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POST-INDUSTRIAL DEVELOPMENT IN EAST ASIA

Taiwan and South Korea
in Comparison

Min-Hua Chiang



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palgrave
macmillan

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ISBN 978-981-13-0273-2 ISBN 978-981-13-0274-9 (eBook)
<https://doi.org/10.1007/978-981-13-0274-9>

Library of Congress Control Number: 2018942744

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Printed on acid-free paper

This Palgrave Pivot imprint is published by the registered company Springer Nature
Singapore Pte Ltd. part of Springer Nature.
The registered company address is: 152 Beach Road, #21-01/04 Gateway East, Singapore
189721, Singapore

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CHAPTER 1

Introduction

Abstract This introductory chapter sets the scene for the remainder of the book and briefly reviews the main ideas of analysis in each chapter. It compares Taiwan and South Korea's economic conditions after World War II and after the Asian financial crisis. The *problematique* appears from the different economic performance of Taiwan and South Korea during these two different periods. The theoretical debates about both countries' post-war economic development are discussed and used as references to examine Taiwan and South Korea's economic development after they have achieved post-war industrialization.

Keywords Post-war economic development • Post-industrial development • Developmental state • Entrepreneurship • The US-led modernization project

What happened to Taiwan's and South Korea's economies after having achieved successful post-war industrialization? The success of economic development after World War II (WWII) in both countries is well known but their development after post-war industrialization has not yet been comprehensively recorded and compared. Did Taiwan's and South Korea's economies continue to grow not only in terms of quantity but also in terms of quality? If so, what are the contributing factors behind their post-industrial economic development? If not, what made these two economies

stop progressing? This book purports to investigate and compare the economic development experiences in both Taiwan and South Korea in the most recent two decades. Through analyzing and comparing these two empirical cases, the book aims to incorporate additional factors into the explanatory paradigms in development theories. In the process, this book also attempts to highlight and synthesize some major features of these two economies' development experiences in modern history.

This chapter sets the scene for the remainder of the book by providing the background information about Taiwan's and South Korea's development after WWII. We will firstly review the similar and different development paths in Taiwan and South Korea after WWII. Second, the major theories explaining Taiwan's and South Korea's post-war economic development are discussed. Third, we compare Taiwan's and South Korea's economic development after the Asian financial crisis (AFC). Comparison of the major economic indicators in these two countries in the last two decades allows for subsequent summary of the main development differences after the AFC. The research questions and research methods are addressed in the final section of the chapter.

SIMILAR POST-WAR DEVELOPMENT PATHS

Taiwan and South Korea are widely considered as two successful economic development models after WWII. In less than two decades after the war, both had transformed from agricultural nations to major global manufacturers. Their successful industrialization from light to heavy industries supported their high economic growth rates for more than three decades since the 1960s except during the oil crises in 1973 and 1979 (Fig. 1.1). The gross domestic product (GDP) per capita in Taiwan increased from a mere US\$152 in 1961 to US\$9092 by 1991. During the same period, South Korea's GDP per capita also augmented from a mere US\$91.5 to US\$7523 (IMF 2015). In addition, the successful industrialization allowed the manufacturing sector to provide job opportunities for the mass of laborers released from the agricultural sector. As a result, tens of millions of people were quickly pulled out of poverty. With the economic advancement, these two US-aid recipients in the 1950s and 1960s quickly transformed into aid donors and important investors, particularly in Asia since the early 1990s.

Taiwan and South Korea had similar conditions for development at the initial stage. Both had been colonized by Japan before and during the

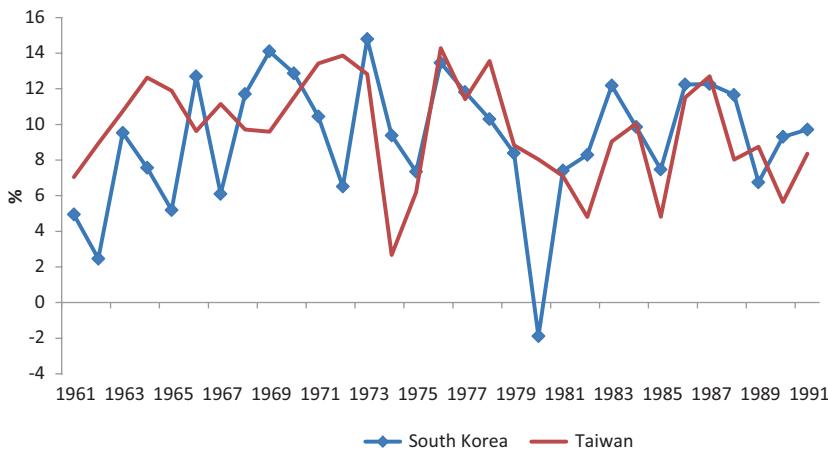


Fig. 1.1 Taiwan and South Korea's annual economic growth rates 1961–1991.
Source: IMF (2015)

WWII, and had very limited natural resources and endowment for development. After WWII, both faced potential armed conflict with Communist regimes. In general, the evolution of these two countries' post-war development paths can be categorized into three major stages. First, US aid played an important role in Taiwan's and South Korea's post-war economic recovery during the 1950s. The aid financed their imports of food and consumption goods after the war as well as the governments' fiscal deficits. Domestic economy would not be easily stabilized without US aid. Although defense expenditure was large, it would be even larger if there had not been for US military aid. The US military intervention in both the Taiwan Strait and the Korean Peninsula further helped Taiwan and South Korea prevent military invasion from the communist regimes. The sense of security encouraged private investment and bolstered confidence of the two populations.

Second, the governments in these two economies were strongly committed to economic development as a national goal. Both had engaged in a short period of import-substitute industrialization before the implementation of the export expansion strategy that successfully drove their post-war industrialization. Import-substitute industrialization was carried out through strict quantitative restrictions on imports. The industrialization was further promoted by highly subsidized credit and selective foreign

exchange licensing allocations. However, the industrial output was not competitive on the world market and domestic demand for the industrial output was exhausted few years later. Import substitution was soon replaced by the export-led growth in labor-intensive consumer goods manufacturing (Adelman 1999). The US and Japan were the two essential pillars in supporting Taiwan's and Korea's export expansion. Japan acted as the key supplier of capital equipment to Taiwanese and South Korean manufacturers while the US was the largest destination market for manufactured final goods in both countries.

Finally, both countries have embarked on a broad range of economic liberalization measures since the 1980s. In response to the growing protectionism from the Western countries, import tariffs were substantially reduced in Taiwan and South Korea. Control over financial sectors, foreign exchange rates, interest rates, and investment were progressively deregulated. The market liberalization did not result in economic volatility as some conservative politicians had expected. Instead, both economies continued to expand at remarkable rates until the AFC in 1997.

SOME DIFFERENCES

Despite their similarities in economic performance and policy measures, macroeconomic figures reveal some differences between the two countries as indicated in Table 1.1. First of all, Taiwan's GDP per capita was higher than that of South Korea after the war. This could be reasoned by South Korea's lag in industrialization at the initial stage of post-war development (Hattori and Sato 1997). Indeed, Taiwan's head start in industrialization can be traced back to the Japanese colonial period, in its provision of military goods for Japanese armed forces during WWII. Taiwan's industrial capacity accumulated during the war facilitated its post-war economic recovery. Although Japan also industrialized Korea during the colonial period, most of the factories were located in the North. South Korea lost its industrial power after the Korean Peninsula was divided after 1945.

Second, while Taiwan's economy grew rapidly after the war, it managed to improve income distribution with a fairly stable price level. Korea also improved its income distribution in the course of drastic economic growth before 1970. Nonetheless, its income distribution has been worsening since the 1970s. The low interest rate policy, rapid development of urbanization, and large companies' dominance in business are considered responsible for the enlarging income inequality in South Korea (Yoo 1990).

Table 1.1 Selected macroeconomic indicators in Taiwan and South Korea 1980–1995

		<i>Taiwan</i>	<i>South Korea</i>
Economic growth rates (%)	1980	7.3	−1.7
	1985	4.8	7.8
	1990	5.6	9.8
	1995	6.5	9.6
Per capita GDP (US\$)	1980	2367.4	1710.8
	1985	3295.1	2457.7
	1990	8178.2	6513.2
	1995	13,076.0	12,340.0
Inflation (%)	1980	19.0	28.7
	1985	−0.2	2.5
	1990	4.1	8.6
	1995	3.7	4.5
Unemployment rate (%)	1980	1.2	5.2
	1985	2.9	4.0
	1990	1.7	2.5
	1995	1.8	2.0
Current account balance (US\$ billion)	1980	n/a	−5.3
	1985	9.2	−2.1
	1990	10.9	−2.4
	1995	5.5	−9.8

Source: International Monetary Fund ([2015](#))

In particular, in order to attain economies of scale, the government deliberately concentrated economic power in the hands of a small number of conglomerates. Korea's high inflation rate is also considered an important reason for the wider income inequality (Byun [1993](#)). Unlike South Korea, it was small and medium enterprises (SMEs) that drove Taiwan's export-oriented economic development. Taiwan's SMEs-dominated economic structure was considered indispensable in equalizing income distribution.

Third, although the unemployment rate in South Korea had clearly declined from 7.7 percent in 1964 to 5.2 percent by 1980, it was still relatively higher compared to that in Taiwan. The stability of employment is another contributor to the equal income distribution. Taiwan's low unemployment rates showed that its industrialization successfully absorbed the large labor force from the agricultural sector. In South Korea, its unemployment rates were clearly decreased only after the latter half of the 1980s. One explanation for its relatively higher unemployment rates

before the mid-1980s was that South Korea's policy shift toward capital-intensive heavy industries during the 1970s has reduced its demand for the large number of unskilled labors (Kim 1990). In comparison, while developing heavy industries, Taiwan also emphasized on labor-intensive light manufacturing production.

Fourth, it is noteworthy that South Korea relied heavily on international borrowing to finance its investment whereas Taiwan relied more on domestic savings. As a result, Taiwan had a much lower foreign debt burden than South Korea. Taiwan's high interest rate and flat inflation accelerated its capital accumulation. While high interest rate encouraged savings, the lending rates were not high enough to reduce business investment. Although South Korea also adopted a similar high interest rate policy in 1965, it was hard to reconcile with governmental control over private investment through concessionary loans (Scitovsky 1986).

Finally, the external trade balance was different. As mentioned, the successful industrialization allowed Taiwan and South Korea to export large manufactured goods to the Western countries. At the same time, both depended on importing key components from Japan. Owing to the much larger exports of manufactured goods than imports, Taiwan enjoyed constant trade surplus since the 1980s. In contrast, South Korea's annual trade balance had remained in deficit before 1997. Taiwan's gradual development of trade surplus has also contributed to its constant current account surplus. In comparison, South Korea's annual current account had mostly remained in deficit during the 1980s and early 1990s, mainly a result of its constant trade deficit.

THEORETICAL EXPLANATIONS

How did these similar and different economic features in both countries contribute to their economic success after WWII? This question has brought many developmental economists into an incessant debate. The neoclassical economists believe that market forces are the engine of economic growth while the developmental state supporters argue the greater role of the governments in guiding the development. Taiwan's and South Korea's post-war economic success also challenged the Marxist view that countries in the periphery are not able to develop due to the asymmetrical power relations with the center and semi-periphery. Below are three major arguments from the literature in explaining Taiwan's and South Korea's post-war industrialization, including private sectors' contribution, appropriate state policies, and the US factor.

Private Enterprises' Contribution to the Economic Boom

Taiwan's export expansion in the 1970s and 1980s was mostly attributed to the efforts of SMEs. In 1985, for example, the 12 largest firms in Taiwan only accounted for 10 percent of exports, the remaining 90 percent was made by the SMEs (Taniura 1992). Strong entrepreneurship, high production flexibility, and high sensitivity to external market demand are often cited as Taiwan SMEs' major strengths for their success (Hu and Schive 1998; Lee and Hsiao 2014; Lin 1998; Wu 2005). Although the Kuomintang (KMT) government did not intentionally nurture SMEs, the business-friendly environment, such as inexpensive labor cost and low inflation rate, had facilitated SMEs' business operations. Unlike in South Korea, the major economic development policies such as export promotion policy did not discriminate among firms of different sizes (Hu and Schive 1998). When many export-oriented foreign companies arrived to invest in Taiwan, many Taiwan SMEs established individual production contracts with them, in particular with American and Japanese firms. These contracts were mostly original equipment manufacturer (OEM) arrangements in which Taiwan SMEs were responsible for producing under the multinational corporations' (MNCs') brand names. During the 1980s, local companies in Taiwan gradually moved from manufacturing computer mice, keyboards, and power supplies to more advanced products, such as motherboards, scanners, and monitors for foreign MNCs (Kraemer et al. 2011). Since the 1990s, with the spike in the global demand for PCs, Taiwanese firms became original design manufacturers (ODM), which allowed the firms to design as well as manufacture for foreign MNCs.

Different from the SME-dominant Taiwanese economy, South Korea's economy grew as a result of leadership by a few colossal enterprises, a family-controlled commercial and industrial combination, called *chaebol*. Korean chaebol development began as early as in the 1950s. In order to secure political support from the private sector, South Korea's first president Syngman Rhee distributed state-controlled resources to certain companies which had close relations with the ruling party. A military government led by Park Chung-hee in the 1960s and 1970s consolidated the partnership between the government and large business groups even further. The Park government provided many incentives, such as preferential banking loans and induced foreign capital to large private firms to spur their production capacity for exports. Compared with other small firms, large companies were able to capitalize on the economies of scale of their

production. The government also favored a handful of large firms over a large number of small firms, given the convenience of cooperating with a few business leaders (Chiang 2016). The government's promotion of heavy and chemical industry (HCI) in the 1970s further strengthened its coalition with large companies at the expense of smaller enterprises. At the end of the 1970s, HCIs dominated by a few chaebols accounted for 80 percent of fixed investment and 40 percent of output in the manufacturing sectors (Lim 2003). On the other hand, Korean SMEs have been more focused on the domestic market and less involved in international trade.

Some considered the different entrepreneurship in Taiwan and Korean SMEs as a result of government policy. While the Taiwanese government adopted a policy of supporting enterprise growth by their own efforts, the Korean government selected sectors of industry and enterprises to be fostered. Consequently, Taiwan enterprises have developed an ability to be competitive in the world whereas Korean SMEs are not able to develop their own independent capabilities to compete internationally (Hayashida 1994). One common characteristic of Taiwan's SMEs and Korean chaebols is that they are all family-owned companies. Underlying small business dynamics in Taiwan is the Chinese family style of management. Small entrepreneurs in Taiwan have been alert to profit opportunities. With short-term planning, they act as imitators as well as OEM manufacturers in international subcontracting markets (Yu 2009). On the other hand, Korean chaebols' structure of ownership was based on cross-ownership linkage among affiliated companies. As the distinction between ownership and management was fuzzy, chaebol owners dominated both board of directors and management (Ha and Lee 2007). Unlike Taiwan SMEs' struggle to win orders from foreign MNCs, Korean chaebols often found new business from the government's industrial policies in the domestic economy.

The State Policy

From the statist viewpoint, a strong government is the key to rapid growth as the state's autonomous power would facilitate the national growth strategy and prevent policy distortion due to the disagreement from domestic interest groups (Tsai 1999). The KMT's pro-capitalist nature, the relative absence of military participation in economic policymaking, and the distant relation with local elites reinforced its autonomy in Taiwan (Evens and Pang 1989). Wade argued that both Little and Gustav Ranis' work "largely ignore the promotional role of government after the economic