

INTERVIEW

AN ALTERNATIVE PERSPECTIVE

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South Korea's rapid economic growth from the 1960s to the 1980s has helped it to become highly recognized as one of the four tigers in Asia, and the so called the "development state" model is believed by many to account for this phenomenon. To search for alternative views, we reached out Dr. Jungho Yoo to discuss South Korea's economic development and the legacies in the contemporary economic structure and policy especially Chaebols and Free Trade Agreements (FTAs). Dr. Yoo currently is a visiting professor at the KDI School of Public Policy and Management and also at Yonsei University's GSIS. He graduated from the College of Law, Seoul National University, and earned a MA in Public Policy and Administration and a Ph.D in Economics at the University Wisconsin – Madison. He also served as the Senior Counselor to the Deputy Prime Minister in charge of Economic Affairs, Republic of Korea. The areas of his research interest includes international trade, economic development, and related policy issues.

–Editor

PEAR: *As you know, from the development state, we had this economic structure based upon or highly oriented towards a Chaebol economy in Korea. We often compare this to the Taiwanese economy that has more medium sized companies. We were hoping you could comment on the advantages or disadvantages of an economy centered towards Chaebols.*

Professor Yoo: We need to distinguish the contribution made by the Chaebols and the visibility of Chaebols. Many people seem to be under the impression that chaebols made a great contribution because they are highly visible in exports, employment, sales volume, even in the size of their debt. No doubt they are highly visible. But we need to think about if it would have been better or worse, say, if we had a system similar to the Taiwanese. In other words we need to compare what has happened with counterfactual. Otherwise, we cannot make a fair judgment. Many people are impressed by the visibility of the chaebol. Even professional economists think that the Korean economy owes a lot to the Chaebol. As I said, we need to think about the counterfactual, the best example of which is Taiwan. And I think that Taiwan had a much better performance.

Their record is much better in almost every aspect. At one point, I did some study on the performance of Chaebol. I estimated the Rate of Return on Assets (ROA), which simply tells you how much income a firm generates with a given amount of assets. Chaebol firms' ROA in the manufacturing sector was typically 2 or 3% lower than the small and medium sized firms. My data starts from 1985, because the government began in that year to identify firms either as chaebol and non-chaebol firms. Anyhow, based on that, there is really no reason to think that Korea really benefited from the Chaebol dominant system. Probably we could have done better if smaller firms were dominant in the economy.

PEAR: *What do you think of the Global market? Companies like Samsung or Hyundai are rather big players abroad.*

Professor Yoo: Well, that is also a matter of visibility. Taiwan's performance of exports and their composition of export products are not any worse than Korea's. Korea's may be bigger because the economy is bigger and the population is twice as large, but if we take that into consideration, what kind of product are they exporting, things like that, Taiwan is doing better. Macroeconomic performance, per capita income, inflation, saving rate, investment rate, in all these Taiwan has a better performance. Even in income distribution, they have a more equal income distribution. They have had surplus in the balance of payments almost all the time; Korea had almost all the time deficit. So, why do people always discuss Korea, not just domestically but also internationally? Well, I think that has to do with the People's Republic of China. Since it became a Member of the United Nations, Taiwanese statistics disappeared from international publications of UN, IMF, and the World Bank.

PEAR: *You mean Taiwan's?*

Professor Yoo: Yes, because it is a non-state. So, one has to make an extra effort to get Taiwanese data. This is again a visibility problem. Taiwan has sort of disappeared.

PEAR: *Korea benefited in some ways from the Vietnam War. Taiwan did not have these same opportunities. So, in East Asia you had Japan benefiting from the Korean War, Korea benefitting from the Vietnam War. Yet, Taiwan was still able to make comparable gains to Korea without support from the US in this way. So, what do you think of the argument that Korea benefited from the Vietnam War?*

Professor Yoo: I think that the benefit from the Vietnam War is exaggerated. The increase in export was something like at most 10% of the total exports, and probably Korea also benefitted from the earnings of the soldiers who were dispatched there and the workers who worked there. But, I don't think it was what really makes a difference. At least it was not the main story. Korea would have grown at a somewhat slower pace, perhaps, but it still would have made rapid growth without the so-called benefits of the Vietnam War.

PEAR: *Could you discuss the states role in development a little?*

Professor Yoo: We tend to think that, if there is an exceptional phenomenon, there must be an exceptional explanation. Korea's rapid growth is called a miracle, an exceptional phenomenon. So they look for exceptional explanation. Some point to the dictatorship. But that is nonsense, pure nonsense. There are plenty of counter examples, dictatorships that failed. Some mention Confucianism. But this used to be cited as the reason why Korea did not develop, because it looks down on manual labor, it puts a high value on scholarly works such as writing a poem. Moreover, it has been around nearly 3000 years. It doesn't really make sense to consider as the main factor. Another example of the exceptional explanation that people search for is the industrial policy, the HCI policy. In my opinion, it would have been better had there not been the policy. To understand this, we need to compare two states with the HCI policy and one without it. Taiwan provides the counterfactual example. They had a similar attempt to promote this style of program. However, there were some important differences. Some Taiwanese scholars now observe that their policy did not discriminate future industry from main industry.

PEAR: *For Korea this main industry at the time was wigs?*

Professor Yoo: Yes, that's right. Attention should be drawn to the fact the HCI policy was highly discriminatory. If your firm belongs to one of the six selected industries that the policy tried to promote, you receive a lot of favor from the government. If not, then you were left out in the cold. An example is so-called "directed credit" policy, under which industries not favored by the policy, such as labor-intensive industries suffered shortage of investment funds. Another example is revision of tax code in the beginning of HCI policy. It lowered the tax rates for those firms in the selected industries but raised the rates for the firms in other industries. In my class I say that the government is not a rich uncle. If the government gives something extra to someone, that something extra has to

come from others in the society. So the burden of this policy has to be borne by someone else within the economy. The HCI policy attempted to promote certain industries at the expense of others. And these other industries suffered, leading the economy into trouble. The economy registered a negative growth in 1980. Usually three reasons are given, the first is political instability due to the assassination of President Park in October 1979, the second is poor harvest due to a cold spell, and the third is the oil shock and the global recession that followed. However, if they are the only reasons, then Korea's share in the world exports should not have declined. However, it declined, especially in comparison with Taiwan. And where was it decreasing? In the labor-intensive light manufacturing, the ones that were discriminated against in the HCI policy. And, export decline and the decline in investment that moved together with exports resulted in worsening economic performance. That's exactly why Park stopped the policy before he died. But unfortunately it was a little too late; export decline had already begun in 1978 and 1979 due to the cold spell. The main reason I believe was the HCI program.

PEAR: *You mean after the assassination of Park Chung-Hee?*

Professor Yoo: Actually, 6 months before the assassination. Many believe that it was stopped because he was assassinated. But he actually stopped it six months before he was assassinated because the economy was getting into serious trouble because of the HCI policy. If Korea had followed this policy for another 5 years, say, the economy could have been ruined.

PEAR: *In your current class, you emphasize institutions when discussing economic success. Things such as property rights, contract enforcement, etc. Prior to Park Chung-Hee, did you see the necessary institutions to succeed?*

Professor Yoo: No, the reason Korea had such rapid growth did not have much to do with the improvement in institutions. There were not large enough improvements to explain it. The rapid growth was made possible because the Korean economy was seriously engaged in international trade. What matters in this story is the size of the world market. The size of the world market, as Adam Smith says, limits the extent of division of labor. The size of the world market in the early 1960s was more than 110 times as large as it was in 1820, the earliest date when the trade volume estimates are available. It is also the time when most of the western countries started to industrialize. Now, the world market that is bigger than 120 times makes a huge difference.

PEAR: *So, why specifically Korea then?*

Professor Yoo: Excellent question. Consider this water on a table. If you don't drink it, it doesn't help quench your thirst. At the time Eastern European countries were going for self-sufficiency due to their ideology. Latin American countries were pursuing protectionism, and sad to say, African states were not ready to take advantage of the size of the world market. This leaves Asian countries, but Southeast Asian countries were not interested either. Practically, East Asian countries were the only ones to take international trade seriously. In Korea I think this happened by accident. In Taiwan there were economists who proposed this to the government. It was only after the experience of these Asian tigers that they started to seriously consider exports as an industrialization strategy. Before then no developing countries had been successful in exporting manufactured goods. Many economists recommended the policy of import substitution industrialization at the time. It was only the East Asian poor that took advantage of the world market. Hong Kong and Singapore were naturally positioned to take advantage and depended on trade naturally, and Korea and Taiwan took advantage as well.

PEAR: *Samsung was originally an exporter of fruit and vegetables. When a country enters the world market, should it focus on what it has an immediate comparative advantage?*

Professor Yoo: What began the rapid expansion of Korean exports were clothing, handbags, artificial flowers; these were not even made by Chaebol. In fact Chaebol were not even there. They actually grew big during the time of HCI. Why was Korea exporting those goods, though? Korea had a natural advantage in these industries. Ghana's per capita income at the time was three times as high as Korea's at the time. It was the poorest country in the world; it's hard to imagine now. So, the labor was incredibly cheap. This means of course meant that the country had a comparative advantage in labor-intensive goods. So, there was no connection between this and the Chaebol or government.

PEAR: *To make a transition from where you have a comparative advantage, is the market enough of a force to make a transition to the industries responsible for development and success?*

Professor Yoo: If you are asking me what the main reason for the transition, I would say it is the market. Sure the government can push things a little further, but, the question to ask is, how and why does an economy grow? Some would

argue that an industry can only grow if the government helps. But what I say in my class is that market order is spontaneous. How does an industry grow? Basically, an industry grows, if it is profitable. Even if the government subsidizes an industry, if it is not profitable people, it cannot grow, because businessmen will not make in the industry. What makes a country successful in producing completely different things than it did previously? What has happened in Korea was rapid accumulation of capital. Because lots of investments were made, capital became more and more abundant. This means big change in the relative prices of the factors: the cost of capital fell lower and lower, and wage rose higher and higher. Almost everything you now see in Seoul now wasn't there. It was nearly completely destroyed by Korean War. There are estimates of capital stock in 1960 and in 2007. During the period, the amount of capital stock grew more than 200 times as large. If you do not discuss this then you are missing the main story. Whether there is a government policy or not it is marginal. And when we compare Korea to Taiwan, there is really no evidence that it was the government policy that made the growth possible. Korea's economic progress was achieved not because of the government's policy, but despite the policy. We have to study empirically, without settling for mere causality by association.

PEAR: *Is this point of view becoming clear internationally? Those similar government interventionist policies are not necessary?*

Professor Yoo: It is hard to prove these things definitely in economics beyond a shadow of a doubt. We have cases of where a government tried to develop certain industries and failed. But this then becomes invisible. In the Indonesia, there was an economic minister who tried to promote the airplane industry. However, this policy failed miserably. Have you heard of it? Probably not, because the industry became invisible. However, in Korea, they pushed this strong, archetypical example of government intervention, the HCI policy, and the policy is now credited with the development of many heavy and chemical industries, while the real reason lies in the increase in capital stock that was more than 70 times faster than the increase in labor force.

PEAR: *Why does the idea of Korea's development persist? Is it simply people seeing what they want to see?*

Professor Yoo: To some extent. But, as I said before, I think you see exceptional results and people look for exceptional reasons.

PEAR: *So what could be the lesson, a sort of guide or recommendations, to countries going through development currently?*

Professor Yoo: My advice: try to find impediments to growth, and get rid of them before trying to promote certain industries. Because if you really believe that the economy works it self, that market order is spontaneous, and so on, then lack of economic growth must mean that there are some impediment to growth. For Korea, I discuss this in class and in my paper. One example of impediments was the government policy that tried to keep the won to dollar exchange rate as low as possible.

PEAR: *Can you elaborate?*

Professor Yoo: As soon as the Korea War broke out, the UN decided to send troops to fight on the side of the South. To fight, of course, you need ammuni-tions, tanks etc. But you also need local money to buy things in the local mar-kets, to hire local workers, and so on. So within weeks after the outbreak of the War, the Korean and US government made an agreement. The Korean govern-ment would advance Korean won to the UN command, and would get paid back in US dollars. So, it's nothing but sale of Korean won for US dollars. In that situation, if you keep the exchange rate low, you get more US dollars in return. At some point, I believe in 1952 or 1953, of the total foreign exchange earnings of that year, 70 or 80% was coming from this won advance. So it was hugely important. This means that there was every reason for the government to keep the won overpriced. But, with that kind of exchange rate policy you cannot ex- port. It's like selling everything for double or triple the price on the world mar- ket. This worked as a great impediment. This impediment was removed from Feb 1960 to Feb 1961 by three devaluations that raised the won-dollar exchange rate from 51 won to the dollar to 131 won to the dollar. The overvaluation was effectively eliminated. So the export of labor-intensive products began to in- crease, let me rephrase that, it was like an explosion. One of the most prominent examples was clothing. In 1961 an export of US \$2000 worth of clothing is recorded. In 4 years, in 1965, it is US \$20 million. Within a span of four years, we have this huge explosion. What this means is that there was a large weight suppressing the exports, and as soon as it was lifted the exports shot up like a rocket. This cannot be explained by growing or promoting something, only by eliminating impediments.

PEAR: *The potential was there, and once the impediment was removed, it could succeed. So, finding and removing these is important for developing countries?*

Professor Yoo: Yes, for countries it could be some other examples. It could be corruption, or a lack of infrastructure such as railroads, if it were a landlocked country. If something doesn't work, there must be some reasons why it doesn't work.

PEAR: *Transitioning to future issues, what do you see in Korea currently? The new Prime Minister has discussed "economic democratization", which seems hostile to larger corporations. Is this going to promote smaller companies?*

Professor Yoo: This policy is a response to social discontent. We need to go back to the basics and ask why this social discontent arises.

PEAR: *Does this have to do with a feeling of people not being on equal footing and not having opportunities?*

Professor Yoo: I am not a sociologist, so I will just tell you my opinion. Where does this discontent come from? From the perception that wealthy are wealthy because of their privileges, and the poor are poor because they did not receive privileges. This so-called polarization is seemingly going to continue, and there is no reason to think it would be different in the future, unless this society's rules of the game change. It may be over simplifying it, but this is how I see it.

PEAR: *Many western countries are facing similar issues, with the OWS in the US as an example. It seems that most capitalist countries reach this point where there is a visible and acknowledged gap.*

Professor Yoo: Here, we need to distinguish two cases. One were institutions are more or less seen as fair and one were it is not. My favorite example is Park Ji-Sung, a football player who used to play for Manchester United. When he was playing there, a newspaper report said his weekly earnings were nearly three times as large as my annual salary. If I say this is social injustice what would you say?

PEAR: *This depends on your standpoint. Some would say he worked hard all his life to succeed and deserves it,; while some would say it is undue given what he does. Some would say it is just supply and demand.*

Professor Yoo: The main reason why some think those who are wealthy are so called bad guys is because they think they earned their wealth unfairly, illegally, through a privilege. So the main reason for this discontent is the fraud, privilege, and violence, which I discuss in my class, that are present in society. Even though we cannot say it is social injustice, the poverty problem still remains. The government, need to make sure there is as little of this fraud, privilege, and violence, as possible in the society. We need to make the society's rules of the game fair and transparent before addressing the symptom. Back to the question, the current policy is trying to address the symptoms, such as the Chaebol taking advantage of smaller companies, benefitting from tax issues, etc. Really though, it is the failure of government to enforce the laws and protect smaller guys. The government is neglecting its responsibility and the reason of its existence. If a country has a relatively fair institution and still has an income disparity, then it is an issue of social security. If people see and perceive the rules as fair, then the issues of discontent will disappear.

PEAR: *Would you be able to discuss free trade?*

Professor Yoo: Yes, I am a big fan of free trade.

PEAR: *Well, there are issues with the KORUS FTA, politically as well as with the discussion of losers in the deal. One of the most well known being agriculture workers.*

Professor Yoo: Of course there will be losers in any kinds of change. So what we have to discover is if the change is good for the country or not. And if it is and we have losers, then we need to compensate them, without making this compensation a permanent thing. It should be a help them to move to another sector. It is called trade adjustment assistance. This is not an issue of whether or not to go for free trade; in principle free trade should be welcome. Trade was the most important reason why Korea could grow so rapidly.

PEAR: *This responsibility once again falls to the government?*

Professor Yoo: Yes, of course.

PEAR: *If you wouldn't mind, one final question. What do you think of Korea's dependency on trade, especially with China and the US?*

Professor Yoo: That is an issue of trade-off, something we can't escape. At the moment Korea is exporting 25% of its total exports to China. To the US, EU, and Japan combined, this figure is something like 27%. We are extremely dependent on China as an export market. I think the Korea's exports to China will soon exceed those to these three countries. So dependency is a real issue. What can we do? Become less dependent, of course, but to what extent? There is only so much we can do. So, it definitely is an issue of trade-off.

PEAR: *The KORUS FTA could go a way to rebalance this.*

Professor Yoo: Yes, we should try to trade more with the US, and also with India and others. That is about the best we can do. **Y**