

## Democracy and Economic Development in South Korea and its Application

*WheeGook Kim*

East-West Research Institute  
Washington, DC

The South Korean economy has been highly praised by foreign economists as a successful model of development and proudly joined OECD in late 1996 as the world's eleventh-largest economy, with per capita annual income of over \$10,000. Since then, a series of business bankruptcies and a financial crisis resulting in the imposition of IMF supervision on December 3, 1997, has caused a shift in political power. The new administration began to work for systemic reforms, which have been interrupted by the political opposition, the entrenched *chaebols*, and labor unions.<sup>1</sup>

Despite popular pressures for reform, the lack of driving forces reduced direct foreign investment, which caused the stock index to fall from the mid-500s in late February to the low 300s by mid-June 1998, coinciding with President Kim Dae Jung's official visit to Washington. The victory of the president's party in local elections and the promise of strong United States supports energized the Kim Dae Jung administration to expedite reform programs. However, progress may take longer than expected due to the weakened political coalition; the lack of "new blood" among political appointees; the unrelenting resistance of special interest groups; the enduring old habits, particularly in politics;<sup>2</sup> and the unhealthy economic environment in the region, including Japan.

Democracy and economic development have interacted in the modernization of South Korea, as in most other Asian countries: authoritarian politics has controlled the market while economic growth has facilitated democratization. President Park Chung Hee launched a series of economic development plans (EDPs) in 1962, which enabled the government to allocate its resources by restricting political freedom in South Korea. The first three five-year EDPs proved to be very successful, when the economy was small and inelastic. As the market grew, state intervention in the later period caused structural problems

within the economy that eventually led to idle capacity and bottlenecks in industries. As efficiency and competitiveness declined, President Park's early successes were becoming a fading memory while structural problems loomed ahead.

State intervention in the economy pursues either capitalistic efficiency or democratic equality, which cannot be achieved simultaneously because of necessary tradeoffs between the two objectives. In fact, state intervention in Korean politics caused more problems than solutions in recovering market competition, because the government either failed to act where it should have, or chose the wrong action. Corrupt politicians collaborating with *chaebols* could only result in the creation of a political-economic complex, which jeopardized market functions and finally forced economic decline and a financial crisis requiring expensive structural reforms. Since corrupt politics caused market and government failures, the theory of balanced development in politics and economy, rather than Asian values, became persuasive in the age of globalization.<sup>3</sup>

South Korea has been a model for economic development. Faced with the financial crisis, a painful restructuring of the entire system was required, bringing into question whether the East Asian economic development model (EAM) is still viable. The Asian financial crisis happened in the process of economic development, where unresponsive politics ruined the economy. The efficiency of the EAM must be considered to have a strong link to politics. Under a redefined EAM, the time span for development would be extended to the stage of advanced democracy. In this scenario, South Korean development would occur over three stages: first, economic takeoff under an authoritarian regime; second, conflicting interests between democracy and economic growth; and third, balanced development of subsystems in the age of internationalization.<sup>4</sup>

The economic experiences of South Korea provide valuable lessons for later transition economies, particularly North Korea's. If North Korea pursues systemic change towards a market economy, then Pyongyang needs to follow the course of opening that took place in China. The Chinese model teaches how to smooth out the "freedom waves" coming from economic openness, and the South Korean model teaches how to maximize efficient resource allocation in the takeoff stage. The mixture of the two kinds of experiences, in China and South Korea, will provide indispensable lessons for North Korea in its political and economic transformation, while the Kim Dae Jung

engagement policy is realistic and will be mutually beneficial for inter-Korean economic cooperation.

The present study sets three goals, to be discussed in three main sections. In the first, the role of the state in the South Korean economy will be assessed in terms of market and government failures. Second, the EAM will be redefined to show that the model is not dead but is progressing. The study also will discuss major issues of structural reform arising in the final stage of South Korean economic development. Third, lessons taken from the South Korean economy will be applied to future transitional woes expected in the North Korean economy. The study's findings will contribute to policymaking for structural reforms in South Korea and for transformation of the systems of China, Vietnam, and North Korea by reducing trial-and-error efforts to escape from poverty.

### **The Role of the State in the South Korean Economy**

The welfare economic theorem states that a government cannot do any better than the market, and market efficiency is achieved by the Pareto optimal allocation of resources, which defines that no one can be better off by reallocating resources without making someone else worse off.<sup>5</sup> Under this theorem, government intervention is justified to recover efficiency in cases of market failures due to imperfect competition, external effects, and public goods.<sup>6</sup> Imperfect competition is caused by uncertainty arising from inadequate information, increasing returns to scale, and entry barriers.<sup>7</sup> The government attacks imperfect competition and external effects to overcome market failures while it pursues public goods, hurting more or less free competition in the market.<sup>8</sup>

A serious problem of state intervention in the market appears in the conflict and tradeoff between capitalistic efficiency (dollars) and democratic equality (rights).<sup>9</sup> If a government favors efficiency measures to correct market failures by ignoring equality values, income distribution is worsened and social security is threatened. If a government favors equality measures to secure the social welfare by ignoring efficiency values, the market fails by losing free competition. The dilemma of state intervention, therefore, is an issue of political choice among "candidates" in three categories: a conservative advocating efficiency, a liberal advocating equality, and an independent advocating neutrality **or compromise**. The choice depends on the political climate, which continually shifts from one pole to the

other according to the power dynamics between parties and government branches.

Government failures, both those of commission and those of omission raise social costs without achieving goals.<sup>10</sup> Failures of commission come from improper state intervention in public enterprises, budget allocation, and private sector control, while failures of omission arise from negligence of the state in necessary matters, such as maintenance of infrastructure and foreign exchange and interest rates. Government failures are caused by administrative incapability or interruption of government function by the corrupt political-economic complex. Problems of developing countries are largely the result of both kinds of government failure, but those of South Korea belong mostly to the category of omission.

The nature of power shows increasing returns to scale, so that incumbent political power is used to acquire economic power, which makes it possible to acquire additional political power.<sup>11</sup> This kind of chain of action generates monopoly power in politics and economics by creating the political-economic complex. In the legislative branch in Korea, for example, candidates running for National Assembly seats are not chosen by primary elections in each electoral district but are nominated by a central committee of their party. This allows incumbent party bosses to strengthen the factional power in politics so that the same failed candidate runs in presidential races repeatedly. The lack of political competition prevents new candidates from entering national politics, weakening democratic checks and balances. So it is possible that a president dominates the National Assembly, and politicians are secure from legal charges resulting from malpractice, a starting point for government failures.<sup>12</sup> Similarly, in both administrative and judicial branches, bureaucratic monopoly by regionalism and school faction jeopardizes societal fairness and reduces efficiency.

The rise of the *chaebols* is a byproduct of market failures and government failures. First, the Korean government provided *chaebols* with easy access to financial institutions for loans and credit through cross-finance guarantees withheld from non-group companies. Their monopoly power destroyed small businesses and created a series of subcontracts which produced a worsening quality of goods, as shown in the collapse of poorly constructed bridges and buildings. Second, *chaebols* obtained most government contracts through disguised competition. It is a well-known secret that former Korean presidents used to collect campaign funds from their offices, and endless scandals in government contracts were disclosed after power transfers. Third,

elements of subsystems, including politics, economy, national security, society, and others. If the economy moves quickly forward while politics lags behind, market competition will be interrupted by political problems, thus distorting resource allocation. As a result, adjustment costs will become expensive in the future, which the EAM has demonstrated.

The theory of balanced development between politics and economy is controversial since the initial conditions are different in various countries, including the transition economies.<sup>19</sup> First, China chose the autocratic path in its modernization, pursuing economic growth first and moving gradually toward democracy later, by adopting the South Korean model, where political sacrifice is temporarily compensated by rising income. Second, Russia chose the democratic path by pursuing democratization first and economic reforms later, resulting in the regime's collapse since the economy could not support liberalized politics.<sup>20</sup> Third, the balanced path would provide for simultaneous interactions between political opening and economic reforms in development.<sup>21</sup> Taking the autocratic path in the early stage of economic development, South Korea eventually has been forced to choose the balanced path and has been pursuing simultaneous development of politics with the economy since the financial crisis hit.

China survived while the USSR perished in the process of economic transformation. Economic reform preceded political reform in the former case, while political reform preceded economic reform in the latter. The collapse of the USSR is explained by the fact that its failing economy could no longer support the country's vast political-military system, and the bankrupt government could no longer guarantee law and order. In contrast, Deng Xiaoping adopted a gradual opening policy, attracting foreign capital, promoting exports, and pursuing economic transformation, finally to be followed by political reform.<sup>22</sup> Deng achieved economic success, but he did not expect the shock of "freedom waves" resulting from opening to hit Tiananmen Square so suddenly and violently in 1989. Similarly, President Park experienced political crisis in the major cities in South Korea, which threatened the survival of his regime.

Political-economic interactions may be investigated from the point of view of economics looking toward politics, or vice versa. On the one hand, economic development facilitates democratization.<sup>23</sup> First, economic growth is accompanied by trade expansion, by taking comparative advantage of a country's assets, which requires more education and training to produce better-quality products to beat

However, when the economy became more complicated in the second half of the 1970s, government intervention distorted resource allocation, which reduced efficiency and growth. The shipbuilding industry, for example, was expanded based on government subsidies at a time when the world demand was beginning to decline, so that the level of capacity utilization remained below 40 percent until the mid-1980s, lowering factor productivity and increasing foreign debt.<sup>28</sup> Corrupt politicians and bureaucrats sold monopoly power to favored businesses and labor unions and received bribes in return, which caused failures in both the market and government, financial crisis, and finally economic recession. Corrupt politics ruined the economy of South Korea while economic development nevertheless facilitated its democratization.

What are the sources of corruption?<sup>29</sup> First, corruption is accompanied by the lack of transparency and accountability in government and business. Corrupt public officials use their power for personal gain by accepting bribes, while private donors get what they want from the government. Second, policies and regulations that produce gaps between demand and supply invite corruption since businesses and individuals try to avoid red tape by offering bribes to reduce costs and to save time. Those working in the thriving underground economy aim not simply to evade taxes, as in rich economies, but are mainly attempting to dodge the red tape and the inevitable bribes in the formal sector.<sup>30</sup> Third, if corrupt individuals are rarely detected and punished, if expected returns from breaking laws are much higher than expected costs, or if social justice does not exist in the system, the system itself facilitates corruption. Finally, if the salaries are low and job loss is not a problem, it is easy to be corrupt since benefits are much higher than costs of punishment.

Then what can be done about entrenched corruption in South Korea? The answers lie in three categories: enhancement of democratic checks and balances in politics and government, promotion of competition in the economy and business, and organization of active citizens' groups for social interaction and consensus building in order to oversee civil services and provide policy input.<sup>31</sup> The first category should focus on reducing the discretionary power of government officials, enforcing anticorruption laws, reforming the civil service, and increasing the accountability of government to its citizens.<sup>32</sup> It is essential for the people to see and to believe that anyone, without exception, who violates the law will have to pay the price for his wrongdoing sooner or later.

occurs through the learning-by-doing process on the job at joint-venture facilities. The World Bank estimates that the contributing share of total factor productivity to total growth was over 33 percent for Japan, Taiwan, and South Korea during the period 1960 to 1989.<sup>38</sup> This number is much higher than Jorgenson's estimate of 24.7 percent for the United States. As long as the marginal return of capital exceeds its cost, growth based on rapid capital accumulation would be highly desirable, though its marginal productivity is likely to decline — not sharply, as Krugman worried, but gradually, as the capital stock deepens.

Due to the following shortcomings in its definition, the EAM needs to expand its scope to include the stage of advanced democracy. First, even though economists have disregarded the influence of political elements in the model, democratization has, in fact, greatly affected economic development. Political elements are fundamental to accurately defining the EAM from the viewpoint of political economy. Second, the time-line of the EAM has formerly considered only the two stages of economic takeoff and growth expansion. But the model must include the advanced stage of democracy to be built after structural adjustment since financial crisis is part of the process of economic development. Third, technological advancement in transportation and communications has brought the world closer more rapidly than ever before. Trade relations strongly affect foreign relations, as recently seen in the interaction between the United States and China. The globalization of the information age must be considered in defining the economic development model.

South Korean economic history is divided into three periods of major political change. In the initial stage, economic takeoff under the authoritarian regime (1962-1979), President Park controlled the hybrid market economy by suppressing democracy. By crushing the opposing freedom movement, he fortified his authoritarian regime and allocated resources by launching a series of EDPs. An input-output analysis by this author indicates that the export-led growth strategy of South Korea was the best choice among available alternatives.<sup>39</sup> This strategy produced the largest GDP for the same level of aggregate final demand. Import substitution required a huge amount of physical and human capital, which could be financed by export earnings, while export promotion required advanced technology, which could be accumulated by import substitution; both were mutually supportive and complementary. The movement of comparative advantage due to the shorter product-life cycle transformed the industrial structure absorbed

relatively weak. Park's assassination amidst the social instability of 1979 temporarily reduced these problems, but little progress in democratization was made by his two successors.

President Kim Young Sam allowed full freedom of expression, unlike his predecessors, but his administration could not make any real difference because the system and people remained unchanged. As the first civilian president, he removed the military culture from the government and pursued ambitious social reforms. However, his lack of professional knowledge and experience caused him to ignore the need for a democratic decisionmaking process in the system, and his authoritarian leadership caused many errors. After the Hanbo Steel Group scandal, Kim lost control of his presidency, which was shared with President-elect Kim Dae Jung, who had been meeting with his Transition Committee at his home since the election. Conflicting political and economic interests plagued Korea during this period, and the confused leadership failed to integrate differing social interests. Seoul experienced government failures, and the external forces of the IMF took control of the Korean economy. The political situation, which would be expected to change in the third stage, was the major reason for this external supervision.

In the third stage, balanced development of politics with economy (1998-2015),<sup>43</sup> the South Korean economy pursues a balanced development for its structural reforms, where the following must be considered: First of all, market forces are not enough to remove the monopolistic power prevailing throughout the nation's system; the lack of driving forces slows reform. Only government intervention will promote efficient reform, by rooting out resistance from the anti-reform groups, including politicians and *chaebols*. In order to avoid errors, the reform priorities should be clearly delineated through professional evaluation free from the persuasive pressures of political interest groups. Temporary state intervention will help to reconstruct fair competition in South Korea.

Second, the burdens caused by reforms should be shared equitably in a manner acceptable to all parties. The political opposition, *chaebols*, and labor unions do not want to lose any part of their interests, but no reform will succeed without downsizing and cutting costs. The leadership should force all parties to share burdens coming from systemic reforms. The Tripartite Committee, consisting of labor, business, and government, should unite constructively to achieve the goal of recovering economic strength. If not, the South Korean people will pay a high cost.



Third, the initial conditions for fair competition should be seriously considered in reforms. The wealth of the *chaebols* came not from fair competition but from monopoly power provided by the corrupt government, which devastated nearly all small businesses. The revival of small and medium-sized businesses is essential in reforms. Therefore, the government should bar *chaebols* from participating in government contracts, except in certain industries which are not appropriate for small businesses, until the initial conditions are fully recovered. This kind of concession to small businesses would correct the distorted initial conditions that suppressed fair competition.

Fourth, in banking reforms it is essential to investigate the real demand of funds and to set available resources. Previous bank management should be brought to justice for their misconduct and replaced by fresh, new, efficiently operating management teams. The Bank Supervision Commission should be controlled not by the Office of Prime Minister but by the Bank of Korea in order to ensure its political neutrality. It is dangerous to amend the banking laws by allowing *chaebols* to enter the banking business; such amendments oppose the direction of economic reforms.<sup>44</sup>

Fifth, the Bank Supervision Commission should strictly require banks to maintain each firm's debt-equity ratio below 200 percent through removal of cross-finance guarantees. The Fair Trade Commission should closely watch internal transactions among group companies to root out monopolistic practices that violate antitrust laws. Consistent supervision increases efficiency and expedites structural reforms. It is neither reasonable nor helpful that *chaebols* incite nationalistic sentiments in order to avoid foreign competition, or that labor unions reinforce workers' hatred of foreign investment in order to promote union cohesiveness. The labor market, particularly, jeopardizes economic reforms by encouraging domestic firms to operate in foreign countries and by forcing foreign firms to hesitate in their direct investment activities in Korea, which threatens job creation in South Korea.<sup>45</sup>

Sixth, in the course of economic recovery Seoul should reduce the negative effect on the economy of excessive military expenditures. The United States-Korea security alliance deters external threats from the North, establishing a low-cost national defense. If Kim Dae Jung's engagement policy with the North yields a peace treaty and disarmament agreement as a preliminary step toward Korean unification, the two Koreas can divert military spending to future

economic development. The leaderships of the two Koreas should achieve disarmament benefits by compromise as soon as possible.<sup>46</sup>

In sum, the outlook is optimistic for South Korean economic recovery because of its highly educated labor forces, accumulated capital and technology through advanced industries, world-class management and marketing experience, and mature and self-adjusting democratic leadership. When South Koreans pursue speedy reforms by sharing burdens equally for structural adjustment, the recovery will be successful, proving that the EAM is not dead but progressing, alive and continuing its rapid growth. As mentioned, however, reforms and recovery can be significantly delayed if conflicting interests weaken the driving forces as seen in political underdevelopment.

We may consider the following three possible scenarios: (a) If the Kim Dae Jung leadership pursues speedy and aggressive structural reforms in the right direction, South Korea will regain its previous economic strength and growth rate within three years, (b) If Kim Dae Jung's administration fails to integrate productive reform elements because of conflicting interests within the system, economic recovery will take more than a decade, as witnessed in Latin American countries, (c) If the Kim Dae Jung government fails in promoting expeditious change but maintains a desirably focused reformative direction, the result will lie somewhere between these two extreme cases, taking five to seven years. However, it is too early to predict economic recovery since there are various obstacles hindering structural reforms in South Korea — such as political skirmishing, the resistance of the *chaebols*, and labor strikes. Swift success of system reforms depends on the people's ability to mobilize all possible resources, and the historical results will be judged by the next generation in Korea.

### **Application of South Korea's Experiences**

As discussed previously, South Korea has experienced the development of political-economic relations while modernizing from authoritarian rule to the Western standards of democracy. Democracy, reducing intervention costs through its feedback adjustment mechanism, is essential to maximize capitalistic efficiency. The balanced development of the system minimizes costs induced by lagging subsystems. Government intervention in politics causes market failures, and corruption from the political-economic complex results in government failures, becoming a heavy burden on growth. EDPs are efficient in the early stages of economic takeoff, when the economy is

small and inelastic. But in the later period, when the economy becomes large and complicated, problems in efficiency and equality emerge under EDPs due to misallocation of resources without competition in the market.

If South Korea had chosen a different strategy, the adjustment costs would have taken a different form. As long as the difference between integrated returns from the chosen growth strategy and those from other strategies is larger than reform costs, the costs must be the lowest price that South Korea has to pay for adjustment. If from the beginning Seoul had chosen a strategy that balanced economics with democracy, today's frustration would not have occurred; no greater economic performance could have appeared in the history of its economic growth.<sup>47</sup> Once recovered, Seoul's economy will be stronger than ever before, having achieved both advanced democracy and a market economy through structural reforms. Through this financial crisis, with the help of external forces, South Korea will have matured towards political and economic internationalization.<sup>48</sup>

The South Korean experiences provide several lessons for the transition economies of China, Vietnam, and North Korea, (a) A series of economic development plans should be used in the early stages of economic takeoff, even if political freedom is restricted. The aggressive driving forces will expedite a big "push" effect on the economy. The planning period must be less than fifteen years.<sup>49</sup> (b) Government intervention should be gradually reduced after ten years, and a balanced path should be pursued between politics and economics by leaning in the direction of fair competition. It is necessary for the leadership to watch corruption closely, (c) Economic development should start from import substitution of labor-intensive products and move to export promotion of the same industries. Import substitution of capital- and technology-intensive products should be emphasized at the start, moving to export promotion of the same products, (d) Proper capital should be supplied by selling ownership, except in energy, transportation, communications, finance, and media businesses. Aggressive investments should be made in education and training with research and development, but with an effort to minimize protection of infant industries, (e) If politics remain unchanged, the economy will lose efficiency and equality, which will reduce exports, employment, and income. Then the economy will have a problem in the balance of payments, which threatens continuous growth. Time is of the essence in this case to reduce adjustment costs for recovery, (f) Balanced growth of politics and the economy is essential, and other sectors are

also important to reduce adjustment costs. The defense budget should be minimized to avoid damaging the economy, (g) Subsequent policy reforms for adjustment are necessary to make the economy efficient, reducing accumulated costs arising from state intervention. It is dangerous to maintain improper or outdated policies without correction, because such inaction raises unnecessary costs in the future.<sup>50</sup> Speedy policy adjustment is possible by making people work together with the system through the democratic process, with qualified economists.

In the case of China, system transformation has faced obstacles in justifying its ideological shift, improving privatization and managerial efficiency, and struggling with corruption. Zeng Peiyan writes, "Building a socialist economy with Chinese characteristics means developing a market economy under socialism and constantly emancipating and developing productive forces....The party and the state have shifted the focus of their work from the practice of 'taking the class struggle as the key link' in the past to socialist modernization with economic construction as the core."<sup>51</sup> The party conservatives need excuses for transformation since they, who have enjoyed the old system of equality, are not used to the new system of efficiency.<sup>52</sup> China has set four goals for building its socialist economy through reform programs: to readjust its ownership structure, to improve its socialist market economy, to enhance its system of income distribution based on the ownership of productive means, and to liberalize its domestic market to the world. Thus Chinese policy pursues efficiency with equality.

The starting point of economic transformation in China is allowing property rights and privatizing state-owned enterprises by introducing the price system into the market. This generally invites three major problems: bankruptcies due to poor corporate management, unemployment due to efficiency improvements, and inflation from high growth and poor financial policies.<sup>53</sup> A survey suggests that the authorities should suspend production of unprofitable products, make calculations in light of real market conditions, and drop production plans that are not cost-effective.<sup>54</sup> Meanwhile, the unemployment rate in China has approached 20 percent in major cities such as Harbin and Shenyang. The government fears high unemployment may cause social instability. Fortunately, the authorities have been able to curb inflation, while *yuan* values have appreciated due to the fall of other currency values in Asia.<sup>55</sup>

Corruption has been a persistent problem in China.<sup>56</sup> Property in the socialist economies belongs to the state, and the political power sets privatization rules and distributes state-owned properties to qualified individuals. The phenomenon of corruption emerged along with private property and ownership, so China has initiated a radical cure for corruption, as follows:<sup>57</sup> First, China maintains an ideological guarantee opposing corruption and advocating integrity by enhancing party building and education in ideology and ethics. Second, China is providing better administration to remove the environment in which corruption flourishes, by formulating new regulations and institutions. Third, China has launched a comprehensive project of system engineering for effective supervisory mechanisms to oppose corruption and to advocate proper behavior. Since the initial political conditions were based on proletarian dictatorship and Marxist class struggle, political monopoly allowed corruption, as the second generation of bureaucrats were helped to acquire privatized corporations. The same set of conditions must be considered in transforming the North Korean economy.

Military confrontation in the Korean peninsula has remained unchanged for half a century despite paying the price of authoritarian political rules, economic burdens from national security costs, and an extreme dichotomy in societal values. Pyongyang has also paid the price of confrontation directly and indirectly — more than South Korea has, because of the fall of the Soviet Union and its satellites. In applying lessons from the reform of other economies, it is necessary to revisit the reasons why the North Korean economy has hopelessly fallen, similarly to the fall of communism.

The DPRK's problems are caused by the nature of the system.<sup>58</sup> The centrally planned economy, with projected consumption and production determined by the state, causes inefficiency by creating bottlenecks and idle capacities in industries. Marxist ideology does not allow for personal property rights, and a small interest group holds all political and economic power in the name of the proletariat. Position in the hierarchy of the proletarian dictatorship is rewarded as opposed to performance-based compensation for workers, which undermines motivation and reduces productivity. Heavy military spending from the dual economic system reduces investment in infrastructure and manufacturing facilities, raising overhead costs in the economy. Government censorship threatens communications, socialist brainwashing preempts creative ideas, and lack of education and training with research and development delays technological

advancement, reducing productivity. Its self-sanctioned autarkic economy makes it difficult for North Korea to exploit comparative advantages and to mobilize resources, thus limiting its production possibility frontier. North Korea misuses its resources by repressing its own people, particularly intellectuals and political dissidents, in order to prevent internal uprising. The rigidity and inflexibility of centralized power interrupt self-adjustment, which reduces efficiency and productivity. While China is expediting economic transformation towards a market economy, Pyongyang wastes its golden time in playing fruitless games. Ignoring the value of the moment, the DPRK leadership is losing opportunity and money.

Pyongyang faces a dilemma: openness threatens survival of its regime, but the economy cannot be revived without openness. The only choice for the regime's survival is in the strategy of "soft landing" and multidimensional, simultaneous, and gradual transformation of the system. To be multidimensional and simultaneous in change, all subsystems of North Korea, including its politics, security, economy, and society, should be developed at the same time, in a balanced manner. Gradual transformation means that reform starts partially in a specific region, such as the Rajin-Sunbong area, in a first step, and gradually expands to other locations, such as Wonsan on the east coast and Nampo on the west coast, thus minimizing shock waves from new freedoms. Eventually, after building confidence and immunity to external culture in the population, openness can be applied to the entire area of North Korea.<sup>59</sup>

Time is essential in economic development. Let us assume that Pyongyang wants to build a manufacturing plant for fertilizer in the suburban area of Wonsan. The first thing to be done is to build infrastructure, including power stations, water and sewerage lines, highways and byways, railways, seaports, airports, and communications facilities — which will take at least five to seven years. The second step is to build the manufacturing plant itself, including buildings and equipment, which will take at least three to five more years if there are no financial problems. The third step is to recruit and train employees and to assign jobs, including overseas marketing, accompanied by the opening of plant operations and sale of products to the world, taking three to five more years. Pyongyang thus would need at least ten years to normalize its new plant without constraints. There is no time to waste.

The real condition of the North Korean economy is rather serious. Interviews with North Korean refugees suggest that "over 25%

of population in many villages....have died, with the height of the crisis occurring in fall 1996....Even isolated instances of cannibalism are simply too widespread and too specific to be dismissed....A major humanitarian disaster has already occurred with tens of thousands of people already dead from starvation and starvation-related illness."<sup>60</sup> The central government has been losing political influence over provincial and local authorities due to lack of "grain power." The private market activities throughout the country are accepted, and the household responsibility system is selectively implemented. But no reforms have yet been observed.

North Korea has burdened China by demanding economic aid and producing a flow of refugees into the Chinese border provinces.<sup>61</sup> Meanwhile, South Korea has been a partner with China in the growth of mutual trade and investment. Despite the rhetoric of equidistance in its relationship with the two Koreas, China has begun to recognize that its economic interests in Seoul are more significant than its strategic interests in Pyongyang, and that a unified Korea is not a danger to China's security. As Sino-American relations improve, China's economic interests generally become more important than its strategic ones. So China may agree that the status quo is not sustainable on the Korean peninsula.<sup>62</sup> It is true that the ball in the North-South game is in the court of the Koreans; they themselves must determine their future peace and prosperity.

A Chinese study maintains that a "soft landing" is the most feasible strategy for achieving Korean unification.<sup>63</sup> First, the risk of destruction caused by war is unacceptable to both sides, and war does not correspond with the interests of the relevant parties when North and South both have serious economic problems. Second, China wants to strengthen its traditional friendship with the North while improving its economic relations with the South. The United States for its part does not want the casualties of war, nor does Japan desire a second Korean War threatening its national security. Finally, quadripartite talks will help find a way towards a rational settlement of the Korean peninsula issue in terms of relaxation of tensions, cooperation, and consultations as a gradual process. This view represents the reality as honestly judged by Chinese intellectuals.

The United States and South Korea pursue constructive engagement with North Korea, and the regional powers are supportive of peace and prosperity. The international community is becoming closer through market openness as barriers towards globalization are removed, and Pyongyang would be wise to lean with the wind. South

Korea wants to save military expenditures and apply them to economic recovery and repayment of external debts. Further suppression of the North Korean economy pushes the regime towards collapse, which Seoul does not want. Possible returns from negotiations are limited, and continuous demands for concessions from the North waste time without gains. If Pyongyang cannot develop constructive relations with the Kim Dae Jung government, another five more years will be necessary before North Korea can meet the next South Korean leadership — which may not be as friendly as Kim Dae Jung's.

Kim Dae Jung's engagement policy towards the DPRK includes three principles: no armed offensive from the North, no intention on the part of the South to harm or to absorb the North, and pursuit of conciliation and cooperation between North and South.<sup>64</sup> The theory is realistic and mutually beneficial; North Korea can transform its system without external risks while South Korea can minimize unification costs as a result of Northern self-regeneration. Both sides can save and divert resources from defense to economic purposes by signing a peace treaty with disarmament. Thus, it was not wise for the hardliners in the North to cause the recent submarine incident and armed infiltration of the South when the two sides are pursuing cooperation. If Kim Dae Jung loses patience, Pyongyang will become the loser, and its difficulties will be prolonged.

The lessons from the experiences of South Korean and Chinese reforms prove to be meaningful as North Korea faces difficulties of capital formation in its transformation. DPRK capital comes from external loans, foreign direct investment, foreign assistance, war compensation, cooperation with Seoul, disarmament, domestic savings, sales of state properties, and labor exports. Its resource allocation should coordinate the structural balance with South Korea, invest early in agriculture, substitute imports of labor-intensive products, provide sufficient infrastructure, and educate human resources.<sup>65</sup> If Pyongyang hesitates to transform its system with the Kim Dae Jung engagement policy due to its "absorption phobia" of the South, it may permanently lose the chance of recovery.<sup>66</sup> Now is the time for the two Koreas to engage each other in economic revival and peaceful reunification.

## **Conclusion**

In summary, we have viewed the role of state in the economy, survival of the EAM with reforms, and application of South Korean experiences to transforming North Korea. First, the EDPs were efficient in the early stage of development, when the economy was



small and inelastic. As the economy grew in scale and complexity, government intervention invariably caused market failures, and a corrupt political-economic complex led to government failures. Economic development facilitates democracy since it is essential for sustainable growth. In turn, democratic development promotes checks and balances in politics, minimizing corruption while enhancing competition in the economy by maximizing efficiency. Thus, the theory of balanced development between subsystems becomes persuasive while the effects of Asian values in the economy have been controversial. The direction of structural reform in South Korea points towards promotion of fair competition in the entire political, economic, and social system by removing the monopolistic power held by the old interest groups.<sup>67</sup>

Second, the current financial crisis is a stage in economic development, and the EAM is still valid and continuing to progress. Krugman argues that the EAM is driven not by productivity growth but by resource mobilization, a view we can reject since its contributing share of total factor productivity to growth proved to be over 33 percent during the period 1960 to 1989. The prospects for the South Korean economy are optimistic owing to a highly educated labor force, accumulated capital and technology, world-class management and marketing experiences, and mature leadership and democracy with a self-adjustment function. If the Kim Dae Jung leadership pursues speedy and aggressive reforms, the economy will start to recover by the year 2000. South Korean reforms require government intervention in restructuring, appropriate burden-sharing, equalized initial conditions, tight bank supervision, fair trade supervision, disarmament and resource conversion, and no leadership corruption.

Third, the experiences of South Korea reveal how North Korea can escape its economic vicious circle, while those of China can teach the DPRK how to transform its system towards openness by smoothing out "freedom waves." Since inter-Korean economic cooperation is fundamental for revival of the DPRK economy, Pyongyang may permanently lose the chance of recovery if it hesitates to make system changes due to "absorption phobia" of the South. Kim Dae Jung's engagement policy is realistic and mutually beneficial since the North can transform its system without external risks, the South can minimize unification costs by Northern self-regeneration, and both sides can save costs by diverting resources from military to economic purposes. It is necessary in supplying and allocating resources in North Korea to consider the likely industrial structure of a future unified Korea, to

invest in the agricultural sector first for self-sufficiency, to substitute imports of labor-intensive products, to provide sufficient infrastructure for inexpensive overhead costs, and to educate and train human resources.

This study concludes with three policy recommendations: first for the South, second for the North, and the last for the international community.

***Recommendations to Seoul:*** South Korea is now in the third stage of political and economic development and is approaching the Western standard of democracy and market economy. The Kim Dae Jung leadership was successful in managing the current financial crisis in its early stages, but the people have begun to question the president's capability and intentions regarding structural reforms. President Kim must maintain speedy and aggressive driving forces in a consistent direction to recover fair competition within the system. In rooting out corruption, the government must honestly investigate campaign finance and political contribution scandals related to corrupt politicians and businessmen who have violated the law. Bringing wrongdoers to justice is a starting point for making the system fair. The South Korean people should not confuse nationalism with patriotism. In domestic capital formation, it is better for South Korea to sell ownership to foreign investors than to borrow funds from foreign banks when domestic firms are weak in financial creditability and technological competitiveness. The kind of nationalism that rejects foreign investment is not truly patriotic since it hurts the Korean economy in the age of globalization.

***Recommendation to Pyongyang:*** The North Korean leadership pursues survival of its regime through economic recovery. As long as the *Juche* regime holds onto its old principles, the DPRK economy will not fully recover its strength. Pyongyang must shift its ideological orientation, as did China, from the equality sought through Marxist class struggle towards the efficiency of classless competition by removing the monopolistic power of the proletarian dictatorship system. The dual economic system separating the military from the economy hurts integrated policy formulation. The independent military sector expedites arms buildup and reduces investment in infrastructure and capacity generation, jeopardizing productivity growth. Both a peace treaty and a disarmament agreement between the two Koreas is urgently needed so that resources may be diverted from military to commercial purposes. Inter-Korean economic cooperation is essential

for the recovery of the North. The South is undoubtedly the most potentially helpful partner for the North in the world. The DPRK must recognize that economic interests in the post-cold war period have become more important than political-military interests due to the absence of external threats.

***Recommendation to the international community.*** Other nations should help the two Koreas to pursue balanced development of democracy along with their economies. Constructive engagement between the United States and China became visible after President Clinton's China visit in late June 1998. Since both powers want peace and stability in the region, they should cooperate to build a peaceful, reunified Korea. Particularly China should make greater efforts to construct a peaceful relationship between Seoul and Pyongyang, since a unified Korea is more beneficial to China than a divided one. Politically, China has been successful in transforming its system, so the "freedom waves" from Korean reunification would not be a threat. Economically, China's capital market is mature enough to absorb foreign capital, and a shift of South Korean capital from China to North Korea would not present a problem. China's trade with a unified Korea would be much greater than at present with North and South. Strategically, the DPRK's buffer role for China has gradually faded out since Washington has begun to engage Beijing. Seoul has been approaching Beijing for mutual security cooperation, while Pyongyang has created problems threatening regional security in various ways. Culturally, Koreans share more similarities with the Chinese than with people in any other Asian country. It should be persuasive to China that a unified Korea would satisfy more Chinese interests than a divided Korea does.

## **Notes**

A draft of this paper was presented to the Eighth International Economic Convention held at Korea University in Seoul on August 18 and 19, 1998, sponsored by the Korea Economic Association. For more information see the author's home page at <http://www.ewri.org/drkim.html>.

1. Koh Young Jae, "Sunshine: Kim Dae Jung's Dilemma," *Internet Hankyoreh*, July 14, 1998.
2. Some reflections of the "old habits" that may be observed are as follows: (a) The Kim Dae Jung administration placed the Commission on Bank Supervision under the control of the Office of the Prime Minister, though it should have been under the control of the Bank of Korea to keep political neutrality, (b) The National Assembly stopped the adoption of the Real Name System in financial transactions mainly to allow the continued flow of hidden funds. The president's party collaborated, though it was criticized since the use of parties' real names in financial dealings would help to provide transparency of campaign funding, (c) Kim Dae Jung's party allows *chaebols* to own their own banks, a practice which was restricted in previous administrations. See "The Ruling Party Allows Bank Ownership to Chaebols," *Joongang Ilbo Internet*, June 8, 1998. (d) The five top *chaebols* absorbed over 76 percent of the total amount of corporate bond sales during the first five months of 1998, another type of corporate debt that should be reduced. See Yoo Seung Ho, "Big Five Alone Ate All Funds, 27 Trillion Won by Selling Bonds," *Hankook Ilbo from Korea Link*, June 25, 1998.
3. President Kim Dae Jung emphasized that balanced development of politics with economics is necessary in order to avoid the political-economic complex. See his speech delivered to Korean-American invited guests at the Korean ambassador's residence, Washington, D.C., June 9, 1998.
4. For further reference, see WheeGook Kim, *Evolution of Democracy and Economic Development: A Case of Korea* (Washington: East-West Research Institute, February 1998), pp. 15-20. The paper was originally presented to the Philadelphia Symposium, "Korea's Challenges Ahead," held at the University of Pennsylvania on February 13, 1998.
5. WheeGook Kim, *The South Korean Economy and the Chaebols* (Washington: East-West Research Institute, May 1998), pp. 3-8. This paper was presented at the 1998 Annual Conference held at Adams Mark Hotel, Columbia, South Carolina, May 15-17, 1998, sponsored by the University of South Carolina.
6. World Bank, *World Development Report 1997: The State in a Changing World* (New York: Oxford University Press, 1998), p. 27. Governments provide public goods for infrastructure, defense, law and order, education, public health, anti-poverty programs, disaster relief, and so on, as measures largely aimed at achieving equality.
7. Amartya Sen, Nicholas Stern, and Joseph Stiglitz, "Roundtable Discussion, Development Strategies: The Roles of the State and the Private Sector," *Annual Conference on Development Economics 1990* (Washington: World Bank, 1991), pp. 421-35
8. The exceptional cases can be seen in government investment for production capacity generation
9. Arthur M. Okun, *Equality and Efficiency: The Big Tradeoff* (Washington: Brookings Institution, 1975), p. 120. "In that sense, capitalism and democracy are really a most improbable mixture. Maybe that is why they need each other — to put more rationality into equality and some humanity into efficiency."
10. See Anne O. Krueger, "Government Failures in Development," *Journal of Economic Perspectives* 4, 3 (Summer 1990), pp. 9-23; and Vito Tanzi and Hamid Davoodi, *Roads to Nowhere: How Corruption in Public Investment Hurts Growth*

(Washington: World Bank, 1998). Lack of infrastructure investment is a case of government failure.

11. Adam Przeworski et al., *Sustainable Democracy* (New York: Cambridge University Press, 1995), p. 40. The author quotes Frederick C. Lane, *Profits from Power: Readings in Protection Rent and Violence Controlling Enterprises* (Albany, NY: State University of New York Press, 1979).

12. WheeGook Kim, "Check and Balance: Watching Revival of Local Elections in South Korea," *Hankook Ilbo* (Washington), April 14-17, 1995. A three-day series of articles.

13. Larry E. Westphal, "Industrial Policy in an Export-Propelled Economy: Lessons from South Korea's Experience," *Journal of Economic Perspectives* 4, 3 (Summer 1990), pp. 41-59; and Mrinal Datta-Chaudhuri, "Market Failure and Government Failure," *ibid.*, pp. 25-39. Both authors viewed the results of state intervention as positive. Corruption effects were hidden under the surface at that time.

14. Kevin Sullivan, "Thousands of Strikers Demonstrate in Seoul: Workers Protest New Labor Legislation," *Washington Post*, December 12, 1996, p. A14; and WheeGook Kim, "A Big Shake of Labor Laws in South Korea," *Hankook Ilbo* (Washington), January 4, 1997, p. 3. Unemployment measures have not been seriously considered.

15. Adam Przeworski and Fernando Limongi, "Political Regimes and Economic Growth," *Journal of Economic Perspectives* 7, 3 (Summer 1993), pp. 51-69; Jacob De Hann and Clemens Siemann, "Political Instability, Freedom, and Development," *Economic Development and Cultural Change* 44, 2 (January 1996), pp. 339-50; and Michael A. Nelson and Ram D. Singh, "Democracy, Economic Freedom, Fiscal Policy, and Growth in LDCs: A Fresh Look," *Economic Development and Cultural Change* 46, 4 (July 1998), pp. 677-96.

16. Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (London: Routledge, 1992), p. 284. For the source of inefficiency under socialism, see Friedrich Hayek, *Knowledge, Evolution, and Society* (London: Buttler and Tanner, 1983). For Asian cases, see Robert A. Scalapino, *The Politics of Development: Perspectives on Twentieth Century Asia* (Cambridge, MA: Harvard University Press, 1989), and S. P. Huntington and J. M. Nelson, *No Easy Choice: Political Participation in Developing Countries* (Cambridge, MA: Harvard University Press, 1976).

17. Huntington and Nelson, *No Easy Choice*, pp. 289-96. For democratic method in Korea, see Jongryn Mo and Chung-in Moon, "Democracy and ROK Economic Crisis," *NAPSnet Forum Online* (Berkeley, CA: Nautilus Institute, March 18, 1998), discussed by WheeGook Kim and others on March 24, 1998, <http://www.nautilus.org/napsnet/fora/index.html>

18. Peter L. Berger, "The Uncertain Triumph of Democratic Capitalism," in Larry Diamond and Marc F. Plattner, eds., *Capitalism, Socialism, and Democracy Revisited* (Baltimore: Johns Hopkins University Press, 1993), pp. 1-10.

19. Minxin Pei, "The Puzzle of East Asian Exceptionalism," in Larry Diamond and Marc F. Plattner, eds., *Economic Reform and Democratization* (Baltimore: Johns Hopkins University Press, 1995), pp. 112-25.

20. Andres Aslund, "The Case for Radical Reform," in *ibid.*, pp. 74-85.

21. Joan M. Nelson, "Linkages between Politics and Economics," in Diamond and Plattner, eds., *Economic Reform and Democratization*, pp. 45-58, and Jusup Wanandi, "East Asian Domestic Policy and International Stability after the Currency Crisis," paper presented at the 1998 "Pacific Symposium on the Asian Financial Crisis: Security Risks and Opportunities," held at the U.S. National Defense University, Washington, D.C., May 5-6, 1998.
22. WheeGook Kim, "The Impact of Sino-American Relations on Korean Unification," *Journal of East Asian Affairs* 11, 1 (Winter/Spring 1997), p. 21. Further, see Paul Kennedy, *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000* (New York: Vintage Books, 1989), and William H. Overholt, *The Rise of China: How Economic Reform Is Creating a New Superpower* (New York: W. W. Norton, 1993).
23. Francis Fukuyama, "Capitalism and Democracy: The Missing Link," in Diamond and Plattner, eds., *Capitalism, Socialism, and Democracy Revisited*, pp. 94-104.
24. Adam Przeworski, "The Neoliberal Fallacy," in *ibid.*, pp. 39-53.
25. [The transition economy, as in China, has faced a similar conflict between political conservatism and economic liberalism. In line with this, the DPRK has hesitated to open its economy due to conflicts between the different interests of politics and economy. The engagement policy of the Kim Dae Jung administration has tried to win compromises in the differences by separating economics from politics despite transitional challenges from internal and external adversaries. The human rights movement in developing countries is considered as a similar process of democratization.
26. Economic Planning Board, *The Fifth Five-Year Economic and Social Development Plan 1982-1986* (Seoul: Government of the Republic of Korea, 1982), p. 10.
27. Pam Woodal, "Survey East Asian Economies," *Economist*, March 7-13, 1998, p. 12. In the survey, the sources of the Asian crisis include the virtues of high investment, small government, good government, flexibility, long-term relationships, and education.
28. WheeGook Kim and Moosug Chang, *Mobilization and Industrial Potential for War: A Case Study of Republic of Korea* (Seoul: Korea National Defense University Press, 1987), p. 92. The government took over bankrupt firms using tax money and sold those businesses to third parties at low prices.
29. World Bank, *World Bank Development Report 1997*, pp. 99-109.
30. Pranab Bardhan, "Corruption and Development: A Review of Issues," *Journal of Economic Literature* 30, 3 (September 1997), pp. 1320 - 46, quoted in Francis T. Lui, "An Equilibrium Queuing Model of Bribery," *Journal of Political Economy* 93, 4 (August 1985), pp. 760-81.
31. "175 Assembly Members Signed Anti-Corruption Law," *Digital Chosun Ilbo*, August 4, 1998.
32. Susan Rose-Ackerman, "Corruption and Development," in Boris Peskovic and Joseph E. Stiglitz, eds., *Annual World Bank Conference on Development Economics 1997* (Washington: World Bank, April 1998), pp. 35-57. Laws and programs breeding corruption rather than promoting competition must be eliminated, but deregulation and privatization should be carried out with care not to worsen the existing problems. See

Michael Johnson, "What Can Be Done about Entrenched Corruption?" in the same volume, p. 82.

33. Paul W. Kuznets, "An East Asian Model of Economic Development: Japan, Taiwan, and South Korea," *Economic Development and Cultural Change* 36, 3 (April 1988), pp. SI 1-S43. For further information, see World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York: Oxford University Press, 1993).

34. On the subject of Asian values, see Fareed Zakaria, "A Conversation with Lee Kuan Yew," *Foreign Affairs* 73, 2 (March/April 1994), pp. 109-26; Kim Dae Jung, "Is Culture Destiny? The Myth of Asia's Anti-Democratic Values," *Foreign Affairs* 73, 6 (November/December 1994), pp. 189-94; "Asian Values Revisited," *Economist*, July 25-31, 1998, pp. 23-28, which observes, "The attachment to the family becomes nepotism. The importance of personal relationships rather than formal legality becomes cronyism. Consensus becomes wheel-greasing and corrupt politics. Conservatism and respect for authority become rigidity and an inability to innovate. Much-vaunted educational achievements become rote-learning and a refusal to question those in authority."

35. Herbert Giersch, ed., *Towards an Explanation of Economic Growth* (Tubingen: Institut für Weltwirtschaft an der Universität Kiel, 1981), and Jose Edgardo Campos and Hilton L. Root, *The Key to the Asian Miracle: Making Shared Growth Credible* (Washington: Brookings Institution, 1996).

36. Dale W. Jorgenson, "Productivity and Postwar U.S. Economic Growth," in Dale W. Jorgenson, ed., *Productivity*, vol. 1, *Postwar U.S. Economic Growth* (Cambridge, MA: MIT Press, 1996), pp. 1-23; Dale W. Jorgenson and Zvi Griliches, "The Explanation of Productivity Change," in the same volume, pp. 53, 85; Robert M. Solow, "A Contribution to the Theory of Economic Growth," *Quarterly Journal of Economics*, February 1956, pp. 65-94; Edward F. Denison, *Trends in American Economic Growth, 1929-1982* (Washington: Brookings Institution, 1985), pp. 28-30. Further see William J. Baumol, Richard R. Nelson, and Edward N. Wolf, eds., *Convergence of Productivity: Cross-national Studies and Historical Evidence* (New York: Oxford University Press, 1994); and John Middleton, Adrian Ziderman, and Arvil Van Adams, eds., *Skills for Productivity: Vocational Education and Training in Developing Countries* (New York: Oxford University Press, 1993)

37. Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, 6 (November/December 1994), pp. 62-78. Others have different views. See Steven Radelet and Jeffrey Sachs, "Asia's Reemergence," *Foreign Affairs* 76, 6 (November/December 1997), pp. 44-59. Asian corruption is equivalent to a tax of 20 percent or more on foreign firms, according to Shang-Jin Wei, "How Taxing Is Corruption on International Investors?," National Bureau of Economic Research Working Paper No. 6030 (Cambridge, MA: National Bureau of Economic Research, 1997), quoted by Radelet and Sachs.

38. World Bank, *East Asian Miracle*, p. 58. Also see "The Asian Miracle: Is It Over?," *Economist*, March 1-7, 1997, pp. 23-25. Paul Krugman used Alwyn Young's estimates for 118 countries over 1970, which proved to be incorrect.

39. WheeGook Kim, *An Alternative Growth Strategies of North Korea: Lessons from Experiences of South Korea and Taiwan* (Washington: East-West Research Institute, January 1996), p. 28. This paper was presented to the 1996 Annual Conference of Allied Social Science Associations held in San Francisco, January 5-7, 1996.

40. Since 1961, authoritarian regimes in Korea have laced difficulties due to their lack of legitimacy and political consensus. Political operations exhausted funds collected from *chaebols* expecting corresponding favors. Since the judicial system was controlled by politics, social justice was seriously damaged. The weakness of checks and balances caused corruption in personnel and financial affairs in every part of the society and provided special benefits to interest groups, deepening income inequality between rural and urban, east and west, owners and workers, and favored and disfavored. The flow of information was monopolized and controlled by the authorities to avoid fueling antigovernment movements. The intelligence agencies and national police used huge amounts of funds to collect information needed to dry up student protest turmoil and to destroy the organized activities of opposition parties and human rights groups. The planned economy lost efficiency in resource allocation due to centralized decisionmaking. Political instability and government inefficiency discouraged savings and foreign investment. The tenure system in university faculties was used by the government in order to coerce loyalty or at least silence from intellectuals in academic circles. The authorities arranged duties of the officer corps of the armed forces so they would not have free time to read or think, in order to avoid military uprisings against the regime. For further reference, see "South Korea: A New Society," *Economist*, April 15-21, 1989, pp. 23-26.

41. Economic Planning Board, "The Korean Economy at the Turning Point," *Fifth Five-Year Economic and Social Development Plan*, p. 10. The South Korean government recognized that its intervention through economic plans caused serious problems in the period of the Fourth Five-Year Economic Development Plan (1977—1981), in terms of high inflation, inefficiency, and inequality.

42. WheeGook Kim, "Problems and Remedies of the North Korean Economy: A Strategic Approach," *Korea Journal of Defense Analysis* 8, 2 (Winter 1996), pp. 223-68; Kim, *The Impact of Regional and Global Developments* (Washington: East-West Research Institute, September 1996), pp. 20—21; and Kim, "Openness, Coexistence, and Peaceful Unification," *Hankook Ilbo* (Washington), August 8, 1994, the third in a six-day series of articles.

43. The third stage is set to end in 2015, based on an eighteen-year political cycle as seen in the previous periods. The extension does not necessarily mean the EAM will be successful. Whang In-Joung, *Economic Transformation of Korea 1945-1995: Issues and Responses* (Seoul: Sejong Institute, 1997), pp. 9-40. This author divides the period into three segments, including the nation-building stage (1945-1961) but excluding the period after 1995.

44. The reasons why *chaebols* should not own banks are as follows: (a) *Chaebols* may use the banking system for their own interests rather than for general public good. *Chaebols* should not own infrastructure, financial institutions, or media, for the same reason, (b) The debt-equity ratio of the top thirty *chaebols* was 518.9 percent by the end of 1997. They should reduce the ratio to below 200 percent by selling existing bank stocks to keep their main industries, (c) The concept of a leading bank insisted upon by the owners of Daewoo is no more than that of a banking monopoly. *Chaebols* have tried to stimulate nationalism as a tactic in order to gain bank ownership, but the existence of at least a couple of foreign banks in Korea is beneficial for consumers, to improve competition, (d) Since the funds for bank restructuring come from taxes, bank ownership should be transferred to the people, not to *chaebols*, which would raise savings and improve income distribution, (e) *Chaebols'* participation in the banking



business would help to revive the old corruption coming from the political-economic complex.

45. The *chaebol* reforms have been often interrupted by politics due to campaign fundraising for approaching elections, as seen in June and July 1998 under Kim Dae Jung's leadership. The next election for the National Assembly, in the year 2000, may cause the same effects. If the Kim Dae Jung administration fails in reforms by that time, the driving force towards reforms will be greatly reduced, and the regime may fail to make the needed changes. In this case, the survival of the EAM will be hopeless. See Morton I. Abramowitz and James T. Laney, "The Costs of Unification," in *Managing Change on the Korean Peninsula: Task Force Report* (Washington: Council on Foreign Relations, 1998), p. 41.

46. Daryl M. Plunk, "A Silver Lining in Korea's Crisis: New Pledges Signal Hope for Economic Recovery and Peaceful Reunification," *F. Y.I. No. 169* (Washington: Heritage Foundation, January 15, 1998), and Selig Harrison, "Dual Effects of Disarmament," *Internet Hankyoreh*, January 14, 1998.

47. Kim Sung Woo, "An Essay: Evolution of Democracy and Economic Development," *Hankook Ilbo from Korea Link*, January 9, 1998.

48. Lee Jong Soo, "An Interview with Dr. Guy Surmont, a French Critic: The Korean Crisis Is a Development Process," *Hankook Ilbo from Korea Link*, January 21, 1998.

49. The duration is based on the initial political-economic conditions of South Korea in 1962.

50. Ching-yuan Lin, "East Asia and Latin America as Contrasting Models," *Economic Development and Cultural Change* 36, 3 (Supplement, April 1988), p. SI 56. "What set the experiences of Taiwan and South Korea apart from those of Chile and Argentina, therefore, were not the initial conditions and the incentive systems, which were largely similar, but the subsequent policy reforms, which were successful in Taiwan and South Korea, but not [in Chile and Argentina]."

51. Zeng Peiyan, "Develop Socialist Economy with Chinese Characteristics," *Beijing Qishi*, October 16, 1997, No. 20, pp. 2-6, in *World News Connection*, February 23, 1998, FBIS-CHI-98-030; and Wei Shi, "Social Justice plus Market Economy," *Beijing Zhenli De Zhuiqiu*, February 4, 1998, in *World News Connection*, February 6, 1998, FBIS-CHI-98-035.

52. On November 7, 1997, in New York, the author interviewed Dr. Dyu In Yu, an immigrant from Moscow to New York. He indicated that his most difficult problem after immigration was competition for survival in the free market, which it had not been used to previously.

53. Chi Feng, "China Finalizes Economic Principles for 1998," *Hong Kong Kuang Chiao Ching*, February 4, 1998, in *World News Connection*, February 6, 1998, FBIS-CHI-98-035.

54. Shi Xiaohong, "Strengthen Enterprise Management, Increase Competitive Power," *Beijing Jingji Guanli*, June 5, 1996, in *World News Connection*, November 1, 1996, FBIS-CHI-96-212. For the case of Poland, see Jeffrey Sachs, *Poland's Jump to the Market Economy* (Cambridge, MA; MIT Press, 1993).

55. Erik Eckholm, "On the Road to Capitalism, China Hits a Nasty Curve: Jobless," *New York Times on the Web*, January 20, 1998. "Most of the state industries haven't yet laid off the workers they should, so the problem is still being hidden. ... In the rural areas where a majority of China's 1.2 billion people still live, 130 million workers are already surplus, neither needed for farming nor employed by rural industries." See also, Chen Yen, "Poll Shows Inflation Problem No Longer Sensitive; Unemployment Issue Becomes Focus of Popular Attention," *Hong Kong Ming Pao*, February 2, 1998, in *World News Connection*, February 8, 1998, FBIS-CHI-98-033.
56. Ye Tan, "Zhu Ronghi Openly Said: 'Leave No Route of Retreat,'" *Hong Kong Ming Pao*, July 7, 1998, in *World News Connection*, July 8, 1998, FBIS-CHI-98-188; "Nationwide Anticorruption Campaign Begins," *Beijing Xinhua*, July 8, 1998, in *World News Connection*, July 9, 1998, FBIS-CHI-98-189; and editorial, "Launch a Large-Scaled Struggle against Smuggling," *Beijing Xinhua Domestic Service*, July 15, 1998, in *World News Connection*, July 16, 1998, FBIS-CHI-98-196.
57. Ruan Chongwu, "Perfecting Mechanisms, Opposing Corruption, Advocating Honesty and Cleanness," *Beijing Renmin Ribao*, May 16, 1996, in *World News Connection*, June 20, 1996, FBIS-CHI-96-120. Zheng Hongfan and Cui Shixin, "The Test of Time — Account on the Building of Clean and Honest Party Style in the New Period," *Beijing Renmin Ribao*, June 27, 1996, in *World News Connection*, August 8, 1996, FBIS-CHI-96-153.
58. WheeGook Kim, "Problems and Remedies of the North Korean Economy," pp. 234-40. Also see *Northeast Asia Peace and Security Network Daily Report*, July 12, 1996, for discussions by the present author.
59. This is the Chinese model, which is in line with Kim Dae Jung's engagement policy.
60. United States Institute for Peace, *Special Report: North Korea's Decline and China's Strategic Dilemmas* (Washington: U.S. Institute for Peace, October 1997), p. 2. See further, Chen Jian, "Conclusion: Living Peacefully with China in the 21<sup>st</sup> Century," *The China Challenge in the Twenty-First Century: Implications for U.S. Foreign Policy*, Peaceworks No. 21 (Washington: U.S. Institute for Peace, 1998), p. 24.
61. "The Grain Dependency of North Korea to China Rose Largely," *Digital Chosun Ilbo*, March 2, 1998. North Korea imported 1.135 million tons of grain (value of \$194 million), including corn, wheat, and rice from China in 1997 — over twice the 1996 imports from the same country, 0.497 million tons.
62. Robert Scalapino, "An Interview: Two Korea Relations, Advancement or Stalemate," *Hankook Ilbo from Korea Link*, January 30, 1998. Scalapino believes that China will not give up its interests in North Korea. However, we can imagine the time when economic interests will become more important than strategic interests between the United States and China.
63. Su Suiyou and Liu Yusheng, "An Analytical Report on the 1997-1998 International Situation," *Beijing Zhongguo Xinwen She*, January 26, 1998, in *World News Connection*, January 29, 1998, FBIS-CHI-98-026.
64. "Inaugural Address of 15<sup>th</sup> President," *Digital Chosun Ilbo*, February 25, 1998.
65. WheeGook Kim, "Problems and Remedies of North Korean Economy," p. 249.

66. United States Institute for Peace, *Special Report: Challenges of Building a Korean Peace Process* (Washington: U.S. Institute for Peace, June 1998).

67. WheeGook Kim, "The Initial Conditions in Competition," *Professors Newspaper*, July 13, 1998, p. 3.