economy

*Suk-Bum Yoon**

I. Introduction[1]

The world economy is currently undergoing drastic restructuring. The restructuring is not a mere change toward the 21st century. Cataclysmic changes are underway.

The most incredible change is the end of the Cold War. East Germany was absorbed by the West after the dramatic collapse of the Berlin Wall. The Soviet Empire in Eastern Europe was dissolved. The Soviet Union itself was dismembered. Ideology no longer has priority over economic development. The former authoritarian communist economies are undertaking reforms towards the market-oriented economy.

The international trade environment has changed significantly over the last few years. The European Community (EC) is to be further integrated into a single market after 1992. The North American Free Trade Area (NAFTA), comprising the United States, Canada and Mexico, is taking shape. The emergence of regional trading blocs, although not necessarily negative features in world trade but those which could eventually lead to more trade expansion rather than trade diversion, have unavoidably created the concern on possible inward-looking policies within each trading group which

* The author is the Director, Asian and Pacific Development Centre (APDC). Views expressed are personal.

1. Asian-Pacific economy in this paper refers to the economy of East Asia, South Asia and Oceania.

may lead to the reduction of imports from countries outside these groups. Even the change towards market economies of the centrally-planned states in Eastern Europe, which should contribute positively to world trade and development, has prompted concerns among some Asian-Pacific economies that trade and investment, and more importantly, international development assistance resources, may be diverted from the Asian-Pacific region to Eastern Europe.

Meanwhile, the threat of trade protectionism has not subsided. The Uruguay Round Multilateral Trade Negotiations (MTN), which failed to be concluded on schedule by the end of 1990, have created tremendous concerns among countries in the Asian-Pacific region. Now although the MTN has resumed, the chance of a successful conclusion as well as the extent of agreement which could be reached on various issues is still uncertain. Should the MTN finally break down, there is a danger of international trade sliding back to bilateralism, and developing economies, which depend on international trade for their continued economic growth, facing increased vulnerability to protectionist and retaliatory measures. Even if the MTN is successfully concluded, developing economies in the Asian-Pacific region would also have to be concerned about the implications of the various agreements reached which might significantly affect their international trade positions. The implications of GATT agreements on issues such as agricultural subsidies, trade in services, trade-related investment measures, intellectual property rights protection, and the phasing out of the multifiber arrangements will have to be carefully assessed, so that appropriate policy responses an be made promptly.

The changing international trading environment, although creating threats and uncertainties, also provides new opportunities and challenges to developing economies in the Asian-Pacific region. The development in Eastern Europe towards market economies, for example, could open up new markets for certain types of consumer products which could be supplied from the Asian-Pacific region. A better under-standing of rules, regulations and standards imposed on imports of the EC single market could also help exporting countries to supply their products to the world's largest consumer market. All these imply that there is a need for a better understanding of the implications of the rapidly changing international trade environment. Indeed, it is not only international trade policy, but also policies on agriculture, manufacturing, and services which have to be adjusted to accommodate the changing situations.

Besides the rapid change in the international trading environment, technological progress is now being carried out rapidly and massively. New technology not only creates new markets but also improves productivity substantially. The degree of technological progress in a country is one of the most important factors in determining its competitiveness. Amid the trend that technology transfers are becoming more restricted by technology protectionism, developing countries in the Asian-Pacific region are facing the possibility of losing the traditional advantages from cheaper labour and raw materials.

During the 1990s, there appears to be no sign of relief for the debt burdens, which had cost them too much during the last decade, of developing countries in the Asian-Pacific region. On the other hand, the environmental problem is emerging as a new issue in economic development. Undoubtedly, the global economic restructuring mentioned above will bring new challenges to developing countries in the Asian-Pacific region.

The major restructuring of the global economy has been summarized above. In Section 2 the economic performance of the Asian-Pacific economy during the last decade will be reviewed and the short-term prospects of the Asian-Pacific economy forecast. In Section 3 the impacts of global economic restructuring on the Asian-Pacific economy will be analysed. Section 4 reviews the internal development constraints the Asian-Pacific economy faces and Section 5 will conclude the paper with some policy recommendations.

II. Overview of the Asian-Pacific Economy

1. *Growth and Structural Adjustment in the Asian-Pacific Economy in the 1980s*

In the 1980s, the Asian-Pacific economy experienced relatively higher economic growth than the rest of the world (Table 1).

Especially, the emergence of the East Asian industrial belt, extending from Japan, the Asian NIEs, and later towards the ASEAN group, has resulted in one of the strongest industrial belts on a global scale. Japan and the NIEs have enjoyed the advantage of export-led growth by moving from labour-intensive industries to the dominance of the skill and technology-intensive sector capable of increasing their market shares in the developed economies of the U.S. and Europe. The ASEAN group gained its growth through relatively lower wage rates and resource-based development, and is now at the

Table 1. GDP Growth Rates by Region

Group and Region	Real GDP growth rates		Real GDP per capita growth rates	
	Trends, 1965-80	Recent Experience, 1980-89	Trends, 1965-80	Recent Experience 1980-90
Developed countries	3.7	3.0	2.8	2.5
Developing countries	5.9	4.3	3.4	2.3
East Asia	7.3	8.4	4.8	6.7
China	6.4	10.1	4.1	8.7
Other	8.1	6.4	5.5	4.2
South Asia	3.6	5.5	1.2	3.2
India	3.6	5.6	1.2	3.5
Other	3.9	5.0	1.2	2.2

Source: World Bank, *World Development Report*, 1990.

stage of accelerating its industrialization further. China recorded the highest economic growth of 10.1 percent in the 1980s. However, her growth rate in 1989 fell to 3.9 percent, less than half the average for the decade, as the speed of economic reform slowed and the government adopted austerity measures to curb inflation by controlling the expansion of domestic credit. The South Asian countries were able to maintain a 5.5 percent growth rate in the 1980s through continuous efforts to increase agricultural productivity and rural development.

2. Current Status and Short-Term Prospects of the Asian-Pacific Economy

The world economy in 1991 grew by approximately 0.9 percent, the lowest since 1982, due to continued recessions in some industrial countries, especially in the United States, Canada and the United Kingdom, and due to a substantial decline in the economy of the Middle East, Eastern Europe and the former Soviet Union. Accordingly, the global economy achieved a slow growth rate for three consecutive years beginning in 1989.

The recessions in some developed countries in 1991 were accounted for by the lagged effects of the higher real interest rates and higher oil prices and the increased uncertainty related to the Gulf crisis. As a result, the growth rate in world trade volume dropped to 0.6 percent much lower than the 4.3 percent in 1990.

Despite the recession in the world economy and the slowdown in world trade, the Asian-Pacific economy in 1991 was robust and it remained the most dynamic region of the world. Economic performance, however, differed significantly across individual countries in the region and for many Asian-Pacific countries the year 1991 was a difficult year as evidenced by a declined growth rate, accelerated inflation and a worsened balance of payments.

Economic prospects for the Asian-Pacific economy in the next two years will depend much on both external environment as well as demostic policies. It is generally projected that recovery in the U.S. economy will set in more firmly and world income and trade growth will accelerate, while the Asian-Pacific economy is expected to pursue domestic policy reforms to mobilize more domestic resources and enhance the efficiency of the overall economy. Under the assumption of improving the world economic environemnt and sustained policy reforms in the Asian-Pacific economy, the economic prospects for the Asian-Pacific region in the next two years are better than the recorded performance in 1991. There are, however, a number of constraints to rapid economic growth in the Asian-Pacific economy. Those constraints include infrastructural bottlenecks, environmental concerns and labour shortages. The possible slowdown in the Japanese economy and less-promising prospects for the increase in official development assistance will also affect the Asian-Pacific economy adversely. Efforts at diversifying export markets should be continued and restructuring of the economy will have to be pursued to meet the dictates of shifting comparative advantages.

III. The Impacts of Global Economic Restructuring on the Asian-Pacific Economy

Even though the preceding section has painted a rather rosy picture for the Asian-Pacific economy, there still exist many emerging issues that the economy faces along with the impacts of global economic restructuring. The trade deficit of the U.S. induces her to adopt more protectionist and inward-looking trade policy. The EC member countries, which lost their comparative edge vis-a-vis Japan and the U.S., will try to regain their past economic glory by integrating their markets by the end of 1992. Therefore, the world's trade environment is changing from one of free and multilateral trade to somewhat restrictive and bilateral trade. This kind of protectionism, along with regionalism, exerts an unfavourable influence on the economy of the Asian-Pacific region. The more significant impacts of global economic restructuring ont he Asian-Pacific economy are identified as follows.

1. Changes in the World Trade Regime

The traditional world trade regime is embodied in GATT, which has successfully been upholding the principle of free trade and investment. Although successive GATT rounds have reduced the tariffs of developed countries significantly, the use of non-tariff barriers (NTB) has been on the rise lately. In the U.S., non-tariff barriers on steel, automobiles and textiles are estimated to be equivalent to an additional tariff of about 25 percent, raising protection to the level of the early postwar years. For example, in 1989 the U.S. warned Brazil, India and Japan that it might take unilateral steps to protect trade by using its "Super 301" legislation. Trade frictions with the U.S. have been reduced through bilateral discussions, but the threat of unilateral action still remains. Voluntary export restraints (VER), particularly on more sophisticated manufactured goods, have increased very rapidly. For instance, in 1989 more than 120 such restraints influenced the exports of developing countries in the Asian-Pacific region.

The strengthening of the GATT through the Uruguay Round, which was initiated with the prime motivation of reducing NTB, offers a chance to create a truly global and multilateral trade regime. The ambitious negotiation proceedings are including such new sectors as intellectual property, services and foreign investment, as well as old areas such agriculture and emergency import relief. The Uruguay Round, however, has not reached satisfactory results in such areas as discriminatory non-tariff protection.

Dispute settlement procedure, on the other hand, has achieved some concrete results. Moreover, an OECD-like surveillance mechanism to scrutinize member countries' policies has been established. Liberalization, however, has not been well promoted, except in tropical products with limited results.

Negotiations on non-tariff barriers such as in safeguards, non-tariff measures, subsidies, agriculture and textiles and clothing groups, have not progressed much. Agriculture negotiations could not reach an agreement on the method of approach, let alone the extent. Voluntary export restraints (VER) related to safeguards are not approved by the developing countries, since those restraints can be imposed on an arbitrary basis.

Non-discrimination such as the most favoured nation clause is the most fundamental factor in the GATT. However, negotiators have often disregarded this clause by mentioning manifest discriminations like voluntary export restraints. Since discrimination impedes the spread effects of bilateral negotiations, it may threaten the whold GATT mechanism.

Without new political efforts by member countries, the Uruguay Round will bring about rather poor results in key negotiations. Due to the existing conflict between the EC and the United States regarding agricultural support, negotiations in the agricultural sector will progress slowly. Non-tariff barriers will not be reduced much either, due to each country's domestic political pressures. The most likely outcome in this area is an agreement on some continuing form of standstill. Even the United States, the main promoter of the service negotiations, is reluctant to include transportation and telecommunications in the service negotiations.

The likely outcome of the Uruguay Round seems insufficient in creating free and fair economic environments. The Uruguay Round has its own limits due to the various negotiating positions of participating countries. If the Uruguay Round fails to secure a multilateral trading system, more trade blocs such as the EC and the North America Free Trade Area (NAFTA) will emerge. For in recent years trade blocs have emerged partly as a substitute for the multilateral liberalization of trade that should be taking place in the GATT framework.

Generally speaking, open trade relations are ultimately in everybody's interest. Protection in the developed countries preserves only a small number of jobs, and at a great cost to consumers. Protection in developing countries burdens consumers and industries that need imported inputs, and it creates an environment that rewards inefficiency. Furthermore, the failure of the Uruguay Round will hinder the expansion of world trade volume, with negative impacts on the export-led-growing developing countries in the Asian-Pacific region.

2. *Growing Trend Toward Regionalism*

Since the replacement of the dollar by the tripolar system of dollar, yen and deutschemark following the Plaza Accord of 1985 there has been a gradual mvoe toward the development of regional trading groups which focus on these three currencies. The full economic integration of Europe by 1992, the North America Fre Trade Area (NAFTA), and the Asian Pacific Economic Cooperation (APEC) demonstrate this trend.

The European Communits (EC) 1992 Project aims at creating a true common market in which goods, services and capital can move freely between member countries without being subject to any frontier controls. Ever since its creation in 1958 by the Treaty of Rome, the EC has been trying to improve the internal welfare of member countries through the balanced growth between member countries. It had, by abolishing internal tariffs and import quotas, completed the Customs Union by 1968. In spite of such an achievement, it has failed to achieve its original goal, namely, the creation of a common market. Moreover, its economy has been overshadowed by the U.S., Japan and the NIEs. This is because there still remain non-tariff barriers to the free movement of commodities between member countries, which has compelled EC member countries to conceptualize and eventually introduce the 1992 Project.

The bases of the EC 1992 Project are the "White Paper on Completing the Internal Market" and the "Single European Act." The former aims at integrating the entire EC area as a single market by ensuring free movements of goods, services and capital. In order to achieve such an aim, it tries to abolish all the existing non-tariff barriers to enable free movement of all commodities. The barriers are classified into three categories, namely, physical barriers, technical barriers and fiscal barriers. On the other hand, the latter changes the EC's decision-making process from the previous unanimity rule to the qualified majority system and fixes the date for completing the EC common market at the end of 1992. Its aim is to speed up the integration of European markets.

As the EC evolves into an economic union, North American countries are developing their own trade bloc. The main thrust of the NAFTA is the Canada-United States Free Trade Agreement (CANUSTA), completed in January 1989, and several agreements between the U.S. and Mexico. Since North America is a bigger market for the Asian-Pacific countries than the EC, the progress of the North American Free Trade Area will become more significant to the Asian-Pacific economy.

Negotiations for the NAFTA began in June 1991. In comparison with the Canada-US Free Trade Agreement (CANUSTA), negotiations including Mexico will be substantially different. In the case of the CANUSTA, the Canadian economy adjusted smoothly after its formation not only because Canada and the Untied States have similar industrial structures, but also because three-quarters of the bilateral trade was already conducted free from tariffs. However, the transitional period for Mexico from tariffs. However, the transitional period for Mexico to integrate further into the North American economy will probably take longer than was the case with the CANUSTA, due to the vast differences in culture, economic development level, wages and productivity.

With the formation of the NAFTA, some U.S. and Canadian producers will have difficulties in competing with cheaper Mexican goods. Thus, most U.S. labour unions are strongly opposed to the establishment of the NAFTA. Similarly, on the Mexican side, even though the government considers the NAFTA an opportunity to modernize its economy, several union leaders criticize that it would increase imports and create chronic unemployment. Canada also worries about the dilution of benefits from the CANUSTA by the inclusion of Mexico. Furthermore, the trilateral negotiations for the NAFTA could involve a reopening of the Canada-U.S. Free Trade Agreement and such an event could extract new concessions from Canada.

Despite the discouraging factors, the negotiations for the NAFTA will be completed in the near future. The NAFTA will not only increase the market size but also induce more efficient economic structures in member countries.

Complementarity in industries will strengthen their competitiveness. The NAFTA will also give certainty and predictability to investors in the member countries, resulting in accelerated capital and investment flows.

The gorwing trend toward regionalism, such as the EC 1992 and the NAFTA, will have a substantial impact on the Asian-Pacific economy. Although there is a tendency to form trade blocs, it will be difficult for the Asian-Pacific countries for several reasons First of all, the Asian-Pacific countries are mutually suspicious because of their historical backgrounds. In addition, the ecoomies of the Asian-Pacific region are heterogeneous in size, development level and natural resources. Thus, economic cooperation bodies like the Pacific Basin Economic Council (PBEC), the Pacific Economic Cooperation Conference (PECC) and the Asian Pacific Economic Cooperation (APEC)[2] have only a loose bond among member countries. Because of these drawbacks, actual multilateral cooperation has not progressed much, in spite of the potential benefits from economic interdependence.

If the efficiency gains from these kinds of economic integration are pur-

---

2. It is in this context that 12 nations formed the Asian-Pacific Economic Cooperation (APEC) in 1989 after it was proposed by Australia. APEC includes Australia, New Zealand, Japan and Korea and the six countries of the ASEAN: Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand. Canada and the U.S. are also members.

sued within the context of an open and liberalized trading system, the welfare gains from trade could be expanded substantially. However, there is a risk that these three large free trade areas may erect higher tariff barriers against the rest of the world. In this case there could be a significant dampening effect on international trade and a loss in welfare. Furthermore, developing countries in the Asian-Pacific region which are excluded from this system would need to integrate with one of the groups in order to participate more effectively.

3. *Economic Reorganization of Europe*

Recently many changes are going on in Europe. The major changes can be summarized into the following three: a) EC integration (European single market) in 1992, b) a unified Germany as of October 3, 1990 and c) democratization of Eastern Europe. These drastic changes will bring about serious impacts on the economy of the Asian-Pacific region.

As for the European single market, the 12 EC member countries are now trying to integrate into a new European single market, which will be the world's largest single market with a population of 320 million and a GDP of about $6 trillion, by the end of 1992 through the elimination of all existing barriers (i.e., physical, technical, and fiscal). The elimination of these barriers will increase thrade volume between EC member countries, which is called a *trade* creation effect. On the other hand, this elimination of the brriers will lower the production cost of EC firms and make the EC products more competitive in the world market. Therefore, EC countries will import less form non-EC countries, such as the Asian-Pacific region countries, and import more from member countries. This is called a *trade* diversion effect.

This trade diversion effect, which reduces the exports of the Asian-Pacific region to the EC market, will result in serious impacts on the economy of the region. Because the EC integration in 1992, as stated above, will make EC firms more competitive in the EC market, many firms of non-EC countries, such as the U.S., Japan and Korea, are expected to lose their competitive edge in Europe after 1992. In order to overcome this plight, non-EC countries are now initiating many FDI (foreign direct investment) projects in Europe. This implies that the capital of advanced non-EC countries which has flowed to the Asian-Pacific region so far will flow away from the region to EC countries. Accordingly, capital account of the Asian-Pacific region countries will deteriorate.

As for the impacts of a united Germany and the democratization of Eastern Europe on the Asian-Pacific region, similar phenomena are likely to result. As West Germany absorbs East Germany and Eastern Europe bloc countries pursue more a market-oriented economy, the economic ties between Western Europe and Eastern Europe will be strengthened. Therefore, as a natural consequence, trade volume and capital flow between Europe and the Asian-Pacific region could diminish in the near future.

4. Rapid Technological Progress

New innovations in micro-electronics, robotic technology, biotechnology and new materials in recent years have gradually entered into the industrial process and production and are beginning to affect relative factor costs and the comparative advantage of production among countries in Asia and the rest of the world. Amid the trend of technology transfers becoming more restricted by technology protectionism, developing countries in the Asian-Pacific region are facing the possibility of losing the traditional advantages of cheaper labour and raw materials.

5. Gulf Crisis and Its Aftermath

The Gulf crisis in 1990-1991 hurt the Asian-Pacific economies by raising the price of imported oil, disrupting trade with West Asia and producing a sharp drop in remittances from Asian workers in West Asia. There also was the high cost of repatriating those workers.

The loss of remittances due to the Gulf crisis alone totalled several billion dollars, representing a substantial cutoff of such funds for the main Asian labour, exporters: Pakistan, India, Sri Lanka, Bangladesh and the Philippines. The crunch was also felt in Thailand, Indonesia, Korea and Vietnam.

This huge loss of remittances, coupled with the increase in the import value of oil and the decrease in the export value of commodities, raised the aggregate current account deficit in 1990 for the developing Asian-Pacific countries from US$25 billion to US$50 billion.

On the other hand, angered by their countries' support for Iraq, Gulf countries expelled hundreds of thousands of Yemenis, Palestinians and Jordanians after the Iraqi invasion of Kuwait in August 1990. This, coupled with teh reconstruction needs of Kuwait, created labour shortages in the Gulf region, especially Saudi Arabia, that labour-exporting countries in the Asian-

Pacific region now hope to fill in the postwar period. Therefore, the major Asian labour-exporting countries should take advantage of this opportunity to rehabilitate their economies severely hurt by the Gulf crisis. This will ease their unemployment and labor redundancy problem to some extent and be a direct balance of payments support as well.

IV. Internal Development Constraints

Along with the global economic restructuring, the Asian-Pacific economy is now facing internal development constraints as follows:

1. *Persistent Poverty and Environmental Problems*

Although crude birth rates in the low income countries of Asia have declined considerably from their peak in the mid-1960s, when combined with much-reduced mortality and increasing life expectancy rates over the last two decades, net population growth in the most populated areas of South and Southeast Asia still maintained an average rate of 1.5-2.3 percent in the 1980s with the exception of China which dropped to a level of 1.2 percent due to extensive family planning efforts.

In spite of steady economic growth, less than one-third of the increased population has been absorbed in the urban industrial sector. In other words, population pressure in rural Asia has intensified and this trend will continue in poorest Asia. The irrigation system becomes more difficult and costly in the poorest areas and social rigidities in a number of countries still prevent the poor and other disadvantaged groups from gaining access to equal opportunities in the whole development effort. Effective delivery of governmental development aid to target groups has yet to be improved.

After the UN Decade for Women, attempts to involve women in the development process and the problems of child labour, etc. still require serious and continuous effort in the coming decade.

Robust economic development in the Asia and Pacific region has been accompanied by the unwelcome by-product of environmental problems. Rapid industrialization in many of these countries is contaminating air, water and soil as in the industrialized North. In addition, environmental problems affecting a vast majority of populations in the region are found in the rural areas.[3] Problems such as deforestation, soil erosion, salinization, siltation, and so on are not as amenable to technical cures as urban industrial pollution. Instead, they are much more complex and are rooted in socio-economic, cultural and political settings.

In the analysis of various socio-economic political factors that bear upon the rural environment, the dominant and crucial point is the control over resources. Who has access to, manages, uses and benefits from available resources — both natural and others like credits, markets, public services and so on — determines the way these limited resources are used. Experiences in many countries have shown that rigid control and imposition from centralized governmental authorities can lead to neglect and disregard for such measures by the deprived people, thereby resulting in more severe environmental degradation. Hence, local control over resources and the people's participation in this control is the key to sustainable and environmentally sound development. The implementation of this concept encompasses the factors of sociology, economics and politics at the local grassroots level. It has to be remembered that the poor are the worst victims of environmental degradation.

2. Needs for Urban Development Management

Although rural development management will continue to be an important area, urban development management has and will emerge as another pressing concern of the public sector as the urban population in Asia is expected to increase from 700 million in 1985 to 1,187 million in 2000.

During the last decade, the Asian-Pacific countries achieved economic development by pursuing the policy of rapid industrialization. This economic development, however, had been accompanied by rapid urban growth because the prospect of a better living standard and expected income gain in the industrialized urban areas has generated the impetus for rural-urban migration. This rural-urban migration, along with the natural increase of the existing urban population, has created explosive urban growth in the cities of the Asian-Pacific region.

The explosive growth has now resulted in serious problems in the urban areas such as housing shortages, traffic congestion, air and water pollution, social crimes, urban poverty, and so on. The major metropolitan areas in

3. Colonization of frontierland and deforestation has also reached a critical stage among resource-rich Southeast Asian countries, while ecological deterioration has reached an alarming power in the Himalayan watersheds, inland China, and many pockets on the Asian sub-continent.

the Asian-Pacific region are no longer good places to live. Therefore, some policy measures must be taken in order to meet th basic needs of the urban poor and to secure a beter quality of life in the urban areas in general.

3. *Need for Changing the Role of Government and Human Resource Development*

Since their independence, Third World governments have increased their role in national development through both direct and indirect intervention, leading to an enlargement of their functions in an effort to ensure greater growth and equity in post-colonial development. Recently, however, the growth of government bureaucracy has reached a limit which necessitates serious retrenchment and restructuring to improve its efficiency. This is partly due to the fact that in many newly independent countries the private sector at the time of independence was still too small and weak to undertake the scale of investment needed for development. Many governments also intended to secure social justice and redistribution of income by expanding the economic role of government. Some of those efforts have now become an increasing burden to those very governments.

This, however, has coincided with the increasing capacity of the private sector to assume some of the developmental functions carried out earlier by the State. Privatization has thus recently emerged as a dominant policy of reforms as governments cut back their economic role in this region.

However, governments are also under pressure to assume new functions and management responsibilities for coping with the emerging structural adjustments at the global level. These include tackling the rise of new protectionism, energy planning and resource utilization, growth of transnational corporations, international transfer of technology and R&D policies, environmental problems, political negotiation and cooperation at the regional and sub-regional level — all aimed at achieving a higher level of collective self-reliance.

This trend requires a new orientation and enhancement of management skill at different levels of government including the adoption of new information systems and technologies in management. Towards this effort of strengthening management capability, human resource development becomes of strategic importance to a government concerned with future development in the coming decade. Human resource development, in parallel with social capital formation, will strengthen the availability of qualified personnel and skilled manpower needed for the sustained and long-term development of a country.

4. Cultural Constraints to Development: Issues of Ethnic Diversity

Cultural issues have always been recognized in development theory. The issues which have drawn attention are traditional values and their conflict with industrial ethos, extended family system vis-a-vis nuclear family, fatalism versus efforts at self-improvement, or superstitions and subservience to nature vis-a-vis the scientific spirit of interrogation and ministering nature to satisfy human needs. Somehow the questions of ethnic and religious diversities and their impacts on development have been largely neglected, at least in the Asian context. In Asia, the social caste system and development efforts have been the closest concerns in the field of ethnic diversity issues.

Ethnic problems are matters of serious concern in a large number of the countries in the Asian-Pacific region, such as Sri Lanka, Pakistan, India, Malaysia, Fiji, the Philippines and, to some degree, Indonesia. In recent times such problems have greatly shaken development momentum. But this is too sensitive a subject to lend to impartial handling and analyses by national institutions and it is a subject spanning a multiple of disciplines such as sociology, economics, history, political science, anthropology and public administration. This is again a subject where regional experience-sharing covering both developed and developing countries can be useful.

V. Summary and Conclusions

In the previous sections, the impacts of global economic restructuring on the Asian-Pacific economy were analysed and some internal development constraints were reviewed. This section will conclude the paper with policy recommendations as follows.

1. Strengthening Asian-Pacific Economic Cooperation

As explained above, the world trade regime is changing from free and multilateral trade to restrictive and bilateral trade. This kind of protectionism along with regionalism exerts an unfavourable influence on the Asian-Pacific countries which are pursuing an outward-looking development strategy.

In order to mitigate the negative impacts of world protectionism and regionalism, the Asian-Pacific countries should strengthen their economic cooperation. However, it is very unlikely that the Asian-Pacific countries would form and economic integration for the time being. Therefore, the Asian-Pacific countries should collaborate effectively in order to keep the EC and other regional bodies from adopting inward-looking policy. By preventing regional blocs from raising external barriers, the strengthened economic cooperation will in turn promote global liberalization. It is expected that as the economies of the Asian-Pacific region achieve higher stages of development, they will increase interdependence among themselves, and with or without the EC and other regional blocs, some form of close cooperation might well emerge.

For further development of Asian-Pacific economic cooperation, several preconditions must be met: countries in the region should first change their attitudes. Until now, the heterogeneity of economies in this region has been overly emphasized. There is also the concern that Japan, the economic superpower, will exert too much influence in the region. Due to such doubts, the process of economic cooperation in the region has not been smooth. Yet, now might be the time to enhance ecomomic cooperation by discarding such misgivings and doubts. This will encourage Asian-Pacific countries to improve the awareness of a promising cooperation based upon mutual trust and common interest for mutual gains. The bigger the trade flow and foreign direct investment, the stronger the internal bondage is likely to be. Appropriate organized support for economic cooperation could promote mutual benefits.

2. Beyond Regionalism Toward Globalism

As shown above, more trade blocs such as the EC and the NAFTA are likely to emerge as the Uruguay Round fails to secure a sound and lasting multilateral trading system. This growing trend toward regionalism will have substantial negative impacts on the Asian-Pacific economy. Therefore, the Asian-Pacific countries should overcome regionalism to pursue globalism, following a non-exclusive and non-discriminatory principle.

The economies of the Asian-Pacific, as well as those of the other regions, will be able to attain maximum benefits from free and fair trade. This principle guarantees that regional liberalization remains consistent with the multilateral trading system of the GATT. This also makes it possible to avoid unnecessary trade conflicts with countries outside the region. Furthermore, it would maximize the trade creation effects by eliminating potential negative trade diversions.

For smoother regional liberalization, the economies of the region need to pay attention to non-tariff barriers and make every effort to abolish them. Non-tariff barriers have greater protective and distortionary effects than tariffs. Although tariffs on manufactured goods have been substantially reduced under several GATT rounds, non-tariff barriers, which are neither transparent nor easily measurable, still persist because they serve as an effective substitute for tariffs. The development of a consensus among countries in making non-tariff barriers transparent is a necessary prerequisite for regional liberalization.

Regionalism, whatever form it may take, should be directed toward globalism. The purpose of forming preferential trading areas should be to facilitate trade between the constituent territories without raising trade barriers with other contracting parties. Considering the increasing interdependence in the world economy, countries of the Asian-Pacific region, as well as those of the other parts of the world, should strive to keep globalism as the ultimate goal.

3. Need for Technological Breakthrough

As explained above, due to technology protectionism prevailing in the advanced countries, the transfers of hi-tech to the developing Asian countries becomes increasingly difficult. Therefore, the developing Asian countries should have access to hi-tech through the operations of transnational corporations, (TNCs),[4] and technological absorptive capabilities of the recipient countries should be enhanced through an effective information system and application of computer/electronic technology. Furthermore, exchange of effective technology and development experiences among developing countries in the region should be encouraged.

4. Policy Recommendation for Internal Development Constraints

Poverty continues to afflict a large number of people in the Asian-Pacific

4. Inter-country integration of industrial production is increasing through the operations of TNCs. The role of TNCs is growing not only as a source of technology but also in providing access to foreign markets and international lending and finance.

region despite rapid growth rates achieved by many countries in the region. Therefore, credit for the alleviation of poverty through income-generating activities should be extended as a powerful entry point for intervention in promoting self-reliant development.

Robust economic development in the Asian-Pacific region has been accompanied by the unwelcome by-product of environmental problems. To attain sustainable and environmentally sound development in this region, local control over resources and the people's participation in this control should be strengthened.

The explosive urban growth in the cities of the Asian-Pacific region has now resulted in serious problems in the urban areas such as housing shortages, traffic congestion, air and water pollution, social crimes, urban poverty, etc. Therefore, some policy measures must be taken in order to meet the basic needs of the urban poor and to secure a better quality of life in the urban areas.

The growth of government undertaking in charge of economic development (e.g., public enterprises) has now reached a limit which necessitates serious retrenchment and restructuring to improve efficiency though privatization of these undertakings. On the hand, governments have to assume new functions and management responsibilities in coping with the emerging structural adjustments at the global level. Therefore, the role of government needs to be viewed differently, which requires a new orientation and the enhancement of management skills at different levels of government through human resource development.

The questions of ethnic and religious diversities and their impacts on development should be considered at least in the Asian context. Finally, the Asian-Pacific countries must continue the adjustment and reform measures which are in place now in order to mobilize more domestic resources and enhance the efficiency of the overall economy. Those measures, along with diversifying export markets and restructuring the economy, guarantee some success in the critically changing external economic environment.

References

B., Balassa, "Trade Creation and Trade Diversion in the European Common Market", *Economic Journal*, 1967.

B., Balassa, "Trade Creation and Trade Diversion in the Common Market", *Manchester School of Economic and Social Studies*, 42, 1974.

Cho, S. "Globalization and Sub-globalization Process: Implications for the Asia-Pacific Region", paper presented at the Ninth General Meeting of ADIPA on the Changing World Community: Development Consequences and Adjustments in Asia and the Pacific, Macau, October, 1991.

M., Davenport and R. Cawley, "Partial Equilibrium Calculations of the Impacts of Internal Market Barriers in the European Community", *Research on the. Cost of Non-Europe*, Vol. 2, Ch. 8, 1988.

EC Commission, *Research on the 'Cost of Non-Europe'*, Vol. 1-13.

Ernst and Whinney, *The Cost of Non-Europe: Border Related Controls and Administrative Formalitis*, European Commission, 1987.

M. Emerson, and et al., *The Economics of 1992, Oxford*, 1988.

Kim, S. J. and et al., *The Economics of 1992, Oxford*, 1988.

Kim, S. J. and S. L. Na, "The Effects of European Single Market on Korea-EC Trade Patterns," paper presented at the New Delhi Conference on the Future of Asia-Pacific Economies (FAPE IV) sponsored by the Asian and Pacific Development Centre, New Delhi, India, March, 1991.

Somsak, T., "Project 2.1: International Trade Policy for Asian Economies in the 1990s," *Project Proposals under the Fifth Inter-Country Programme (ICP5) 1992-1996* (mimeographed), Asian and Pacific Development Centre, Kuala Lumpur, Malaysia, September, 1991.

South East Asian Central Banks (SEACEN), *SEACEN Economic Survey 1991 and Outlook 1992*, January, 1992.

World Bank, *World Development Report*, 1990 and 1991.

The Integration of the European Community and Taiwan's Responses

Chung-Cheng Lin

This paper first examines the development and the difficulties of the European Community's Single-Market act and its implications for Taiwan's exports to the Community. Although the Community has become the third largest trade partner of Taiwan, Taiwanese business firms seem to have been slow to respond to the rapidly integrating European market.

I. The Integration of the European Community

Since its birth in 1958, the European Community (EC) has had many stops and starts. For the time being, the EC has a total population of 345 million an aggregate GDP of over U.S.$6 trilion per year, and almost 40% of the total export values of the world. The integration of the United States and Canada has only a total of 270 million people and US$5 trillion GDP, by comparison. The 12 EC nations, which are now all urbanized, educated and service-oriented societies, account for 69% of Europe's population and 81% of its GDP. They are the biggest club, not only in Europe, but also in the world. The realization of the EC single market project will greatly re-shape the comparative advantage of many nations' major products in both European markets and other world markets, besides having huge implications in world politics.

In 1987, the 12 nations of the EC agreed to create a genuine single market by the end of 1992; goods, services, capital and people would be able to mvoe freely across national borders inside the Community to raise both the efficiency of resources allocation and the potential for economic growth due to the increased inside competition. The 12 also decided to issue a single European currency with a European Central-banking system under an "economic and monetary union (EMU)." Through the advantages of the EMU, the 12-nation EC will save tremendous amounts of transactions costs and build a less risky business environment to reduce capital waste from the conversion of different currencies. The gains of one monetary unit in the community may be as high as 5-10% of GDP. Under the EMU, the values of inter-EC nations' trading would also increase by 200 billion European currency unit (ECU), about 5% of its combined GDP, the general price level would fall by 6%, 5 million job opportunities would be created, and the GDP would then rise by 7%. Finally, the EC Commission also announced the establishment of a European political union in the near future.

Even early in 1985, the European Commission hadlaid out a list of about 280 measures to abolish restrictive practices and lift non-tariff barriers in Europe under the pressure of Europe-wide deregulation of industry and finance arising from the business community. Much progress has been made since then for example, the Council of Ministers of the EC introduced majority voting for all single-market issues except taxation, employment conditions, and population mobility. The Council also agreed to introduce the principle of "mutual recognition", which obligates the EC nations to accept each other's commercial rules if they satisfy minimum EC standards. This principle would soon provide a common commercial law among the EC nations. The plethora of paper work required at the EC customs posts has now been reduced to one "Single Administrative Document," The physical trade barriers due to different national product standards are disappearing through either the "mutual recognition" of product standards of the minimum EC standards which would replace national norms in cases where the existing standards are diverse. Moreover, the single-market rules on public procurement, roughly 15% of the Community's combined GDP, now require that tenders be open to any EC bidder. The competition from the open bidding in the Community is expected to improve the budget deficits of public sectors in many EC nations.

Financial barriers have been falling rapidly, and exchange controls have almost vanished within the Community. However, the fiscal barriers remain a problem. The goal to harmonize both minimum value-added tax rates and collection systems will not be able to be achieved in the near future as was expected which implies tht some customs controls even among the EC members may exist after 1992, because of the slow progress in fiscal agreements among governments. Nations with low tax rates are afraid that the higher tax rates may bring inflation, and countries with high tax rates fear that the lower rate may make the problem of budget deficits worse.

The changing of the business rules in the Community will have large effects on economies but will also lead to fast changes in European business structure. According to the European Commission, the number of mergers and acquisitions made by Europe's 1,000 leading companies jumped from 303 in 1986-87 to 622 in 1989-90. Although many of these mergers were domestic, the number of cross-border mergers has been higher than domestic ones since 1990. Cross-border alliances between business firms have become a popular pattern now in EC nations. More marriages among European big businesses are expected after 1992, even though some anti-trust regulations are strictly enforced in the Community now. Besides taking advantage of a barrier-free community, business companies have also entered new markets and reorganized their production and supply chains. These actions taken by EC companies will soon create a market environment with substantial competition and then force an increase in business efficiency. To survive the opening of national markets. The EC nations will create perhaps 15 billion ecus (U.S.$17.8 billion) of new business a year, and under the Single-Market Act the EC nations could annually save 8 billion ecus in administrative costs and billions of ecus more by rationalizing their product standards, according to the figures estimated by the Cecchini report of 1988.

Although no two EC nations have quite the same voting system and democracy, the room for disagreement about economics may have narrowed due to the common wisdom in economics of the 12 nations: for example, to curb inflation, to break the rigidities of regulation, and to limit public spending. Moving along the path of the EC's Single-Market Act, there are many disputes over economic issues, such as how to share the single currency and how far to co-ordinate each other's taxes and government budgets, still waiting for solution. Furthermore, the end of communism in Eastern Europe, the unification of Germany, and the break-up of the Soviet Union in the past few years may destroy the internal balance of national interests and country weight is in the community and change the future of the EC's further integration. Members of the European Free Trade Association (EFTA) want to join the Community: Austria and Sweden have already applied: and

Finland, Iceland, Norway, Switzerland and tiny Liechtenstein could follow. Turkey, Cyprus and Malta have shown interest to join as well. Czechoslovakia, Hungary and Poland are also knocking at the door now. Finally, the European states of the former Soviet Union will also try their luck. Can what worked with the 12 the current EC nations work with 18 later, or even more? These political and economic issues make the future of the EC open-ended by nature. Whatever the EC proves to be, there will be many worries from the rest of world: whether this integrating community will gradually become a "Fortress Europe" against outsiders.

II. The Impacts of the EC Single-Market Act on Taiwan's Economy

The share of commodity trade between Taiwan and all European countries has been growing rapidly since 1986, from 11.0% to the current 18.0% of the total value of commodity trade of Taiwan. The share of the European Community alone was as high as 14.8% in 1990 (See Tables 1 and 2). Electrical machinery products and appliances, machinery products, textile products, as well as rubber and plastic products have been the main categories of Taiwan's exports to both the Community and the rest of world (See Table 3). The top 20 product items exported to the EC nations are listed in Table 4. The export value of Taiwanese products such as computer peripherals, microcomputers, radio and sound recorders, and integrated circuits in 1988 was U$2.1 billion, roughly a quarter of total export value to the EC nations. In general, the major Taiwanese exports to the EC nations can be characterized as capital or technology-intensive products, in comparison with the exports to the United States which are mainly classified as consumer products.

The basic idea of the Single-Market Act for the European Community is to provide a market solution to its economic and fiscal problems. The single market would exploit the opportunities of economies of scale for both production and marketing of many EC products by removing the barriers of competition and reducing the resources tied up in coping with regulations and bureaucracies among different nations. The increased cross-border competition due to the EC Single-Market Act would also strengthen the comparative advantage of its many products in both domestic and international markets, which would not be able to compete with foreign products without the further integration of the EC markets. However, the 1992 Single-Market Act does not guarantee that the current trade barriers to foreign products would also be lifted. For example, some EC nations are still enforcing im-

Table 1. Commodity Trade with the European Community: Taiwan, 1981 — 1990
(unit=US$ million)

Year		Total Commodity Trade of Taiwan	Trade with the EC Nations	Growth Rate	Share
Imports	1981	21,000	1,639	—	7.73%
	1982	18,888	1,867	13.91%	9.88%
	1983	20,287	1,936	3.70%	9.54%
	1984	21,959	1,936	1.39%	8.94%
	1985	20,102	2,062	5.04%	10.26%
	1986	24,165	2,737	32.74%	11.33%
	1987	34,506	4,270	56.01%	12.37%
	1988	49,656	6,152	44.06%	12.39%
	1989	52,267	6,544	6.40%	12.52%
	1990	54,719	7,268	11.10%	13.28%
Exports	1981	22,611	2,653	—	11.73%
	1982	22,204	2,378	−10.37%	10.71%
	1983	25,123	2,528	6.31%	10.06%
	1984	30,456	2,803	10.88%	9.20%
	1985	30,723	2,725	−2.78%	8.87%
	1986	39,789	4,314	58.31%	10.84%
	1987	53,538	7,041	63.21%	13.15%
	1988	60,585	8,848	25.58%	14.60%
	1989	66,205	9,646	9.10%	14.57%
	1990	67,214	10,736	11.30%	15.97%
Total Volume	1981	43,811	4,292	—	9.80%
	1982	41,092	4,245	−1.10%	10.33%
	1983	45,410	4,464	5.16%	9.83%
	1984	52,415	4,766	6.77%	9.09%
	1985	50,825	4,787	0.44%	9.42%
	1986	63,954	7,051	47.29%	11.03%
	1987	88,044	11,311	60.42%	12.85%
	1988	110,241	14,997	32.55%	13.60%
	1989	118,472	16,191	8.00%	13.66%
	1990	121,933	18,004	11.20%	14.77%

Data Source: Various Issues of *Imports and Exports Statistics*, Ministry of Finance, R.O.C.

port quotas on particular products in order to protect their domestic industries and for the same purpose they may persuade the community to apply the policy of import quotas to the whole Single-Market. On the other hand, some Taiwanese export products to the EC nations may receive more favored positions from the integration of the EC market. For example, all imports of textile products are currently subject to quota constraints in each nation of the Community. After 1992, the quotas may be calculated on the basis of whole Community instead of individual nations. The flexibility of textile products exported to individual nations would then be strengthened, even though the total amount of exports to the whole Community is fixed at the current level.

Furthermore, the import quota of some products enforced currently by some EC nations may be lifted by the Single-Market Act and benefit all exporters. Unfair practices of competition such as monopolies, cartels, dumping, export subsidies, and unfair price agreements would be prohibited to keep a fair market environment for all competitors. Imitation would also be strictly watched in the Singel-Market, and some of the export-oriented policies of developing countries may be challenged by the charge of unfair practices. Finally, relatively low labor costs in some EC nations such as Spain, Portugal, and Ireland have already attracted many industrial investments from the other rich EC nations to substitute for low value-added products and may hurt the growing trend of Taiwanese exports to the Community.

In brief, the advantages and disadvantages created by the Single-Market Act for Taiwanese products are listed as follows:

(a) Marketing advantages:
  1. Marketing costs may fall.
  2. The quantity of purchase orders may increase to save some transaction and production costs.

(b) Marketing disadvantages:
  1. Taiwanese exporters' bargaining positions may deteriorate due to the appearance of large buyers or purchase coalitions in the EC market.

(c) Production advantages:
  1. The number of products under the constraint of import quotas may be reduced.
  2. The flexibility of the utilization of import quotas for the European Community may increase.
  3. There are no border controls for imported products between the EC nations, and the production scale for exports can be raised.

Table 2. Commodity Trade with Selected Major Trading Partners, 1991
(Unit: US$ million)

Nation	Imports	Exports
Austria	122	326
Belgium	399	527
Denmark	145	196
Finland	127	106
France	1,140	1,354
Germany	3,012	3,869
Italy	796	1,026
Ireland	49	107
Netherlands	803	2,170
Poland	201	40
Spain	153	770
UK	1,123	2,072
USA	14,114	22,317
Japan	18,860	9,167
Hong Kong	1,994	12,431
Korea	1,747	1,287
All Nations	62,862	76,161

Data Source: *Imports and Exports Statistics*. Ministry of Finance, R.O.C., 1991.

4. Product standards and specifications will be harmonized.
5. Customs procedures will be simplified and standarized with one "Simple Administration."
6. Taiwanese firms may be forced to switch their production to high-end products because of the strong competition inside the EC market.

(d) Production disadvantages:

1. Some import quotas for particular products may be used by the whole European Community.
2. The law for fair practices in business competition are strictly enforced.
3. There is no "mutual recognition" for the national standards between the EC nations and Taiwan.
4. The product cycle may be shortened due to strong market competition.

According to estimates in a recent study, Asian NICs, would be the worst losers from the Single-Market act of the EC, since their exports are almost exclusively manufactures which would face strong price competition and considerable risks in the EC Market and receive a negative "1992" direct effect. Imposition of Community quotas for textiles, footwear or electronic goods would be directed at them, and they have been among the first targets of the rise in anti-dumping actions. The exports of all Asian NICs to the EC market are expected to decrease by about 6% as a whole after 1992. Taiwan may not lose as much as 6% of its exports to the Community, because Taiwan, unlike the other NICs, has not had any restriction or postponement of general, GATT-related, benefits for middle or higher income developing countries.

III. Taiwan's Responses to the Single-Market Act

By the end of 1989, more than 450 Japanese firms had made direct investments in the EC nations with a total amount of U.S.$3.5 billion. These investments were largely to avoid potential discrimination against their products or to take advantage of the Single-Market Act, and many Japanese firms are also seeking opportunities to acquire European companies in order to enter the EC market by accessing their established supply networks. Korean firms have already invested U.S.$50 million mainly in the electric appliance industries such as microwave ovens, video recorders and color TV sets as of June, 1989. By comparison, there were only about 90 Taiwanese firms which had made direct investments in the EC nations up to the end of 1990, and the amount of investment was too small to even be noticed.

Both the Japanese and Korean governments have taken active policies to help their business firms enter the EC market. For example, they are trading their domestic markets in exchange for the opening of the EC market for their exports by either lowering tariffs or lifting trade barriers. There are also policies to encourage their firms to acquire European companies or to establish their own production or supply chains in the Community.

In 1989, the Taiwan government published a policy outline for the promotion of trade and economic relations with the EC nations. It includes: (1) to carry out intensive studies on EC regulations and business information, which would be open to all domestic firms; (2) to increase imports from the EC nations by lowering tariffs and lifting import constraints; (3) to encourage the introduction of high technologies and high-tech products from the EC nations; (4) to establish official communication channels with the Minister Council, the European Congress, and the individual EC nations:

Table 3. Major Exports of Taiwan and Their Growth Rates

(unit: N. T. Billion)

Year	1983	1984	1985	1986	1987	1988	1989	Average Annual Growth Rate
Electrical Machinery Products and Appliances	194	260	256	336	428	474	476	24.3%
Machinery Products	93	114	119	149	178	190	205	20.2%
Textiles	200	240	240	276	285	256	268	5.7%
Rubber and Plastic Products	83	108	117	149	163	160	141	11.7%
Share of Total Export	56.9%	60.1%	60.1%	60.5%	61.9%	62.6%	62.6%	12.3%
Total Export Value	1,005	1,204	1,223	1,506	1,705	1,729	1,745	10.7%

Data Source: Various Issues of *Monthly Reports of Exports and Imports*, R.O. 1 U.S. dollar=25 N.T. dollar.

(5) to help the investment of Taiwanese firms in the EC nations and to attract more investment of European firms in Taiwan; and (6) to establish tax agreements between Taiwan and the EC nations to avoid double taxation.

Since 1989, the Bureau of Industry and the Bureau of National Standards has expended many resources to help the Taiwanese toy industry to adapt to the EC's Standards of EN71. The Bureau of Industry has also supported the Taiwan Research Institute of Economics to translate most major EC documents of regulations, standards, authorization and certification into Chinese and to research their related issues and implications in a long-term contract. The Bureau of National Standards has been promoting manufacturing in a quality-guarantee system by making the ISO 900 series fit the EC's requirements; it also completed the translation of various international standards such as ISO, IEC and EC into Chinese for comparison with Taiwanese national standards so local firms could access more technical information. The Ministry of Economic Affairs has proposed agreements of "mutual recognition" with the DTI and the RESOURCE of the United Kingdom and with the IBN of Belgium, as well as close contacts with the CEN, the CENELE, CEB, etc.

However, there are still many limitations to be improved. For example, there is a lack of official channels for negotiations to remove mutual trade barriers, because there are no diplomatic relationships between Taiwan and any EC nations. There are also no direct freight lines or flights between EC nations and Taiwan to lower the transportation costs of people and commodities. Furthermore, Taiwan is not a formal member of many international political and economic organizations such as GATT, and as a result, Taiwan does not always have an equal and fair position like that of other NICs, iwth the EC nations in many international economic negotiations. Again, due to the diplomatic problem, ther is no investment treaty for mutual guaranty or tax agreement between Taiwan and any EC nation. This is one of the important factors behind the low number of business activities (except international trade) prevailing in each other's market. The other main factor contributing to the low levels of direct investment or acquisition of Taiwanese firms is the small-business oriented structure of Taiwan's economy. Small-business firms are flexible and efficient in both international trade and domestic production but not capable of handling international chains of production and supply because of constraints on capital and manpower.

The following policies are recommended to strengthen Taiwanese business activities in the EC market according to the current consensus from both academic and business circles:

1. to promote more investment in the EC nations as soon as possible by removing unfair regulations on any oversea business activity:
2. to establish more Taiwanese financial branches of State-Owned business firms in the EC market:
3. to increase cooperations of R&D activities with the EC nations;
4. to avoid any EC suspicion of "dumping" or "subsidizing" through the EC nations with trade:
5. to join GATT as soon as possible;
6. to help Taiwanese firms to build up supply depots, consignment depots or warehousing and distribution centers;

7. to promote more agreements of "mutual recognition" with EC national standars;
8. to open the Taiwanese domestic market for both EC products and EC companies;
9. to increase contacts with major European Business associations:
10. to establish official contacts with both EC officials and individual governments:
11. to create close contacts with political parties in the European Congress; and
12. to raise manpower and give more resources to the overseas government agencies located in the EC market.

Table 4. The Top 20 Product Items of Taiwan Exported to the EC Nations, 1988
(unit: US$10,000)

Rank	Item	C.C.C Code	Total	Germany	U.K.	Netherlands	France	Italy
1	peripherals computer	46514	110198	24846 (67.2)	21022 (51.0)	34976 (80.0)	8780 (41.7)	7924 (90.2)
2	micro computers	46511	39314	6564 (50.1)	6633 (97.1)	12162 (95.6)	5203 (51.3)	2136 (−0.7)
3	radio & sound recorders	46320	33597	9680 (−26.7)	11418 (−19.3)	4039 (−15)	853 (−19.8)	2269 (−17.3)
4	integrated circuits	46541	30359	7162 (−8.2)	3168 (1.2)	14955 (38.3)	2741 (53.9)	283 (16.0)
5	leather shoes	36211	21041	8904 (44.9)	2150 (69.3)	3809 (32.5)	1636 (75.1)	1253 (38.3)
6	other sports products	49409	19005	3847 (34.1)	7682 (52.1)	1360 (39.0)	2688 (82.2)	981 (39.0)
7	travel baggage	49913	17700	4555 (−7.6)	3236 (−5.5)	1478 (−11.7)	3068 (−0.2)	2283 (−1.1)
8	plastic shoes	41251	14969	5996 (32.9)	1974 (0.6)	2579 (−13.9)	1774 (4.8)	440 (−20.7)

9	miscellaneous plastic products	41299	14130	3747 (23.5)	2776 (26.9)	1807 (51.2)	1800 (34.0)	1581 (73.1)
10	textile shoes	35734	14124	3554 (−5.7)	2102 (15.3)	1306 (−11.4)	3082 (18.8)	2223 (−0.6)
11	christams decorations	49523	11854	4592 (39.4)	2350 (12.0)	1051 (13.8)	821 (39.5)	1567 (36.6)
12	sports products	9401	10809	2684 (13.7)	2252 (4.3)	982 (−5.4)	1844 (8.5)	832 (35.5)
13	speakers microphone	46330	10457	2763 (4.0)	2493 (35.2)	920 (−3.7)	883 (5.3)	1180 (17.0)
14	umbrellas	49841	9795	3080 (0.8)	2557 (8.0)	873 (3.7)	46 (−27.7)	2474 (33.7)
15	radio & video parts	4638	9369	2357 (33.1)	2771 (91.1)	1159 (−6.5)	1032 (78.5)	805 (61.0)
16	toys	49515	9119	2682 (12.8)	1382 (−21.9)	861 (28.7)	717 (23.4)	1543 (−8.4)
17	mini computers	46512	8724	1941 (26.7)	829 (−46.2)	2243 (102.8)	728 (−11.8)	671 (23.9)
18	electronic distributor & parts	46121	8214	2640 (76.5)	1571 (21.5)	882 (38.4)	778 (7.1)	1124 (70.2)
19	potteryware & chinaware	4249	7696	2333 (6.0)	1537 (54.2)	1245 (18.8)	1028 (18.7)	651 (44.0)
20	optical goods	48221	7351	1505 (75.5)	1705 (39.7)	758 (101.5)	971 (14.3)	484 (11.6)

Table 4. (continued)

1	7924 (90.2)	3407 (26.2)	5514 (101.4)	1009 (20.2)	1761 (−39.3)	457 (−11.8)	385 (77.7)	97 (6.3)

2	2136 (−0.7)	3106 (269.2)	2346 (278.7)	532 (26.0)	49 (−97.2)	398 (76.5)	182 (86.3)	3 (−74.6)
3	2269 (−17.3)	1768 (46.4)	2567 (−23.4)	395 (−1.2)	19 (−53.7)	488 (20.5)	97 (−0.1)	4 (—)
4	283 (16.0)	1857 (5.8)	38 (23.6)	17 (693.0)	17 (5855.0)	1 (7.5)	120 (20266)	— ( )
5	1253 (38.8)	871 (57.9)	324 (30.5)	479 (−29.3)	1353 (583.2)	246 (4.3)	16 (−25.8)	— ( )
6	981 (39.0)	1094 (83.9)	638 (168.7)	383 (32.7)	126 (118.1)	77 (159.2)	116 (247.7)	13 (−50.5)
7	2283 (−1.1)	2194 (2.9)	330 (32.5)	260 (−19.1)	35 (−57.5)	216 (56.0)	41 (−24.6)	4 (−37.7)
8	440 (−20.7)	820 (4.3)	332 (22.3)	301 (−7.8)	441 (180.9)	301 (43.4)	11 (100.7)	— ( )
9	1581 (73.1)	1192 (73.2)	509 (70.8)	438 (−22.3)	110 (−7.8)	176 (97.5)	76 (28.9)	8 (96.2)
10	2223 (−0.6)	349 (−39.3)	498 (7.0)	134 (−46.7)	476 (658.4)	434 (28.1)	19 (254.1)	1 (—)
11	1567 (36.6)	498 (24.2)	428 (42.7)	258 (18.5)	44 (−21.9)	187 (52.1)	57 (181.5)	1 (−82.9)
12	832 (35.5)	626 (39.3)	1094 (17.9)	261 (42.8)	68 (−6.6)	90 (47.0)	55 (−7.4)	21 (−53.4)
13	1180 (17.0)	540 (70.4)	869 (0.5)	317 (−2.1)	22 (1.2)	95 (29.9)	375 (67.8)	— ( )
14	2474 (33.7)	252 (10.6)	196 (138.3)	122 (68.9)	45 (−45.2)	83 (55.2)	67 (−49.0)	— ( )
15	805 (61.0)	229 (48.0)	291 (22.8)	53 (0.7)	521 (1177)	89 (107.6)	61 (32.2)	1 (−60.3)
16	1543 (−8.4)	1217 (−14.4)	363 (12.2)	84 (−41.1)	25 (−62.7)	139 (254.6)	106 (−0.7)	— ( )
17	671 (23.9)	178 (6.3)	1774 (35.8)	75 (−77.3)	18 (259.6)	188 (90.9)	77 (110.0)	2 (−82.7)

18	1124 (70.2)	340 (116.0)	534 (164.0)	99 (41.4)	77 (99.0)	124 (50.5)	35 (33.0)	— ( )
19	651 (44.0)	450 (24.6)	263 (20.1)	101 (13.8)	21 (−81.8)	24 (277.7)	43 (−7.9)	1 ( )
20	484 (11.6)	657 (109.9)	953 (35.7)	148 (58.6)	22 (73.9)	18 (—)	82 (50.0)	48 (—)

Figures in parentheses are annual growth rates.
Data Source: *Statistics of Customs Tariff*, R.O.C., 1989.

References

Fouquir, Michel, "The Single European Market," paper presented in the 1991 Sino-European Conference on Economic Development: Globalization and Regionalization, Taipei, Taiwan, May 23-24, 1991.

Oman, Charless, "Globalisation and Regionalisation," paper presented in the 1991 Sino-European Conference on Economic Development: Globalization and Regionalization, Taipei, Taiwan, May 23-24, 1991.

Hou, Chi-Ming & Chien-Nen Wang, "Globalization—Taiwan's Perspective", paper presented in the 1991 Sino-European Conference on Economic Development: Globalization and Regionalization. Taipei, Taiwan, May 23-24, 1991.

Page, Sheila, "Some Implications of Europe 1992 for Developing Countries," paper presented in the 1991 Sino-European Conference on Economic Development: Globalization and Regionalition, Taipei, Taiwan, May 23-24, 1991.

Han, Sung-Taik, "The Impact of the European Economic Intrgration on the Newly Industrialising Economies of Asia, with Reference to Korea," paper presented in the 1991 Sino-European Conference on Economic Development, Globalization and Regionalization, Taipei, Taiwan: May 23-24, 1991.

Implications of European Economic Integration: A Korean Perspective

Kap-Young Jeong

I. Introduction

The European economic integration is indeed an ambitious project that will improve the efficiency and welfare of the EC economy; it will remove all internal tariff barriers and, there by, expand internal trade. A single EC market, however, poses many implications for non-member countries such as the Asian NICs.

The European Integration of 1992 will not only accelerate regionalism and protectionism, but it is also feared that external walls separating non-member countries from the EC in trade will remain well beyond by the year 1992. Moreover, once the European internal market is complete, the EC will obtain greatly enhanced bargaining power vis-a-vis fairly disorganized countries like the Asian NICs.

For Korea, the formation of a single EC market bares significance in many respects. In particular, the EC will be the world's largest export market into which Korea may, with high potential for success, expand and diversify its export. It is a widely known fact that export has been a major vehicle of growth in Korea; from only $55 million in 1962, total exports multiplied to $71.8 billion in 1991.

Desptie the rapid growth in trade volume, however, Korea has been unable to diversify its trading partners; Korean exports have been largely dependent upon the United States and Japan since the 1960s. Although the EC has been Korea's third major trading partner, the volume of trade with the EC is significantly smaller than with the United States or Japan. Korea's trade share with the EC was also been smaller than that of the other Asian NICs. Therefore, it seems necessary that Korea should penetrate the EC market, the largest trading bloc in the world.

The purpose of this paper is to analyze the current economic relations between Korea and the EC and evaluate the effects of EC integration upon the Korean economy. The paper consists of four sections. The following section reviews Korea's economic relations with the EC. An analysis of the fore—seeable effects and outcome of the EC integration on the Korean economy is presented in the third section. The last section concludes this paper with a brief summary of the issues in discussion.

II. Korea's Economic Relations with the EC

Despite a rapid increase in trade volume, Korea's trade with the EC has not been as active since the 1960s. Geographical distance and cultural differences may be cited as major causes of such inactive trade relations between the two trading nations. Korea's trade has mainly been with the United States and Japan: The U.S. has provided the biggest export market for Korea, accounting for 25.8% of Korea's total exports in in 1991, while Japan's share marked 17.2% for the same year (see Table 1). Although the EC is Korea's third largest trading partner, its share and volume is much smaller than those of the two leading countries. For example, in 1991 Korea's exports to the EC accounted for only 13.5% of total exports, $9.728.5 million.

Recently, Korea has gradually decreased its heavy reliance upon Japan and the United States as major export partners: while Korea depended on the two countries for 54.7% declined to 43.0% by 1991. The EC's share of Korea's exposts of its exportsin 1989, this shme inueased slightly from 11.9% to 13.5%.

This downward trend in Korean dependence upon its two major trading partners is further evidenced by the growth rate of Korean exports from 1989-91: export growth to the United States and Japan declined by 4-5 percent per your, while the growth rate for export to the EC was a 14.8 percent.

Korea's dependence on imports from the U.S. and Japan is much larger than that of export. In 1991, imports from the U.S. and Japan accounted for 23.2% and 25.9% of Korea's total imports, respectively, while the import share of the EC was only 12.1% (See Table2). This pattern of import structure did not substantially change from 1989-91, albeit the EC share slight-

Table 1. Korea's Export by Principal Area of Destination

(mil. U$)

Area	1989 (%)	1990 (%)	1991 (%)	Growth Rate (%) (1989-91)
Asia	23883.0 (38.3)	24639.0 (37.9)	28449.0 (39.6)	9.3
China	437.4 (0.7)	584.9 (0.9)	1002.0 (1.4)	52.5
Japan	13456.8 (21.6)	12637.9 (19.4)	12355.8 (17.2)	−4.2
N. America	22521.0 (36.1)	21091.0 (32.4)	20220.0 (28.1)	−5.2
U.S.A.	20639.0 (33.1)	19360.0 (29.8)	18559.3 (25.8)	−5.2
Europe	9376.0 (15.0)	12034.0 (18.5)	12792.0 (17.8)	17.3
EC	7393.6 (11.9)	8843.6 (13.6)	9728.5 (13.5)	14.8
Eastern Europe	249.0 (0.4)	509.0 (0.8)	541.0 (0.8)	55.4
CIS	207.7 (0.4)	519.1 (0.8)	641.8 (0.9)	86.8
Latin America	1740.0 (2.8)	2104.0 (3.2)	2902.0 (4.0)	29.4
Middle East	1822.5 (2.9)	2000.3 (3.1)	2623.0 (3.7)	20.4
Other	2827.0 (4.5)	2628.3 (4.1)	4242.2 (5.9)	27.2
Total	62377.2 (100.0)	65015.7 (100.0)	71870.1 (100.0)	7.4

Source: The Ministry of Industry and Commerce.

ly increased from 10.5 percent to 12.1 percent. In terms of import growth rates, however, the EC has achieved far better performance than the Untied States or Japan; while imports from the two countries only 9-10 percent per annum, EC imports to Korea increased 23.5 percent from 1989 to 1991.

One of the most conspicous features in the Korean trade structure is that there has been a rapid growth in trade between Korea and the socialist countries. An obvious implication of the growing EC shares in export and import figures is that the EC is becoming — if not already — an important market for Korea as an export demander as well as import supplier. Korea's trade performance with the EC, however, presently lags behind those of the other Asian NICs; The share of the EC's total imports from Korea was only 0.7 percent in 1990, while the shares from Taiwan and Hong Kong were 0.8 percent and 0.9 percent, respectively.

Table 2. Korea's Import by Principal Area of Origin

(mil. U$)

Area	1989 (%)	1990 (%)	1991 (%)	Growth Rate (%) (1989-91)
Asia	25705.0 (41.8)	28515.0 (40.8)	33842.0 (41.5)	14.8
China	1704.5 (2.8)	2268.1 (3.2)	3395.5 (4.2)	41.4
Japan	17448.6 (28.4)	18573.9 (26.6)	21120.2 (25.9)	10.1
N. America	17591.0 (28.6)	18408.0 (26.4)	20867.0 (25.6)	9.0
U.S.A.	15910.7 (25.9)	16942.5 (24.3)	18894.4 (23.2)	9.0
Europe	8139.0 (13.3)	10512.0 (15.0)	12730.0 (15.6)	25.1
EC	6492.2 (10.5)	8410.3 (12.0)	9879.4 (12.1)	23.5
Eastern Europe	111.0 (0.2)	202.0 (0.3)	266.0 (0.3)	56.8
CIS	391.7 (0.6)	369.7 (0.5)	581.5 (0.7)	25.8
Latin America	1544.0 (2.5)	1726.0 (2.5)	2381.0 (2.9)	24.9
Middle East	4612.0 (7.5)	6188.0 (8.9)	7139.0 (8.8)	24.8
Other	3482.1 (5.7)	4125.0 (5.9)	3984.4 (4.9)	7.5
Total	61464.8 (100.0)	69843.7 (100.0)	81524.9 (100.0)	15.2

Source: The Ministry of Industry and Commerce.

Among the 12 EC members, Germany, the U.K., Netherlands, and Frnace have been the largest trading partners of Korea. For example, in 1991, 32.8% Korea's total exports to the EC were allocated to Germany while 37.4% of Korea's total imports from the EC was supplied by Germany in 1991 (Table 3). The shares of Korea's export to the aforementioned four EC countries was 74.6 percent while the import share was 73.6% in 1991. In terms of the trade growth rates between Korea and the EC for the period of 1990-91, The Netherlands received the highest rate of import from Korea, reaching 21.1 percent, while Korean imports from the U.K. showed the highest growth of 27.1 percent.

Table 4 presents the structure of Korea's export to the EC. According to this table it is apparent that the structural components of Korea's exports to EC rapidly shifted from light-industrial to heavy-industrial products. The

Table 3. Korea's Trade with the EC Members

(mil. U$)

Country	Export			Import		
	1990 (%)	1991 (%)	Growth rate (%)	1990 (%)	1991 (%)	Growth rate (%)
Germany	2881 (32.6)	3192 (32.8)	10.8	3295 (39.2)	3698 (37.4)	12.3
U.K.	1750 (19.8)	1768 (18.2)	1.0	1226 (14.6)	1559 (15.8)	27.1
France	1118 (12.6)	1128 (11.6)	0.8	1223 (14.5)	1422 (14.4)	16.2
Netherlands	965 (10.9)	1168 (12.0)	21.1	479 (5.7)	583 (5.9)	21.7
Italy	750 (8.5)	838 (8.6)	11.7	1170 (13.9)	1431 (14.5)	22.3
Others	1380 (15.6)	1635 (16.8)	18.5	1017 (12.1)	1186 (12.0)	16.6
EC (total)	8844 (100.0)	9729 (100.0)	9.6	8410 (100.0)	9879 (100.0)	17.3

table shows that heavy industrial products such as machinery, equipment, and electronics comprised 59.2% of Korea's export to EC in 1991, while light industrial products accounted for 38.6%. In addition, while the share of light industrial products in Korea's export to the EC sharply dropped from 45.9% to 38.6%, the share of heavy industrial produts, in contrast, rose from 51.6% to 59.2% during the same period.

Meanwhile, industrial materials and capital goods accounted for 90.8% of Korea's import from the EC. In particular chemicals, machinery and equipment were the major items of import, accounting for 42.6% of total imports (Table 5). The trade structure illustrated in table 4 and 5 demonstrates that the economic relations between Korea and the EC are complementary: The EC primarily exports machinery equipment, while Korea supplies chiefly durable and non-durable consumer goods.

This pattern of comparative advantage between the two trading partners is well illustrated by Table 6, which lists the major trading items with the EC. Korea's leading export goods include such consumer goods as textiles, home electric appliances, footwear, and synthetic fabrics. The goods imported by Korea, in contrast, mostly consist of machinery and chemicals. It is perhaps noteworthy that Korea's export of transport equipment — predominantly passenger cars — is rapidly increasing, at a rate of 104.8% between 1990-91. This is indicative of the rapid shift in Korea's export structure from light industry to heavy industry.

Table 4. Korea's Export Structure to the EC

(mil. U$)

Commidity	1988 (%)	1989 (%)	1990 (%)	1991 (%)
Foods & Goods for Direct Consumption	147.9 (1.8)	146.3 (2.0)	178.8 (2.0)	166.7 (1.7)
Crude Materials & Fuel	59.6 (0.7)	47.0 (0.6)	42.6 (0.5)	54.2 (0.5)
Light-Industry Products	3728.9 (45.9)	3226.9 (43.7)	3509.2 (39.7)	3751.3 (38.6)
Textiles Products	2031.0 (25.0)	1708.1 (23.1)	1717.2 (19.4)	1934.7 (19.9)
Textile Yarn	59.7 (0.7)	66.0 (0.9)	73.9 (0.8)	69.6 (0.7)
Synthetic Fabrics	114.4 (1.4)	142.3 (1.9)	160.2 (1.8)	176.0 (1.8)
Footwear	515.3 (6.3)	427.8 (5.8)	686.5 (7.8)	766.4 (7.9)
Heavy-Industry Products	4195.5 (51.6)	3973.4 (53.7)	5113.0 (57.8)	5756.3 (59.2)
Chemicals & Chemical Products	114.3 (1.4)	112.1 (1.5)	209.0 (2.4)	243.4 (2.5)
Plastics	55.1 (0.7)	52.2 (0.7)	119.8 (1.4)	120.7 (1.2)
Metal Goods	329.6 (4.1)	349.2 (4.7)	382.0 (4.3)	430.3 (4.4)
Angle, rods of Iron	13.3 (0.2)	15.8 (0.2)	16.1 (0.2)	17.3 (0.2)
Machinery & Equipment	896.5 (11.0)	807.2 (10.3)	1000.3 (11.3)	1226.9 (12.6)
Office Machinery	708.7 (8.7)	591.5 (8.0)	684.4 (7.7)	872.9 (9.0)
Electronic Products	1281.3 (15.8)	1281.8 (17.3)	1668.6 (18.9)	1645.5 (16.9)

Communi-cation Apparatus	202.8 (	2.5)	254.3 (	3.4)	410.1 (	4.6)	469.6 (	4.8)
IC & Micro Assemblies Assemblies	267.7 (	3.3)	326.0 (	4.4)	336.9 (	3.8)	436.5 (	4.5)
Motor Vehicles	103.3 (	1.3)	130.2 (	1.8)	102.5 (	1.2)	311.7 (	3.2)
Vessels & Floating Structures	200.5 (	2.5)	90.8 (	1.2)	513.7 (	5.8)	516.3 (	5.3)
Sound Recorders &VTR's	333.3 (	4.1)	174.3 (	2.4)	209.9 (	2.4)	214.2 (	2.2)
Total	8131.8	(100.0)	7393.6	(100.0)	8843.6	(100.0)	9728.5	(100.0)

*: Preliminary estimates.

The direct investment between Korea and EC has not been as active for the past 3 decades. The EC's direct investment in Korea has been much lower than that of U.S. and Japan. The total share of foreign direct investment made by the EC in Korea was only 10.9 percent of total FDI, while Japan and the U.S. contributed 52.3 percent and 28.5 percent, respectively.

Similarly, Korea's direct investment in the European Community has been negligible: the EC accounted for only 4.3 percent of Korea's total overseas direct investment at the end of 1990 (Table 7). The U.K. and Germany have been the most popular targets of Korean investment, but the share of investment in these countries was still much less than that in Japan and the U.S. (See Table 7).

Korea has made $2,335.4 million direct overseas investment in the world, but the EC's share was only $99.4 million in 89 cases. The average amount of direct investment in each EC project is only $1.1 million, much smaller than the average of other investment projects, $1.9 million. This is primarily due to the fact that Korea's investment in the EC has mainly been concentrated in the trading rather than manufacturing sector.

Overall, one can conclude that the economic relations between the EC and Korea have been inactive despite the large market size of the EC and its high growth potential as a Korean export market. Neither trade volume nor direct investment has been encouraged to perform at its full potential.

Table 5. Korea's Import Structure with the EC

(mil. U$)

Commidity	1988 (%)	1989 (%)	1990 (%)	1991 (%)
Foods & Consumer Goods	519.4 (8.6)	502.9 (7.7)	811.4 (9.6)	909.3 (9.2)
Goods for Direct Consumption	68.0 (1.1)	104.5 (1.6)	138.7 (1.6)	182.4 (1.8)
Consumer Durable Goods	222.3 (3.7)	267.7 (4.1)	469.9 (5.6)	484.8 (4.9)
Industrial Materials & Fuels	2780.6 (46.0)	2958.1 (45.6)	3168.7 (37.7)	3890.4 (39.4)
Producers Goods for Light-Industry	175.1 (2.9)	181.2 (2.8)	200.3 (2.4)	227.7 (2.3)
Chemicals & Chemical Products	881.4 (14.6)	937.8 (14.4)	1017.4 (12.1)	1126.5 (11.4)
Paints & Dye-stuffs	158.1 (2.6)	163.8 (2.5)	190.3 (2.3)	208.2 (2.1)
Textiles	141.1 (2.3)	208.5 (3.2)	261.5 (3.1)	280.4 (2.8)
Iron & Steel Products	290.3 (4.8)	285.3 (4.4)	241.0 (2.9)	475.1 (4.8)
Capital Goods	2741.9 (45.4)	3031.2 (46.7)	4430.2 (52.7)	5079.6 (51.4)
Machinery & Equipment	1424.3 (23.6)	1852.6 (28.5)	2618.9 (31.1)	3084.7 (31.2)
Metal Working Machinery	155.6 (2.6)	229.7 (3.5)	208.6 (2.5)	279.1 (2.8)
Textile Machinery	211.0 (3.5)	230.0 (3.5)	307.7 (3.7)	342.9 (3.5)
Printing Machinery etc.	124.1 (2.1)	189.8 (2.9)	344.6 (4.1)	465.6 (4.7)

Electric & Electronic Machinery	623.3 (10.3)	553.3 (8.5)	865.2 (10.3)	820.1 (8.3)
IC & Micro Assemblies	44.8 (0.7)	96.7 (1.5)	197.3 (2.3)	178.6 (1.8)
Precision	161.5 (2.7)	202.7 (3.1)	290.0 (3.4)	301.1 (3.0)
Instruments	385.4 (6.4)	208.4 (3.2)	400.7 (4.8)	552.3 (5.6)
Transport Equipment				
Total	6042.0 (100.0)	6492.2 (100.0)	8410.3 (100.0)	9879.4 (100.0)

*: Preliminary estimates.

Table 6. 10 Major Trading Item with the EC

(mil. U$)

Item	Export			Item	Import		
	1990	1991	Growth Rate (%)		1990	1991	Growth Rate (%)
Textile	1403.1	1600.6	14.1	Machinery	2597.5	2988.5	15.1
Industrial Electronics	974.3	1197.7	22.9	Organic Chemicals	849.7	945.2	11.2
Home Appliances	1198.7	1079.8	−9.9	Steel Products	289.6	588.3	103.1
Electric Parts	951.8	1060.7	11.4	Pharmaceutical Material	545.7	572.4	4.9
Footwear	727.5	789.9	8.6	Agricultural Products	396.2	479.8	21.1
Vessels	514.0	516.9	0.6				
Synthetic Fabrics	398.9	403.7	1.2	Aircraft/ Parts	171.6	448.7	161.5
Transport Equipment	180.1	368.8	104.8	Precision Machinery	367.9	361.3	−1.8
Machinery	203.6	239.3	17.5	Machine Parts/ Tools	266.5	348.9	30.9
Chemicals	191.5	230.6	20.4	Electronic Parts	329.4	347.9	5.6

				Leather/ Fur prod.	234.8	305.4	30.1
Sub Total	6743.5	7488.0	11.0		6048.9	7386.4	22.1
Total	8843.6	9728.5	10.0		8410.3	9879.4	17.5

* : Percent share in total exports and imports from the EC.
Source: The Ministry of Industry and Commerce.

Table 7. Korea's Direct Investment by Region

(mil. u$)

Region	1988 (No.)	1989 (No.)	1990 (No.)	Total Investment (as of 1990)	% share
Asia	41.5 (64)	124.1 (123)	309.4 (204)	714.7 (522)	30.6
Indonesia	19.0 (12)	72.1(38)	168.4 (66)	424.7 (129)	18.2
Japan	6.5 (15)	10.2 (17)	11.2 (17)	50.8 (92)	2.2
Malaysia	1.3 (3)	2.9 (6)	17.7 (19)	49.6 (43)	2.1
Middle East	41.6 (1)	31.7 (1)	40.3 (1)	56.1 (34)	2.4
North America	96.2 (54)	228.8 (70)	484.2 (91)	1105.5(394)	47.3
U.S.	92.9 (50)	153.8 (64)	353.0 (85)	807.0 (364)	34.6
Canada	3.4 (4)	75.0 (6)	131.2 (6)	298.6 (30)	12.8
Latin America	9.9 (14)	58.9 (27)	36.7 (28)	120.9 (104)	5.2
Europe	18.8 (16)	18.4 (17)	92.4 (22)	151.8 (98)	6.5
EC	18.5 (16)	13.6 (12)	45.4 (18)	99.4 (89)	4.3
UK	10.6 (7)	7.3 (1)	16.2 (2)	41.4 (26)	1.8
Germany	2.0 (5)	0.9 (5)	4.8 (5)	17.4 (34)	0.7
Africa	1.5 (3)	8.0 (4)	26.8 (3)	45.1 (25)	1.9
Oceania	3.4 (13)	22.6 (12)	32.6 (20)	141.3 (66)	6.1
Total	212.9 (165)	492.5 (254)	1022.4 (368)	2335.4 (1243)	100.0

Source: The Bank of Korea

III. Impact of the European Economic Integration on Korea

In contradiction to the EC's promulgated aims to prevent protectionism, the EC has imposed a wide variety of trade barriers against non-member countries. The EC's attempt to protect is trade market has been carried out through a variety of instruments, but this, in turn, has only led to an accumulation of overly complex set of regulations.[1] Although the EC has not extensively used such conspicuous methods of trade barriers as tariff and non-tariff barriers, these have both been widely installed at the EC level and member state level, nonetheless. The non-tariff instruments used by the EC and its members can be classified as follows: VERs (voluntary export restraints), anti-dumping, countervailing duties, technical regulations and certification, public procurement, EC surveillance, minimum prices and quotas.

The EC has also placed tough trade restrictions on Korean products. For instance, in 1988 the EC imposed trade restrictions on over 30 percent of Korea's total exprots, a significantly higher portion than that restricted by the U.S. (19.3%) or Japan (19.7%). Various form of non-tariff barriers (NTB's), including minimum price regulations, countervailing duties and voluntary export restraints (VER's), were used against certain products.

In fact, despite the low trade volume with the EC, Korean exports to EC have consistently been restricted by means of trade barriers. A valid question to raise at this point is why have Korean exports been so severely discriminated against by the EC? This question can be explained by the historical and political adversity undergone by the EC. The most important cause has been the rapid increase in Korean exports to the EC, and the EC's mounting trade deficit with Korea since the mid-1970s.

To make matters even worse, Korea's main export items pose serious threats to some industries which face heavy competition in the internal EC market, i.e., textiles, footwear, electric home appliances, steel and shipbuilding. In other words, the industrial products which faced serious competition within the member states were forced to face further competition by Korean export industires. In particular, steel and footwear are sectors which face the most serious difficulties in the EC due to longterm structural imbalance.

Finally, Korea has continuously maintained a discriminatory trade policy by giving domestic market access the U.S. than the EC. This preferential trade policy in favor of the U.S. has often created serious trade friction be-

1. Hine, R. C., *The Political Economy of European Trade*, St. Martins Press, 1985.

tween Korea and the EC.

Keeping this trade background in mind, we can now proceed with our discussion of the possible impacts of the EC 1992 program on Korea's economic relations with the EC. It is no surprise that the EC 1992 will be accompanied by some negative side-effects on the exports of non-member countries. In particular, the partial equilibrium calculation shows that the EC project will result in a decrease in the exports of non-members to the EC by 2.2-2.6 percent during the first stage and 5.7-7.7 percent in the second stage.[2] For Korea, it is estimated that the price and cost reduction of the EC products by removing all internal barriers would reduce Korean exports to EC by average of 2.4% in the short run, and 6.0 percent fall in the long run.[3]

This appears to imply that the integration of the EC market would not be as damaging as many have originally thought. The EC's non-tariff barriers against the non-members are a different matter and they will create some difficulties for Korea. Non-trade barriers of reciprocity and quota restrictions will prove to be the biggest trade obstacles, and their damaging affects may extend well beyond EC 1992.

Let me first define the reciprocity, quota and tariff barriers in the signle EC market and discuss their effects on Korea.

1. Reciprocity

Companies from a wide number of third countries have establishments in and conduct business with, the Community. Establishment of a signle European market has major implications for such companies, especailly since the right of access to the Community market will depend on the outcome of negotiations over the reciprocal economic obligations on the national level. Fundamentally, reciprocity is aimed at:

(i) providing for equivalent acess and treatment for EC companies in the world market.

(ii) ensuring that economic advantages of opening up the European market will not be extended unilaterally to non-EC, trading partners, from

2. Cawley, R and M. Davenport, "Partial Equilibrium Calculations of the Impact of Internal Market Barriers in the EC," *Economy Papers*, No. 73, 1988.

3. Na, Seong-lin, *Economic Effects of the EC Integration*, (in Korean) the Institute of Trade and Business, 1990.

whom reciprocity will be demanded in return.

(iii) strengtheing the negotiating power of the EC in international trade forums such as GATT. Some of their negotiations are bilateral with each respective country, others are part of the current Uruguay Round negotiations on goods and services.

2. *Quotas and Tariffs*

The EC 1992 plans to remove the existing frontier controls and customs procedures. These formalities had largely derived from differences in technical standards, exchange controls, and health and safety regulations. As the EC moves towards a single market without frontier controls it will become increasingly difficult and ineffective in maintaining separate national quotas on imports — items such as cars, clothing, electronics and textiles — from the non-EC member countries. It seems likely that firms which receive no protection from non-EC imports will face stiffer competition. Consequently, the Community as a whole will assume an increasingly important role in negotiating with the third countries and will assume a more powerful position, both within and outside the European Community.

Of course, the firms facing the difficulties accompanying E.C. unity may strategies. First, there will likely be merge and acquisitions of the EC companies; second, a strengthening of third countries representation through cross-shareholdings and merger and acquisitions; and finally, the establishment of businesses in the EC with the prime objective of exporting to other EC countries.

On the other hand, there are certain benefits to Korea provided by a single E.C. market: the growth impact of the EC integration, the removal of intra-community trade barriers and uniform norms and technical standards. It is estimated that the actual formation of a single European market will boost economic growth within the Community via direct cost reductions, scale effects, learning effects and innovative effects. The single market is furthermore thought to cause an increase in the international competitiveness of European suppliers, while simultaneously inducing sizable structural changes of demand and supply the Community.

The removal of border controls among EC member countries and deregulation of the EC transport market should also allow cost reductions for third-country suppliers. In addition, the new approach to standardization will also lead to cost-savings in production, information, and distribution due to the fact that products from abroad will have to comply with only one standard a harmonized EC standard based on the national standard of the country of entry-to qualify for EC-wide admittance. However, it should be noted that in certain cases EC standards are often defined in such way as to make market access more difficult for some third-country producers.

Finally, the opening of national markets for public procurement would give foreign suppliers improved access at least to "non-excluded" sectors. In regard to the four excluded sectors — i.e. energy, transport, water, and telecommunication — the creation of an EC-wide procurement market may serve as a catalyst to the widening scope of the GATT's government procurement code.

However, this benefit will be realized only in the long run and only if the EC's entry barriers are fully removed. Korea's direct investment in the EC may eliminate this problem, but here are still many constraitns and disadvantages for Korean firms in establishing overseas plants. Namely, it is very difficult for Korean firms when investing in the EC market to secure comparative advantages over EC firms in terms of marketing strategy and technology. In such a case, investment in the associate members of EC like Hungary could be a solution.

IV. Conclusion

Korea's economic relation has remained inactive with the EC up to the 1980s. Despite a surge in Korea's overall trade volume, its trade with the EC has remained relatively small. Korea's trade relations have concentrated on the U.S. and Japan, relying heavily upon these developed countries. However, as the EC 1992 program realizes in the EC, the newly integrated European market has become an important ratget market for Korea. In fact, both the Ec and Korea have a common interest in expanding and diversifying their trade relations. These two trading partners have enormous potential on mutual benefit from bilateral trade and joint investment.

With the integration of its internal market the EC will become the world's largest single market. The removal of internal trade barriers will increase the efficiency of the EC economy and improve the social welfare within the EC.

However, the integration of the EC will bring negative impacts on non-members, including Korea. As a non-member country, Korea is aware of the dangers of the EC 1992 program in that it may accelerate regionalism and protectionism. The removal of internal EC trade barriers and the subsequent reduction of cost and price of EC products could foreseeably make Korea's products less competitive in the EC market. New harmonized standards would be difficult to meet for the Korean firms. Reciprocity may also become a restrictive trade barrier to Korea. More importantly, however, the Asian NIEs fear that the EC may continue to tighten the current restrictive trade barriers even beyond 1992.

With both the completion of the internal EC market and the advancement of Korea's production scale, Korea must reconsider the choice between direct exports to and foreign direct investment in the EC. Until the 1980s the choice was clearly in favor of direct exports, but the choice now shifts gradually towards direct investment in export markets. The EC 1992 accelerates this shift and further enables Korea to enhance its capability to globalize.

Finally, it is certain that the future dynamism of the entire world economy depends on the openness of the EC market. The EC's competition with Japan, the United States and the NICs is essential for the long-term growth performance of the world as well as for the Korean economy. Therefore, the EC should make considerable efforts to open its market to non-members nations, and Korea should eendeavor to meet new challenges of the EC 1992 by engaging in direct investment and reciprocal market opening.

THE INSTITTUTE OF EAST AND WEST STUDIES

was established in March 1972 as a major research center at Yonsei University with the primary objective of conducting academic research on political, economic social and cultural developments in major regions of the world. The Institute is transnational in scope and interdisciplinary in approach. With participation of faculty members of the University in collaboration with scholars and experts from all over the world, the institute places emphasis on regional, global and issue-oriented studies of the contemporary world.

The East and West Studies Series is published by the Institute of East and West Studies, Yonsel University. The other publications by the Institute are one English journal, two Korean journals and three series. They are (1) *Journal of East and West Studies*, (2) *Dongseu Yonku* (東西研究; Korean Journal of East and West Studies), (3) *Canada Yonku* (캐나다 연구; Korean Journal of Canadian Studies), (4) *Kongsankwon Yonku Nonchong* (共産圈 研究論叢; Communist Studies Series), (5) *Kukjekwangye Yonku Nonchong* (國際關係研究論叢; International Studies Series), and (6) *Occasional* Paper Series.

East and West Studies Series (EWSS)

1. Dalchoong Kim and Euisoon Shin, eds., *Energy Policies in Korea and Japan-Comparison and Search for Cooperation*, 1986.
2. Dalchoong Kim and Werner Gumpel, eds., *New Directions in East-West Relations — German and Korean Perspectives*, 1987.
3. Dalchoong Kim, ed., *Resources, Marilime Transport and SLOC Security in the Asin-Pacific Region*, 1988.
4. Dalchoong Kim, Werner Gumpel and Gottfried-Karl Kindermann, eds., *East West Relations and Divided Nation Problems in the Gorbachev Era-German and Korean Perspectives*, 1988.
5. Dalchoong Kim and Noordin Sopiec, eds., *Regional Cooperation in the Pacific Era*, 1988.
6. Dalchoong Kim and Myungsoon Shin, eds., *Korea-Canada in Emerging Asia Pacific Community*, 1988.
7. Dalchoong Kim, Choon-ho Park and Seo-Hang Lee, eds., *Global Ocean Politics — Major Issues and Areas*, 1989.
8. Dalchoong Kim and Brian L. Evans, eds., *Korea and Canada; New*

Frontiers in the Asia-Pacif Era, 1989.

9. Dalchoong Kim, Werner Cumpel and Gottfried-Karl Kindermann, eds., *New Dynamics in East-West Relations,* 1989.
10. Dalchoong Kim, Bela Kadar, Ku-Hyun Jung and Jeno Hamori, eds., *Economic Cooperation Between Korea and Hungary,* 1990.
11. Choon-ho Park, Dalchoong Kim and Seo-Hang Lee, eds., *The Regime of the Yellow Sea-Issues and Policy Options for Cooperation in the Changing Environment,* 1990.
12. Dalchoong Kim and Graham H. Healey, eds., *Korea and the United Kingdom: Political and Economic Trends and Issues,* 1990.
13. Dalchoong Kim, Werner Gumpel, Gottfried-Karl Kindermann and Ku-Hyun Jung, eds., *Divided Nations and East-West Relations on the Threshold of the 1990s,* 1990.
14. Dalchoong Kim, ed., *Peace and Cooperation in Northeast Asia,* 1990.
15. Dalchoong Kim and Doug-Woon Cho, eds., *Korean Sea Power and the Pacific Era,* 1990.
16. Myungsoon Shin, Frian I., Byans and Dae Ryun Chang, eds., *Fartners in a Changing World — Korea and Canada in the Pacific Rim,* 1990.
17. Dalchoong Kim, Tran Due Uguyen, Pham Chi Lan, Young Sun Lee, eds., *Vietman-Korea Economic Cooperation,* 1991.
18. Dalchoong Kim, Werner Cumpel, Gottfried-Karl Kindermann and Ku-Hyun Jung, eds., *Europe in Transition and The Korean Peninsula,* 1991.
19. Dalchoong Kim, Ku-Hyun Jung and Kap-Young Jeong, eds., *The Role of Market and State: Economic and Social Reforms in East Asia and East-Central Europe,* 1991.
20. Dalchoong Kim, Choon-ho Park, Seo-Hang Lee and Jin-Hyun Paik, eds., *Maritime Issues in the 1990s: Antarctica, Law of the Sea and Marine Environment,* 1992.
21. Dalchoong Kim, Werner Gumpel, Cottiried-Karl Kindermann and Ku-Hyun Jung, eds., *Consequences of German Unification and Its Implications for a Dividud Korea,* 1922.
22. Than Nyun, Dalchoong Kim, eds., *Myanmar-Korea Economic Cooperation,* 1992.
23. Ku-Hyun Jung, Dalchoong Kim and Kap-Young Jeong, eds., *East Asia and East-Central Europe: Market-Oriented Reforms and Transformation,* 1993.