# Political institutions and economic performance: the government-business relationship in Japan, South Korea, and Taiwan Chalmers Johnson

The facts are not in serious dispute, even if their explanation and interpretation are among the most controversial issues in the field of comparative political economy today. In 1950, measured in 1974 U.S. dollars, South Korea had a per capita income of $146; equivalent figures were $150 for Nigeria, $129 for Kenya, and $203 for Egypt. Taiwan was then slightly ahead of Korea at $224 but lagged far behind Brazil at $373, let alone Mexico at $562 or Argentina at $907. Thirty years later the per capita GNP of the Republic of Korea (ROK) had risen to $1,553; Nigeria's was $670 (even with oil), Kenya's $380, and Egypt's $480. In 1980 the per capita income of the Republic of China (ROC) was $2,720; Brazil's was $1,780, Mexico's $1,640, and Argentina's $2,230.[1] To take only the two decades of high-speed growth in Korea (1962–80), GNP (expressed in 1980 prices) increased 452 percent, from $12.7 billion to $57.4 billion, achieving an average growth rate of 8.5 percent per year.[2] With regard to Taiwan, during 1983 the London *Economist* noted ruefully: "The 130 million Brazilians export only about as much as the 18 million people of Taiwan, and (outside oil) the 75 million Mexicans—though they sit on America's doorstep—export only a quarter as much as the Taiwanese."[3] And Taiwan and Korea were only the fourth and fifth richest countries in East Asia; the leaders were Japan, with a 1980 per capita GNP of $8,870, Hong Kong with $4,432, and Singapore with $4,298.[4]

Such figures are commonplaces of contemporary Asian economic journalism. The hidden issues behind them are the roles the governments of South Korea and Taiwan played in contributing to their economies' extraordinary growth rates and the relevance of these recent economic "miracles"

1. G. L. Hicks and S. G. Redding, "Industrial East Asia and the Post-Confucian Hypothesis: A Challenge to Economics" (University of Hong Kong, December 1982), pp. 3–4.
2. Citibank, *Executive Guide: Korea* (Seoul, 1982), p. 7.
3. *The Economist*, April 30, 1983, p. 7.
4. Keizai Koho Center, *Japan 1982: An International Comparison* (Tokyo, 1982), pp. 6, 8.



to the earlier and widely acknowledged one achieved by Japan. But why should the issue of governmental activities come up at all? There are several reasons, each of them highly controversial and even ideological. One is what might be called "Taira's enigma." Writing in 1982, Professor Taira Koji observed: "Japan's modern economic growth is believed to have begun in the late 1880s, curiously coinciding with the preparation and promulgation of the Meiji Constitution which defined the character of the Japanese state. . . . The combination of an absolutist state with a capitalist economy from 1889 to 1947 has been an enigma, far from fully unraveled, among scholars interested in Japanese economic history."[5]

Since 1947, despite its adoption of a formally democratic constitution and the subsequent development of a genuinely open political culture, Japan seems to have retained many "soft authoritarian" features in its governmental institutions: an extremely strong and comparatively unsupervised state administration, single-party rule for more than three decades, and a set of economic priorities that seems unattainable under true political pluralism during such a long period.[6] Because the post-1947 period also witnessed even greater rates of Japanese economic growth, it has seemed to some that the coincidence of soft authoritarianism in politics and capitalism in economics had something to do with economic performance.

Japan's achievement of the status of the second most productive economy that ever existed is no longer simply an enigma; it is a challenge to the main political and economic doctrines that currently dominate global thinking about human social organization. Japan's performance challenges the Leninist command economies because it calls into question their theory that capitalism leads to class antagonisms and political instability, and it also suggests that their resort to explicit absolutism without capitalism is misplaced and doomed to failure. Japan's performance also challenges the Anglo-American "free enterprise" economies because it calls into question their theory that governmental intervention in the economy is inevitably inefficient and distorting, and it also suggests that their faith in the market mechanism without explicit political direction is misplaced.

Needless to say, these implications of the Japanese challenge are nowhere fully accepted and are only recently even being debated in either the Communist or the English-speaking capitalist worlds. Most foreign observers, whether Communist or Western capitalist, seem to prefer theories of Japan's economic achievements that deflect attention from the connection between soft authoritarian politics and capitalist economics; and the Japanese themselves, for their own good and sufficient reasons, are among the leading

5. Koji Taira, "Japan's Modern Economic Growth: Capitalist Development under Absolutism," in Harry Wray and Hilary Conroy, eds., *Japan Examined: Perspectives on Modern Japanese History* (Honolulu: University of Hawaii Press, 1983), p. 34.
6. See Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford: Stanford University Press, 1982).

creators and purveyors of such conceptual alternatives to a political theory of their achievements. The most common theme in the alternative view is that Japan's economic achievements are to be explained by Japan's unique culture, often traced back to sociological changes during the Kamakura military government of the 13th century or even earlier. Of course, if that were true then the culture is also responsible for the two-and-a-half centuries of *sakoku* (closed country) during the Tokugawa era, for the militarism and imperialism of the 1930s, and for the defeat of 1945. But no matter. The cases of the ROK and the ROC inevitably draw the analyst's attention back to the political nexus.

If postwar Japan has arguably displayed a degree of soft authoritarianism in its political system, and if this has had something to do with its economic performance, then Korea and Taiwan are "hard states" (in the words of Leroy Jones and Il SaKong) and in economic affairs, "Government, at least in Korea, is the senior partner."[7] These new cases of absolutist states and capitalist economics suggest that there may indeed be a Japanese "model" that the Koreans and Taiwanese have been refining and perfecting. In fact, the study of the new cases may reveal to us what is intrinsic and what is superficial in the older, Japanese example, particularly because the Japanese always prefer to stress the superficial in their own case, shielding the intrinsic from foreign gaze. Thus, for example, it may turn out that the real Japanese contribution lies in the method of operating the soft authoritarian side of the capitalist developmental state—the Japanese have been much more effective on this score than either the Koreans or the Taiwanese—whereas Japan's "unique" labor relations and innovative managerial techniques, staples of Western journalism on the Japanese economy, may actually be insignificant and even counterproductive because they are missing from Korea and Taiwan with no noticeable effect on economic performance.

Writing for the World Bank, Parvez Hasan notes "the apparent paradox that the Korean economy depends in large measure on private enterprise operating under highly centralized government guidance. In Korea the government's role is considerably more direct than that of merely setting the broad rules of the game and influencing the economy indirectly through market forces. In fact, the government seems to be a participant and often the determing influence in nearly all business decisions."[8] Hasan suggests that part of the solution to this paradox is the existence of mass nationalism in Korea and a widespread public-private agreement on economic goals,

7. Leroy P. Jones and Il SaKong, *Government, Business, and Entrepreneurship in Economic Development: The Korean Case* (Cambridge, Mass.: Council on East Asian Studies, Harvard University, 1980), pp. 132ff; and Edward S. Mason, Mahn Je Kim, Dwight H. Perkins, Kwang Suk Kim, and David C. Cole, *The Economic and Social Modernization of the Republic of Korea* (Cambridge, Mass.: Harvard University Press, 1980), p. 255.

8. Parvez Hasan, *Korea: Problems and Issues in a Rapidly Growing Economy* (Baltimore: Johns Hopkins University Press, 1976), p. 29.



thus eclipsing the class or pluralist pressures on governments that are commonly encountered in less mobilized societies. I agree, and I also believe that the issue of the national mobilization of a united people for economic goals is an important challenge to economic theories based on class analysis, which have proved to be particularly sterile in postwar East Asia when used as a guide to policy formulation (notably in mainland China). But what is the "apparent paradox" that Hasan sees in an intrusive government and high-speed economic growth?

Here we encounter the first serious challenge to the authoritarianism-capitalism nexus—namely, the thought that although the high-growth Asian economies are strongly influenced by their governents, their successes are to be explained not because of this influence but in spite of it. The poorly informed simply ignore the role of government in the capitalist developmental cases. Thus, for example, Milton and Rose Friedman: "Malaysia, Singapore, Korea, Taiwan, Hong Kong, and Japan—all relying extensively on private markets—are thriving. . . . By contrast, India, Indonesia, and Communist China, all relying heavily on central planning, have experienced economic stagnation."[9] That is all very well, but it ignores President Park Chung Hee's intent to attain economic self-sufficiency for Korea through the "establishment of a planned economy," Taiwan's repeated justification of its policies in terms of Sun Yat-sen's semisocialist principle of "people's livelihood," and Singapore's single-party "socialism that works."[10]

The tendency (or the desire) to downplay the role of government has been most pronounced in the Japanese case, particularly after the onset of so-called economic liberalization in the late 1970s.[11] In Japan today it is commonly argued that, even if the government once performed important roles in the economy, it no longer does so (thereby dichotomizing the issue of governmental intervention instead of stressing the government's changing role in light of new economic challenges). Many wish passionately to argue that Japanese entrepreneurship always was more important to economic growth than any policies or practices of the government. The *Economist's*

9. Milton and Rose Friedman, *Free to Choose* (New York: Harcourt Brace Jovanovich, 1980), p. 57.

10. Park Chung Hee, *People's Path to the Fulfillment of Revolutionary Tasks* (Seoul: ROK Ministry of Public Information [c. 1962]), quoted by John P. Lovell, "The Military and Politics in Postwar Korea," in Edward R. Wright, ed., *Korean Politics in Transition* (Seattle: University of Washington Press, 1975), p. 177. On Taiwan see Tillman Durdin, "Chiang Ching-kuo's Taiwan," *Pacific Community* (October 1975), pp. 92–117. Durdin's is the best available source on Chiang Ching-kuo's twelve years spent in the USSR, a subject taboo in the Taiwanese press. On Singapore, and on the American tendency generally to interpret Southeast Asian economic growth in American terms, see Donald K. Emmerson, "Pacific Optimism, Part I: America after Vietnam: Confidence Regained," and "Part II: Explaining Economic Growth: How Magic Is the Marketplace?" *UFSI Reports*, nos. 4 and 5 (1982).

11. On Japanese economic liberalization and the extent to which it has been carried out see Chalmers Johnson, "The 'Internationalization' of the Japanese Economy," *California Management Review* 25 (Spring 1983), pp. 5–26.

survey of Japan for 1983 is typical: "Foreign competitors exaggerate the importance of MITI [Ministry of International Trade and Industry] in shaping Japan's industrial future. . . . Japan's major manufacturers are laws largely unto themselves—especially when it comes to investment. . . . It is this, rather than any carefully aimed 'industrial targeting' policy on MITI's part, that has been largely responsible for the surge in Japanese exports that has been sweeping across America and Europe lately."[12] Ever since the catchphrase "Japan, Inc." was invented to refer to the Japanese government-business relationship, writers on the subject have found it *de rigueur* to misinterpret it to mean Japanese government domination of the economy and then to demolish it. But Taira's enigma, with regard to Japan or the role of government in Korea and Taiwan, does not imply domination; it refers explicitly to the *coexistence* of authoritarianism and capitalism—and that must be explained.

For the sake of discussion, the logic of the capitalist developmental state can best be understood if it is approached from the point of view of socialist theory. If one posits the existence of a developmentally oriented political elite for whom economic growth is a fundamental goal, such an elite must then develop a concrete strategy for attempting to reach that goal. If one further posits two more points, that such an elite is not committed first and foremost to the enhancement and perpetuation of its own elite privileges (something that cannot be assumed in Leninist systems or, for that matter, in the Philippines) and that the elite appreciates that the socialist displacement of the market threatens its goals by generating bureaucratism, corruption, loss of incentives, and an inefficient allocation of resources, then its primary leadership task is to discover how, organizationally, to make its own developmental goals compatible with the market mechanism (that is, with such things as prices that are real measures of value, private property in theory and in practice, and decentralized decision making).

Developmental elites are generated and come to the fore because of the desire to break out of the stagnation of dependency and underdevelopment; the truly successful ones understand that they need the market to maintain efficiency, motivate the people over the long term, and serve as a check on institutionalized corruption while they are battling against underdevelopment. The Republic of Korea is an excellent example:

> The rapid economic growth that began in South Korea in the early 1960s and has accelerated since then has been a government-directed development in which the principal engine has been private enterprise. The relationship between a government committed to a central direction of economic development and a highly dynamic private sector that confronts the planning machinery with a continually changing structure of economic activities presents a set of interconnections difficult to penetrate and describe. Planning in South Korea, if it is interpreted to include not only policy formulation but also the techniques of policy implementation, is substantially more than "indicative." The hand of government reaches down rather far into the activities of individual firms with its manipulation of incentives and disincentives. At the same time, the situation can in no sense be described in terms of a command economy.[13]

In previous writing on the Japanese and Taiwanese examples, I have listed as an indispensable element in any model of the capitalist developmental state the commitment by the political elite to "market-conforming" methods of intervention in the economy.[14] Lim Youngil is even more explicit with regard to Korea. He argues that Korean government planning, target setting, and incentive measures have been "market sustaining rather than market repressing" and that it is necessary to distinguish "between market-augmenting planning (reducing risks and uncertainties) and market-repressing planning (increasing fragmentation of the market or rent-seeking opportunities). The former accelerates development while the latter hinders it." Lim further makes the point that markets do not necessarily come into being naturally, that "one of the most common characteristics of underdeveloped countries is underdevelopment of the market system." One of the things a state committed to development must do is develop a market system, and it does this to the extent that its policies reduce the uncertainties or risks faced by entrepreneurs, generate and disseminate information about investment and sales opportunities, and instill an expansionist psychology in the people.[15] Once a market system has begun to function, the state must then be prepared to be surprised by the opportunities that open up to it, ones that it never imagined but that entrepreneurs have discovered. The East Asian wig export industry is the classic example; no state bureaucrat ever thought of it or imagined the profits to be made by switching from human to synthetic hair. East Asia had a comparative advantage in the wig trade, but it was never seen or seized upon until the state had set up the capitalist development system.[16]

The logic of such a system derives from the *interaction* of two sub-

12. "What Makes Yoshio Run?" *The Economist*, July 9, 1983, p. 18. For an unambiguous example of contemporary industrial targeting and nurturing by MITI, see Edward A. Feigenbaum and Pamela McCorduck, *The Fifth Generation: Artificial Intelligence and Japan's Computer Challenge to the World* (Reading, Mass.: Addison-Wesley, 1983). For a study of the role of government in Japanese and Korean growth, see Miyohei Shinohara, Toru Yanagihara, and Kwang Suk Kim, *The Japanese and Korean Experiences in Managing Development*, World Bank Staff Working Paper no. 574 (Washington, D.C., 1983).

13. Mason et al., *Economic and Social Modernization*, p. 254.

14. Cf. Johnson, *MITI*, pp. 315–20; and Johnson, "The Taiwan Model," in James C. Hsiung, ed., *The Taiwan Experience, 1950–1980* (New York: Praeger, 1981), pp. 9–18.

15. Youngil Lim, *Government Policy and Private Enterprise: Korean Experience in Industrialization*, Korea Research Monograph no. 6 (Berkeley: Institute of East Asian Studies, University of California, 1981), pp. 4, 8.

16. B. Balassa, *The Newly Industrializing Countries in the World Economy* (New York: Pergamon, 1981), cited in Hicks and Redding, "Industrial East Asia," p. 10.

systems, one public and geared to developmental goals and the other private and geared to profit maximization. The interaction between the two affects the nature of the decisions made in both systems.[17] The intent of the public system is to manipulate the inputs into the decision-making processes of privately owned and managed enterprises in order to achieve developmental goals, but the content of its inputs is continuously affected by feedback on profit-and-loss conditions, export prospects, raw materials costs, and tax receipts. The intent of the private system is to maximize profits, limit risks, and achieve stable growth given the political-economical environment in which it must operate, but its decisions on products, markets, and investments are continuously affected by changing costs and availability of capital, export incentives, licensing requirements, and all the other things the government manipulates.

Governmental planning in such a context is thus not merely indicative, nor is it part of a state-command allocation system. Planning has indicative functions—to lay out clearly what the elite's fixed-term goals are so that private enterprises and households can adjust to them with precision and over a definite period—but planning also sets criteria through which the operational state bureaucracy can change incentives and disincentives, or intervene directly at the enterprise level, as required. Precise fulfillment of an indicative plan is not necessarily a good measure of its effectiveness. Normally the plan should be overfulfilled, indicating that the synergisms of the system are carrying it toward unanticipated growth. Plans should be underfulfilled when changed circumstances require shakeouts and reorganization—as after the oil crisis of 1973. Korea and Taiwan both have employed explicit planning: five five-year plans (1962–86) in Korea, the first three overfulfilled, the fourth underfulfilled; and six four-year plans (1953–75), one six-year plan (1976–81), and one ten-year plan (1980–89) in Taiwan, four overfulfilled, two underfulfilled, and one without a target.[18]

A developmental elite creates political stability over the long term, maintains sufficient equality in distribution to prevent class or sectoral exploitation (land reform is critical), sets national goals and standards that are internationally oriented and based on nonideological external referents, creates (or at least recognizes) a bureaucratic elite capable of administering the system, and insulates its bureaucrats from direct political influence so that they can function technocratically. It does *not* monopolize economic management or decision making, guarantee full employment, allow ideology to confuse its thinking, permit the development of political pluralism that might challenge its goals, or waste valuable resources by suppressing

17. Cf. Ian Inkster, " 'Modelling Japan' for the Third World," in *East Asia: International Review of Economic, Political, and Social Development* (Frankfurt: Campus, 1983), 1:180.
18. For the plans and their results, see Citibank, *Executive Guide*, pp. 13–14; and K. T. Li and W. A. Yeh, "Economic Planning in the Republic of China," *Industry of Free China* (February 1982), p. 5.



noncritical sectors (it discriminates against them with disincentives and then ignores them).

Why are such political systems normally authoritarian? The first and most obvious reason is to achieve political stability and long-term predictability of the system. Continuity of the government may be achieved by explicit authoritarianism or by a rigged system that nonetheless achieves a monopolization of political power. Such quasi-authoritarian political monopolies are disappointing to liberals, but it should be understood that they are ultimately legitimated not by their ideological pretensions, as in Leninist systems, but by their results. Also, the criterion here is stability, for which authoritarianism is only a means. "Assured political stability [in Korea]," write Edward Mason and his associates, "tended to lengthen time horizons and made manufacturing a much more feasible alternative to commerce as a field of entrepreneurial activity."[19]

Authoritarianism can carry with it exceedingly damaging side effects, such as the suppression of human rights. (It should at the same time not be forgotten that authoritarianism is the most common form of political regime on earth but one that is only rarely accompanied by the trade-off of very high-speed, equitably distributed economic growth.) For Japan since 1955 we must drop the term and substitute for it one of the common Japanese euphemisms—the distinction between *tatemae* (formal principles) and *honne* (actual social reality). For purposes of this discussion, I use the shorthand term "soft authoritarianism," meaning in Japan's case the prewar authoritarianism of the Meiji and early Shōwa eras and the postwar pattern of the monopolization of political power by a single party. The issue under analysis here is not primarily the nature of the Japanese political system but rather the significance for economic management of Japan's having inhibited the coming into being of an effective two-party system, regardless of the possibilities inherent in the constitution of 1947.

In general, the Japanese have been masters at using the least amount of political authoritarianism needed to achieve stability for economic growth; but even they during the 1930s and 1940s, succumbed to the potential trap of all authoritarianism: assumption by the elite of all powers, ideologization, and the displacement of developmental goals. Normally the Japanese disguise and ameliorate their soft authoritarian system through many common, as well as some unusual, political devices: monarchical or democratic constitutions; formal and informal institutional barriers against dictatorship, such as indirect elections, party factionalism, and an implicit balance of power among political, bureaucratic, and economic elites (Japan was the only belligerent power during World War II to change its head of state in a processual manner); gerontological supervision of reigning politicians (*genrō, sempai-kōhai* relationships); a marked separation between reigning

19. Mason et al., *Economic and Social Modernization*, p. 267.

and ruling in the Japanese system; and the systematic nurturing of a meritocratic elite. Japan has been beset by serious political instability on many occasions since the Meiji era, including assassinations, corruption scandals, and massive protest demonstrations, but it has avoided the particular instabilities associated with mass-based political parties and their platforms.[20]

South Korea is ostensibly a democratic country but actually a militarily dominated single-party regime—close in form, if not in ideology, to Japan during the 1930s and 1940s. It would be irrelevant here to either attack or defend the regimes of generals Park Chung Hee or Chun Doo Hwan. My point is that, although the military coup of May 16, 1961, brought to power the kind of developmental elite and political stability necessary for economic development, the personal rule of President Park, particularly after promulgation of the Yushin constitution, made the system more vulnerable to political disruption than it need have been. This was demonstrated by the turmoil and incoherence following the assassination of Park on October 26, 1979. Had Park, in the early 1970s, retired to Taegu and assumed the role of senior statesman supervising his carefully chosen successors (that is, had he become a Korean *genrō*, not on the Meiji model but on that of Yoshida Shigeru in Ōiso), he would be hailed today as the greatest Korean Leader of modern times—and would probably still be alive (he was only forty-four at the time of the coup in 1961).

Taiwan differs from both Japan and Korea in that Taiwan does not even claim to be a democracy. Publicly, Taiwan justifies the single-party rule of the Kuomintang in terms of the sixty-to-seventy-year-old theories of Sun Yat-sen. Privately, it justifies single-party rule in terms of the threat from Communist China, the political crisis caused by its international isolation, and the need to maintain stability on the island so long as mainlander carpetbagging (that is, rule by exiles) is still tolerated. These private justifications have been acknowledged and even to a growing degree accepted by the Taiwanese for several reasons. First, the threat from mainland China is real, just as the threat from North Korea is real and gives added legitimacy to a military government in Seoul. Second, the high-growth, equitable-distribution economy legitimates the Taiwanese government, just as economic performance has built support for the Japanese and South Korean governments. Third, the Chinese mainland government is more authoritarian and less capable in either policy or execution than the Taiwan government, and comparison is an inherent element in legitimacy. Fourth, the actual administration of single-party rule in Taiwan has been ameliorative over time, and moderating trends continue in large Taiwanese membership

20. For an insightful discussion of the Japanese political system during wartime, see Ben-Ami Shillony, *Politics and Culture in Wartime Japan* (Oxford: Clarendon Press, 1981), p. 67 and passim.



in the Kuomintang, multiple centers of power in the party, and weakening of martial law.

Nonetheless, Taiwan is the most explicitly authoritarian of the three countries and has relied for its one instance (through 1986) of leadership succession not on an electoral struggle or assassination but on the most ancient method of all, lineal descent from father to son. It would be easy to say that Taiwan and Korea would have done better with less authoritarianism, but there are no examples to support such a view. It seems more likely that they would have done better with more of the Japanese style of authoritarianism. Here the *deshi* have not yet equaled the *sensei*, even if on some other measures they have improved on their teacher.

I shall return to the topic of soft authoritarianism and other political features of the capitalist development state. First, however, I would like to summarize the discussion thus far in terms of a brief, fourfold structural model of the East Asian high-growth systems. The model's elements are stable rule by a political-bureaucratic elite not acceding to political demands that would undermine economic growth; cooperation between public and private sectors under the overall guidance of a pilot planning agency; heavy and continuing investment in education for everyone, combined with policies to ensure the equitable distribution of the wealth created by high-speed growth; and a government that understands the need to use and respect methods of economic intervention based on the price mechanism.

Each of these elements exists in the Japanese, Korean, and Taiwanese systems, although with differing weights, patterns of historical evolution, and trade-offs that arise from stressing one more than the others. Moreover, each case is a moving target: the model itself remains constant, but the actual degree of bureaucratic autonomy from politics, of public-private cooperation, of investment in education and equality, and of emphasis on incentives rather than commands varies over time. It varies in response to how far down the learning curve of the capitalist developmental state a people is and in response to exogenous and endogenous shocks to the system.

In general, the role of the government and its degrees of reliance on authoritarian intervention are enlarged by actual or anticipated crisis conditions in the environment. By crisis conditions I mean not just obvious crises, such as the oil-price hikes of 1973 and 1979, but also such events as succession struggles, ruptured alliances (for example, between Taiwan and the United States), rising economic protectionism, shifts of industrial structure from labor-intensive to capital-intensive or knowledge-intensive industries, balance-of-payments squeezes, serious exchange-rate fluctuations, and so forth. When crisis conditions abate, the balance of initiatives in the systems may once again shift from the public sector toward the private sector, as we saw in Japan during the late 1970s and early 1980s. Sometimes such a shift toward greater private initiative will reflect a governmental *policy* to forestall foreign criticism or quiet domestic unrest or shift responsibility, and it will be understood by insiders as cosmetic. The changing relations between the public and private sectors are, in my view, cyclical and not linear; the *logic* of the systems remains unaltered even though their particular structures have considerable flexibility. It is possible that all three systems under discussion here will evolve from capitalist development states into capitalist regulatory states, but the evidence is equally strong that instead many regulatory states are evolving toward greater developmental and industrial-policy commitments.[21]

I am aware that models of this sort—or even questions such as "To what extent was the government of Park Chung Hee in some sense 'responsible' for the decade-and-a-half of 10 percent real growth in Korea?"—are not, in the words of Leroy Jones and Il SaKong, "the sort of questions with which economists are comfortable."[22] And the economists are not alone. There are serious methodological problems with any theory or model that posits intentional government intervention as an independent variable. These include a historical problem (there may be causal factors other than policy intervention), a span-of-time problem (the failure to recognize long-term trends inherent in the data), the problem of perspective (mistaking random fluctuations for intentional results), and so forth.[23] There are, however, also serious problems with theories, often highly quantified, that filter out the factors of politics, strategy, and leadership.

In a short presentation it is impossible to discuss all the influences that have affected the growth of three different economies in some thirty years (for example, cheap energy until 1973, U.S. aid until the mid-1960s, a stable system of international commerce until the mid-1970s, land reform in all three countries). It seems to me, however, that sufficient time has passed, sufficient comparative data are in, and a sufficient number of alternative theories have been explored in depth to reject the views that the high-speed growth of the Japanese, Korean, and Taiwanese economies was a purely contingent phenomenon, or one dependent primarily on a favorable international environment, or one in which the role of government has been exaggerated. Most factors cited in nonpolitical theories as favoring the growth of the three East Asian economies have been equally or even more favorable for numerous other economies, with great differences in results

21. For the distinction between regulatory and developmental states, see Johnson, *MITI*, pp. 19–23. For evidence that mature regulatory states may be tending in a developmental direction, see John Zysman and Stephen S. Cohen, "Double or Nothing: Open Trade and Competitive Industry," *Foreign Affairs* 61 (Summer 1983), pp. 1113–39.

22. Jones and Il Sakong, *Government, Business, and Entrepreneurship*, p. 286.

23. For a quantitative analysis of industrial policy that is aimed at overcoming these kinds of objections, see Yakushiji Taizo, "Government in Spiral Dilemma: Dynamic Policy Interventions vis-à-vis Japanese Auto Firms, c. 1900–c. 1960," in Aoki Masahiko, ed., *An Economic Analysis of Japanese Firms* (Amsterdam: North Holland, 1984).



(for example, Mexico with its own oil, or NATO members such as Greece or Portugal or Italy).

My contention is that the Japanese, Koreans, and Taiwanese have put together the political economy of capitalism in ways unprecedented in the West and with quite different trade-offs (greater performance but less political participation). To give further substance to this proposition, I shall explore some of the similarities and differences among the three cases in terms of seven major issues of the theory of the capitalist developmental state: (1) financial control over the economy; (2) labor relations; (3) the degree of autonomy of the economic bureaucracy; (4) the degree to which the state has been captured by its main economic clients; (5) the balance between incentive and command in economic guidance; (6) special private-sector organizations, particularly general trading companies and governmentally favored industrial conglomerates, known in Japanese pejoratively as *zaibatsu* (financial cliques) and more accurately as *keiretsu* (industrial groups) or in Korean as *chaebol* or in Chinese as *caifa*; and (7) the role of foreign capital.

## Financial control

In no area have the East Asian high-growth economies shown more creativity than on the front of ingenious, utterly nonideological, easily manipulated public incentives for private savings and investment. Examples range from Japan's banana-import link system of the 1950s to Taiwan's annual gold-medal awards for companies whose exports exceed U.S. $100 million a year.[24] It would be impossible to discuss here all the different kinds of incentives—Lim alone lists some thirty-eight different "export promotion policy tools" used in South Korea down to 1976—or to take fully into account how new incentives are invented when old ones must be abandoned for various reasons (negative side effects, international agreements against nontariff trade barriers, and so on).[25]

However, one enduring characteristic of all three economies is government reliance on financial and monetary means to guide and control private activities. These financial measures are often unorthodox by Anglo-American standards, particularly in their emphasis on the supply of capital to industry primarily through the banking system. In Korea, for example:

> Around 80 percent, on the average, of assets comes from loans from the banking system and other money markets, including the curb market, [whereas] the Korean stock market is just beginning to serve as a means of

24. For the banana-link system, see Johnson, *MITI*, p. 232; for Taiwan's gold medals, see *Free China Weekly* (June 5, 1983), p. 1.

25. Lim, *Government Policy*, pp. 19–20.

raising substantial capital. The remaining 20 percent comes from an internal source (equity); this compares with more than 50 percent internal financing among firms in the United States.[26]

The corollaries of such debt-based industrial financing are powerful governmental incentives for householders to save through the banking system (or through a governmental "bank," such as a postal savings system), restrictions to prevent easy foreign acquisitions of very highly leveraged firms, freedom of entrepreneurs from the influence of stockholders or securities analysts, governmental underwriting of the "overloans" of designated national banks, governmental ability to ration capital by manipulating its cost, and utter dependence of private managers on their banks in order to operate at all.[27] In South Korea, "The most potent instruments for implementing economic policy have undoubtedly been control of bank credit and access to foreign borrowers."[28]

Japan today might be thought to fit this pattern no longer, because most of its growth-promoting incentives and controls have had to be or are in the process of being dismantled following protests from foreign competitors. However, although some measures of financial "internationalization" have taken place, the government's postal savings system and its unconsolidated "investment budget" (the Fiscal Investment and Loan Plan, *zaisei tōyūshi keikaku*) are still intact and functioning as two of Japan's most important institutional inventions. During 1982 the Japanese postal savings system controlled assets about four times those of the then world's largest commercial bank, the Bank of America, and that is a very considerable financial institution to be totally in the hands of the bureaucracy for public investment and which is generally beyond the influence of pork-barrel politics. Deposits in postal savings and postal life-insurance accounts in February 1982 amounted to Y86,290 billion, or $359.5 billion at 240 yen to the dollar; deposits of the Bank of America on December 31, 1981, were $96 billion.[29] (Of course the Japanese save so heavily in postal savings accounts because, by law, these accounts offer the highest rate of interest available to small savers.)

Equally important, bank-based financing is still one of the most distinctive features of the Japanese system. The sources of funds for large Japanese companies showed almost no change during the period 1972–81: in 1972 companies obtained 75 percent of their funds through loans from banks and only 19 percent from shares, and the figures for 1981 were 68 percent and 21 percent.[30] Indirect financing remains an intrinsic feature not just of new

26. Ibid., p. 26.
27. The classic work on this subject is Suzuki Yukio, *Money and Banking in Contemporary Japan* (New Haven: Yale University Press, 1980).
28. Mason et al., *Economic and Social Modernization*, p. 267.
29. Keizai Koho Center, *Japan 1982*, p. 21.
30. "Survey of International Banking," *The Economist*, March 26, 1983, p. 76.



developmental states such as Taiwan and Korea but also of mature developmental states such as Japan. Although such a system undoubtedly restricts international capital flows, it remains in place because of the power, combined with low political visibility, it gives to Ministry of Finance bureaucrats. With regard to Korea, for example:

> The Korean government has viewed control over the allocation of credit, both domestic and foreign, as an important element of economic and political policy. It has resisted repeated advice (mainly foreign) to let interest rates and competition among independent financial institutions determine the allocation of credit. (Few Korean businessmen have ever advocated such a policy.) Instead, the government has kept loan interest rates below equilibrium levels and has intervened pervasively—although generally unofficially—in allocation decisions. The reasons for this appear to have been both economic and political: the credit instruments could be used to mobilize businessmen for major economic programs such as export promotion or development of the machinery and petrochemical industries, while on the political side they served to maintain control over, and cooperation from, the business community. All Korean businessmen, including the most powerful, have been aware of the need to stay on good terms with the government to assure continuing access to credit and to avoid harassment from the tax officials.[31]

In Taiwan, financial control and loan allocation have been as real and as crucial to economic growth as in Korea, but the form is different. The government in Taiwan tends to rely on monetary rather than fiscal policies—tax breaks and high-depreciation allowances rather than outright loans to encourage investment in particular sectors. Moreover, most Taiwanese loans go to state-owned enterprises rather than to big businesses. The state sector is much bigger in Taiwan than in Korea. In 1976 public enterprises accounted for 22 percent of Taiwan's gross domestic product but for only 9 percent in Korea.

## Labor relations

Foreign analysts have often credited Japan's "unique" labor relations with being the key to Japan's economic success. The virtual absence of economically significant strikes in Japan (except in the public enterprises), a labor force that does not object to technological changes even of a labor-saving type (for example, robotics), and federations of unions devoid of all but token political power are real comparative advantages in international economic competition. It has also often been supposed that the institutions that give Japan these advantages—enterprise unionism, semilifetime employment, and seniority wage scales—rest to a significant extent on Japanese

31. Mason et al., *Economic and Social Modernization*, pp. 336–37.

cultural predispositions. However, the causes of the exceptional weakness of Japan's trade-union movement may lie as much in social engineering by government and management as in cultural factors.

South Korea and Taiwan resemble Japan in their tranquil labor relations, but they have achieved this goal through more directly authoritarian means. "In Korea," writes Lim, "the practice of permanent employment or company loyalty does not exist."[32] There are no Korean minimum-wage standards, and strikes and closed shops are outlawed. Of an industrialized work force estimated at eight million in Korea, only 850,000 are members of a union, a unionization rate of 10.6 percent compared with Japan's 30.8 percent, the United State's 23.6 percent, Germany's 41.5 percent, and Great Britain's 59.4 percent.[33]

Taiwan resembles South Korea: it still applies the basic labor legislation enacted by the Kuomintang on the mainland from the 1920s to the 1940s, and although the Legislative Yuan has discussed a new labor-standards law for a decade, it has yet to pass it. Strikes and collective bargaining are prohibited under martial law; the unions that do exist are under strong Kuomintang supervision, including party controls over the selection of union leaders and all union activities.[34]

Taiwan and Korea have much higher labor turnover rates than Japan, but these have not posed a serious obstacle to high-speed growth. End-of-year bonuses in Taiwan and in Korea two or four bonuses a year, each equal to a month's salary, are part of standard wage packages, just as semiannual bonuses are in Japan; but these are more important to household savings than to labor peace. Large lump-sum severance payments at retirement are more common in all three countries than genuine pensions. It seems that through a combination of authoritarianism, free labor markets, and paternalism, Korea and Taiwan achieve labor relations roughly similar to Japan's, but without Japan's sacrifice of a labor market external to the firm or the rigidities of the semilifetime employment system.

There is, however, more soft authoritarianism in Japan's labor-relations system than is commonly appreciated abroad. According to Totsuka Hideo, during the period 1955–70, "Japanese management developed a sophisticated labor management style which encouraged workers' loyalty to their supervisors and competition among the workers themselves."[35] Management's two main achievements during this period were, first, a very hard line against militant unions leading to the Mitsui Miike coal-mine dispute of 1960, when militants were fired and when the more radical federation, Sōhyō (General Council of Trade Unions of Japan), began to lose ground in the private sector to the more moderate Dōmei (the Japan Confederation of Labor); and, second, the setting up of the Japan Productivity Center in 1955, opposed by Sōhyō but supported by Dōmei, which institutionalized Japan's system of consultations (*jizen kyōgikai*) between management and labor, the zero defect (ZD) movement, and the quality circles (QC) movement.[36] During the 1970s Japanese management was able to hold the annual average rate of real wage increases to less than 2 percent; it had been 5 percent during the 1960s.

32. Lim, *Government Policy*, p. 56.

33. Citibank, *Executive Guide*, pp. 31–34; Keizai Koho Center, *Japan 1982*, p. 64.

34. "Taiwan's Workforce Stirs," *Far Eastern Economic Review*, February 26, 1982, pp. 78–79, and A. P. Coldrick and Philip Jones, eds., *The International Directory of the Trade Union Movement* (New York: Facts on File, 1979), pp. 449–51.

35. Totsuka Hideo, "Japanese Trade Union Attitudes toward Rationalization," in *East Asia: International Review of Economic, Political, and Social Development* (Frankfurt: Campus, 1983), 1:29.



"The 'success' of Japanese management in the 1970s," Totsuka writes, "has very much depended on the full-scale cooperation of the enterprise unions which have followed the Dōmei line."[37] This is not to say that this achievement was negligible or that foreigners have nothing to learn from Japan's labor relations, where wages must be "reconciled with the national economy."[38] It is, rather, to stress that Japan's labor relations are neither as mysterious nor as culture-bound as some Anglo-American writers allege. It would also seem that all three East Asian high-growth economies inhibit political influence by the trade-union movement because developmentally oriented forces have preempted the political scene—but Japan has to be more creative than the other two because it is less authoritarian. All three nations compensate labor for its decreased political role through policies of comparatively equitable distribution and automatic wage increases tied to increases in productivity.

### Bureaucratic autonomy

Serious industrial policy must be long-run in focus, consistent in its various aspects (monetary, regulatory, environmental, and so forth), and operated through mutually supportive policy instruments. It must also be externally oriented (based on cost and price competitiveness in world markets, not just the domestic market); and because it will direct some resources to high-priority sectors cheaply, it must have the power to require these high-priority sectors to meet performance goals.[39] Each of these things is difficult to do politically. Politicians tend to seek popular support in the short run;

36. On the Japan Productivity Center see Chalmers Johnson, *Japan's Public Policy Companies* (Washington, D.C.: American Enterprise Institute, 1978), pp. 52–53.

37. Totsuka, "Japanese Trade Union Attitudes," p. 37.

38. Ibid., p. 33.

39. Hugh Patrick, "Japanese Industrial Policy and Its Relevance for United States Industrial Policy," testimony before the U.S. Congress, Joint Economic Committee, July 13, 1983.

and there will never be a shortage of private claimants on the government, regardless of their economic performances and prospects.

Political leaders attempting to implement a long-term industrial policy must therefore have the capacity to depoliticize in part their key economic decisions. This is normally done by entrusting such decisions to a "nonpolitical elite," sheltered to some degree from direct political pressures and able to justify its decisions in terms of the good of all (for example, the Federal Reserve Board and its control of monetary policy in the United States). In the capitalist developmental states this depoliticization is achieved through a covert separation between reigning and ruling: the politicians set broad goals, protect the technocratic bureaucracy from political pressures, perform "safety valve" functions when the bureaucracy makes mistakes, and take the heat when corruption scandals are uncovered (such scandals are unavoidable when government plays *any* role in economic affairs); the official bureaucracy does the actual planning, intervening, and guiding of the economy.

Where does such a bureaucracy come from? It must first of all be created and recruited from among the technically most highly qualified people in the system. And this is why the commitment to education up to the highest levels is so important in Japan, South Korea, and Taiwan. Perhaps the greatest contrast between these three nations and the Communist states of Asia lies in the emphasis on and nurturing of a rigorously educated elite.[40]

Once the bureaucracy is in place, the greater issue becomes achieving bureaucratic independence from the political leadership. Politicians do not want to give up any of their powers, and bureaucrats usually believe that they themselves should have greater powers. The relationship between the two is *always* unstable, and the greatest task of political leadership in such systems is to maintain a balance between the main wings of the elite. Reigning and ruling are never perfectly separated, but they must be to some degree in order to impose long-term strategic goals on a society that may have strong authoritarian elements but that also has a strong private sector. All three East Asian systems have achieved a workable degree of bureaucratic expertise and independence in their state structures through a combination of historical accident, learning, and astute leadership at the top.

Japan's economic bureaucracy began its rise to power during the 1930s and 1940s in response to the crises of the Depression, the war in China, and World War II. It achieved its greatest power during the Allied Occupation and the early 1950s when its chief rivals, the military and the prewar zaibatsu, were weakened or destroyed and when the issues of economic recovery and independence commanded universal attention. Since the creation of the Liberal Democratic party in 1955 (and in light of the democratic constitution of 1947), the bureaucracy has had to share its power with a

40. Cf. "China's Educated Class Struggles for End to Harassment," *Christian Science Monitor*, July 21, 1983.



political elite. From 1955 to about 1972, the end of the Satō era, a stable pattern of tacit separation between reigning and ruling prevailed in Japan. This was also the period of Japan's unprecedentedly high-speed growth. Since 1972 the politicians have been gaining in strength. The process has been slowed by new crises that again called for nonpolitical policies (for example, energy conservation, trade liberalization), and it has been mitigated by an extensive cross-penetration of political and administrative elites. But the Japanese economic bureaucracy had considerably less independence in the early 1980s than it did in the 1950s and 1960s. Nonetheless, as long as the Liberal Democratic party continues to control the Diet, the bureaucracy of Japan will enjoy more power and more autonomy than state officials in any other advanced industrial democracy.

The Korean case was decisively altered by the military coup d'état of 1961. In a broad, sociological sense the coup was caused by extensive military influence on Korean society during the previous decade (somewhat anaologous to the case of Japan during the 1930s). The Korean military had become an intrinsic elite, and the coup merely served to make it an extrinsic, socially recognized one. "It is difficult fully to comprehend and impossible fully to document," writes John Lovell, "the cumulative impact of the process by which millions of Koreans have been exposed to military institutions and military ideas. One may safely suggest, however, that quite apart from the institutional changes effected by the 1961 coup, the social, economic, and political changes stimulated directly or indirectly by the military have been more far-reaching and significant than those generated by any other single group within the society."[41] Concretely, Cho Suk-choon argues, "especially since the advent of the military rule in 1961, advanced techniques of military management have been extensively adopted in the civil bureaucracy."[42] And Lee Hahn-been adds, "The most general contribution of the military to the development of administration in Korea was its introduction and vigorous application of a 'managerial approach.'"[43] Needless to add, many military officers transferred to and directly managed new civilian enterprises, particularly the public corporations set up in high-risk, strategic sectors (for example, Korean Oil, which in 1980 was headed by Yu Chae-hung, a graduate of the Japanese military academy and the U.S. Army's General Staff College and a former head of the ROK Joint Chiefs of Staff).[44]

The problem in Korea, then, was not a rising political elite challenging an already installed bureaucratic elite, as in Japan. Rather, it was the problem

41. Lovell, "Military and Politics in Postwar Korea," p. 189.
42. Cho Suk-choon, "The Bureaucracy," in Wright, *Korean Politics*, p. 79.
43. Lee Hahn-been, *Korea: Time, Change, and Public Administration* (Honolulu: University of Hawaii Press, 1968), p. 23.
44. Inoue Ryūichirō, "Daehan Sukyu Gongsa," *Ekonomisuto* 58 (June 17, 1980), pp. 96–97.

of a military-bureaucratic elite—President Park's Blue House—assuming political powers and then sharing its bureaucratic functions with an educated, nonpolitical elite capable of working with civilian entrepreneurs. President Park's first economic problem was the decision by the United States to end foreign aid to Korea (the ROK has been the third-highest per capita recipient of United States aid in the postwar period; first and second are South Vietnam and Israel).[45] Park solved this crisis by concentrating all Korean governmental economic powers in a newly created agency, the Economic Planning Board (EPB). The EPB, placed under a deputy prime minister, took over all planning responsibilities from the Ministry of Reconstruction and absorbed the Bureau of the Budget from the Ministry of Finance and the Bureau of Statistics from the Ministry of Home Affairs. The EPB in turn set up the Korean Development Institute, manned by a cadre of professional economists who held advanced degrees from domestic and foreign universities.

The EPB quickly gained some autonomy from the Blue House, but not primarily because Park intended for it to do so. As Lim explains:

> The First Five-Year Economic Plan (1962–1966) document reveals that the government initially did not clearly envisage adopting export-led growth based on unskilled, labor-intensive manufactures. The primary concern then was to improve the chronic balance of payments deficits that foreign aid had permitted. . . . However, this is not what occurred. The composition of actual exports differed drastically from the government's projections, or targets. It was the private exporters who played a major role in identifying and taking risks, exporting unskilled-labor-intensive products in which Korea had a comparative advantage.[46]

The EPB gained its independence as it assumed responsibilities for managing the civilian sector—rewarding the clever and aggressive, penalizing the costly and slow.

Even so, the Korean economic bureaucracy never gained the kind of autonomy from Blue House politics that its Japanese equivalent once enjoyed. This was reflected most obviously in the chaotic state of the Korean economy during 1981, when a new military leader came to power and tried to dictate economic policy to the government and private sectors. However, General Chun was soon forced to recognize that he needed the EPB's expertise even more than the EPB needed his political authority, particularly since foreign investors in the Korean economy made it clear they did not intend to finance a military leader who took very long to learn the same lessons that President Park had learned in the mid-1960s.

45. David C. Cole, "Foreign Assistance and Korean Development," in Cole, Lim Youngil, and Paul W. Kuznets, *The Korean Economy: Issues of Development*, Korea Research Monograph no. 1 (Berkeley: Institute of East Asian Studies, University of California, 1980), p. 1.

46. Lim, *Government Policy*, pp. 16–17.



Taiwan's case is similar to South Korea's in the pervasive influence of the military—China Air Lines, for example, is a direct descendant of the ROC Air Force—and in the existence of an even more firmly entrenched political elite, the Kuomintang, that had a long history of concentrating all power in ideological and political hands.[47] In breaking this monopoly, the influence of the United States was decisive,even though at the time it did not have a comprehensive understanding of what it was doing. Taiwan's economic pilot agency, the Council on International Economic Cooperation and Development (CIECD), founded in 1963, traces its ancestry back to the Council on United States Aid (CUSA), which was set up in 1948 under the U.S. China Aid Act as an interministerial council to supervise aid expenditures. As Neil Jacoby explains:

> Although [CUSA's] chairman was the president of the Executive Yuan and it contained other ministries of the Chinese government, financially the Council was semi-autonomous in nature and functioned outside of the regular ministries. . . . Being free of the need to obtain legislative approval of its expenditures, the Council was able to act speedily on developmental projects. Not being subject to all Chinese civil service regulations, it was also able to pay higher salaries that enabled it to recruit and retain a highly competent staff.[48]

With the 1963 announcement that American aid would end in 1965, CUSA became CIECD and took on developmental planning and coordination functions.

General Chen Cheng, who had been responsible (together with C. Y. Yin) for Taiwan's successful land reform and import-substitution policies of the late 1950s, was the leader, until his death in 1965, of the group concentrated in the CIECD. His main factional rival in the Kuomintang was Chiang Ching-kuo, whose chief experience until the 1960s had been in the secret police and in eliminating subversive influences on the island. With the ending of American aid, President Chiang Kai-shek quietly shifted his priorities from a military campaign against the mainland to the economic indepenence of Taiwan—and he also began to shift his son into the groups Chen had fostered (by 1969 Chiang Ching-kuo was deputy premier and chairman of CIECD). The two Chiangs also appear to have been influenced by the Korean model and by its EPB. With political support and sanction for the work of the economic bureaucracy finally secured at the top, the Kuomintang slowly began to lose some of its ideological rigidity. Somewhat surprisingly, Chiang Ching-kuo proved to be the most capable political sponsor of economic development the ROC has yet seen. The degree of autonomy permitted to expert elites by Chiang Kai-shek rested on personal factors—Chiang's full trust in Chen Cheng and C. Y. Yin; Chiang Ching-kuo enlarged and institutionalized it. Nonetheless, without the initial Ameri-

47. "China Air Lines," *Ekonomisuto* 59 (March 1981), pp. 100–101.

48. Neil H. Jacoby, *U.S. Aid to Taiwan* (New York: Praeger, 1966), pp. 60–61.

can pressure and Chiang Ching-kuo's adroit use of his own authority, it is hard to see how the Kuomintang would ever have invented the capitalist developmental state on its own.

### Autonomy of the state

Any particular political arrangement generates its own special political problems—for example, the powers and influence of the U.S. Congress generate the extensive lobbying and political action committees that surround it, things unknown to the Japanese Diet. However, one problem of the capitalist developmental state is for the political elite to avoid becoming the captive of its major clients, who are the representatives of big, privately owned businesses. Some, particularly the Marxists, would answer that the problem is unavoidable. The whole theory of "state monopoly capitalism" in Japan is devoted to this proposition. But there is clearly a distinction between systems of public-private cooperation in which the state independently develops national goals (the East Asian capitalist cases) and systems of public-private cooperation in which the state's goals are reducible to private interests (Mexico and the so-called bureaucratic authoritarian regimes of the cone of South America). It may be true that even in the Asian cases the state cannot directly contradict the interests of big business, but it is also true that the politicians have maintained their independence to a greater degree than in other quasi-authoritarian capitalist nations. How do they do it?

In Taiwan the politicians appear to rely on authoritarian means: the ideological pretensions of the Kuomintang justify ultimate reliance on military-police powers to put down any challenges to KMT authority. The party itself also owns and manages numerous enterprises and thus is independent of big business for its own funds. Thanks to land reform, moreover, the party's electoral strength in the rural areas remains solid. At the same time it must be said that so little is known about the latter-day Kuomintang (an extremely difficult subject on which to do political research) that it would be best to pass over this case. In Japan and South Korea, however, election contests and the maintenance of large, expensive political parties require that the reigning politicians raise enormous sums of money, and this certainly makes them vulnerable to private interests.

Big business in Japan supplies money to the Liberal Democratic party (LDP) to keep it in power, but it does not thereby gain a dominant influence over government policy. The LDP supports big business, but it also relies on an electorally over-represented farming population to remain in power. The party does pay off the farmers, even though it does not give them a political voice on any subject other than agricultural affairs. In 1983, for example, when the Japanese government was imposing cuts of 5 to 10 percent on all budgetary requests (with the exceptions of defense, foreign aid, salaries, and science and technology) and had frozen public works expenditures for the previous four years, it nonetheless agreed to raise the governmental purchase price of rice by 1.75 percent over the previous year's level.



This Japanese pattern of relying on a powerful but uninfluential agricultural sector while accepting support from an influential but not all-powerful industrial sector is a creative solution to a major problem of the capitalist developmental system. It also suggests the consequences that are likely to follow from any determined foreign or domestic effort to break up the protected and privileged position of Japan's admittedly inefficient agricultural sector. Either the LDP would lose its majority in Parliament and with it the single-party rule on which capitalist developmentalism is predicated, or the LDP would remain in power but only as the captive of big-business interests, with an attendant rise in corruption and loss of national direction.

In South Korea, with its more authoritarian government, the pattern has included support for agriculture, but more with the intent of equalizing incomes among sectors than as a basis of political support. More important, the government has developed sources of income for the political system other than contributions from big business. Korean politicians have had some big expenses. Park's first and perhaps most important (although for him personally, an ultimately fatal) act was to create, by decree of June 10, 1961, the Korean Central Intelligence Agency (KCIA) as an independent political support apparatus. Originally built on a 3,000-man cadre from the existing Army Counter-Intelligence Corps, the KCIA expanded to some 370,000 employees by 1964 and became, without question, the most cohesive political organization in South Korean society. The problem was how to finance it.

Park obtained funds in two ways. First was the ratification on August 14, 1965, of the treaty normalizing relations with Japan, and second was the authorization on August 18, 1965, of the dispatch of some twenty thousand troops to South Vietnam. Both of these decisions had wide popular support in principle but were heatedly and sometimes violently opposed in context because they supplied the funds with which the military government could consolidate its rule. Joungwon Kim explains:

> The Japan-Korea Treaty and the commitment of troops to Vietnam were to provide important new resources to the Park government, both directly and indirectly. The new financial resources would provide funds not only for the carrying out of the government's economic plans, but new resources for political funding as well. During the period from 1965 to 1967, in addition to the claims payments from Japan ($12.08 million in grants and $14.07 million in loans in 1966, the first year of payment, $37 million in grants and $25 million in loans in 1967), the treaty agreement with Japan opened the way to commercial loans from that country. During 1966 and 1967, South Korea received a total of $108.5 million in private loans from Japan. Since private loans re-

quired government approval and repayment guarantees, the Korean party receiving foreign loans was required to pay a percentage (popularly believed to be 10–15 percent and sometimes as much as 20 percent of the loan amount) in payoffs to obtain the necessary government guarantees. The system, of course, applied to foreign loans from other nations as well. The decision to send troops to Vietnam in 1965 and 1966 bolstered confidence abroad in the American willingness to defend South Korea, and helped to induce commercial loans from other nations. During 1966 and 1967, South Korea received $19.9 million in commercial loans from the United States, $53.1 million from West Germany, $30.9 million from Italy and France, $2.5 million from Great Britain, and $41.2 million from other nations, making a total of $256.1 million in private commercial loans during those two years alone. Assuming a kickback-ratio as low as 10 percent, this would mean political fund resources of $25.6 million from this source.[49]

Needless to say, the money received in this manner was not used exclusively to fund the regime and the KCIA; some of it also helped replace American aid and finance the first five-year plan. But the monies also made the regime independent of domestic financial backers, which further meant that the regime's needs were not a drain on the investment funds of enterprises. A pattern similar to that of President Park's first few years emerged in the period 1981–83 under the so-called Fifth Republic of President Chun Doo Hwan, when South Korea sought some $6 billion in aid from Japan and, after a year-and-a-half fight, punctuated by the school textbook controversy, received some $4 billion.

The principle that emerges from this analysis is that the political independence of the "economic general staff" is not easily achieved but that, without it, the setting of long-term economic goals and industrial policy is unlikely to produce the results envisaged by theorists of public policy. If, of course, the politicians and their economic bureaucrats are themselves hopelessly corrupt (viz., innumerable African states) then no amount of foreign aid or independent funding will free them from their business sector: the money will simply be siphoned off or otherwise misspent.

## Administrative guidance

All democratic governments have general, macrolevel economic policies designed to influence private economic decisions in ways that these governments deem desirable. One of the characteristics that distinguishes industrial policy from general economic policy is its penetration to the microlevel, meaning government attempts to influence economic sectors (agriculture, high technology), whole industries (advanced electronics), and individual enterprises within industries (Lockheed, Chrysler). Many democratic governments also implement industrial policies in this sense, such as the American government's long-standing policy of supporting agriculture and the defense industries. But general Western theory and practice concerning either macro or micro interventions hold that they should take the form of incentives, equitably applied and available and not specific commands directed at individual firms. The Western emphasis is on the rule of law and the use of nondiscretionary controls to the maximum extent possible.

One lesson from the East Asian capitalist developmental states is that this concern for nondiscretion may be misplaced. The Japanese economic bureaucracy has long found that its most effective powers are tailor-made, verbal, ad hoc agreements implemented through "administrative guidance." And the Korean case is even clearer:

> A firm that does not respond as expected to particular incentives may find that its tax returns are subject to careful examination, or that its application for bank credit is studiously ignored, or that its outstanding bank loans are not renewed. If incentive procedures do not work, government agencies show no hesitation in resorting to command backed by compulsion. In general, it does not take a Korean firm long to learn that it will "get along" best by "going along." Obviously, such a system of implementation requires not only cooperation among the various government agencies that administer compliance procedures but continuous consultation between firms and public officials. Such a system could well be subject to corruption, and there is some evidence that payments are, in fact, made and received for services rendered, but again it must be emphasized that there is very little evidence that such corruption as exists interferes in any serious way with production processes.[50]

Evidence on the balance between incentives and commands in Taiwan is lacking and must await further research.

The relative importance of incentives and commands in industrial policy pinpoints an often unnoticed trade-off. It is true that, in terms of economic theory, the nondiscretionary manipulation of incentives is to be preferred because it retains to the maximum extent the motives of and information provided by the market. But it is often overlooked that such a system also inevitably increases reliance on laws, lawyers, litigation, and excessively codified procedures. Administrative guidance (a euphemism for governmental orders) is obviously open to abuse and has been abused on occasion, but it is also much faster than the rule of law and avoids the unpredictable impact of new legislation and court decisions on sectors that do not require

49. Joungwon Alexander Kim, *Divided Korea: The Politics of Development, 1945–1972* (Cambridge: Harvard University Press, 1975), pp. 263–64. On the Korean party system, KCIA, Vietnam, and political funding, also see Hahn Bae-ho and Kim Ha-ryong, "Party Bureaucrats and Party Development," in Suh Dae-sook and Lee Chae-jin, eds., *Political Leadership in Korea* (Seattle: University of Washington Press, 1976), pp. 67–88; Hahn Ki-shik, "Underlying Factors in Political Party Organization and Elections," in Wright, *Korean Politics*, pp. 85–103; and Lovell, "Military and Politics in Postwar Korea," p. 191.

50. Mason et al., *Economic and Social Modernization*, p. 265.

adjustment but that are affected anyway because of the universal scope of laws. One of the marked differences between the regulatory and the developmental capitalist states is the pervasive influence of lawyers in the former and their minimal role in the latter. This is not simply a cultural difference but above all a result of having different political economies.

## Zaibatsu

Just as the public sectors of the capitalist developmental states have contributed several institutional innovations that are unusual from the point of view of Western capitalist theory, the private sectors have been no less creative. Perhaps the best known private innovations are the general-trading companies—that is, enterprises that specialize in the import of raw materials for domestic industries and in the export of their manufactured goods. They also maximize cost and price margins through global intelligence networks concerning all available markets, and they perform important functions in the short-term financing of foreign trade. The effectiveness of these organizations is today so widely recognized that legislation has been enacted in the United States authorizing versions of them for the American economy and exempting them from some provisions of the American antitrust laws.[51]

Much more controversial are what are known pejoratively as "financial cliques," or, both in the Japanese language and today generically, as zaibatsu. These are vertically and horizontally integrated "industrial groups" or conglomerates, usually including their own trading company and, in Japan only, their own bank. Over the years, since their first appearance during the Meiji era, zaibatsu have been heavily criticized by both domestic and foreign writers for, among other things, putting their own interests before those of the nation, contributing to a marked "dualism" in the economy (that is, extensive, poorly paid subcontracting firms totally dependent upon and often exploited by the groups), and caving in to irresponsible national leaders (as in the Japanese military-industrial complex of the 1930s and 1940s). During the Allied Occupation of Japan, direct measures were taken to dissolve the zaibatsu—measures that had the unintended effect of modernizing rather than eliminating them.

Today, with several more decades of global experience and knowledge of intentional development programs, ranging from Stalinism to the Alliance for Progress, it seems that the zaibatsu may have been underappreciated. They function as powerful institutions for concentrating scarce capital for developmental projects in underdeveloped countries, and they constitute a

51. See Michael D. Erony, *The Export Trading Company Act of 1981: A Legislative Analysis and Review* (Los Angeles: Coro Foundation, 1981).



compromise between the inefficiencies of purely state enterprise and the indifference to developmental goals of purely private enterprise. Lim adds:

> Vertical and horizontal integration allow an enterprise to alleviate risks and the uncertainties of market instability and rapid structural change. Vertical integration eliminates the need to depend on monopolistic suppliers of input materials or assures steady flows of needed inputs in adequate amounts. . . . Horizontal integration (participation in many different activities not related to input linkages) increases information flows and consequently reduces the uncertainty surrounding investment and production decisions. . . . These are some of the important reasons for the birth of the so-called general trading companies and enterprise groups, started in Japan and recently copied in Korea. . . . Such groups internalize uncertainty, information, and factor-market flows, and substitute for a perfect market as a way of coping with market imperfections in less developed countries.[52]

In addition, in advanced capitalist developmental states they still perform international competitive functions by making capital available more cheaply for companies in the group and by freeing new ventures from the need to make a profit in the short term.

The three leading Korean *chaebol* are Samsung (twenty-seven companies), which produces primarily consumer goods, Hyundai (eleven companies), which concentrates on producers' goods and automobiles (the Pony), and Daewoo (seventeen companies), which is spread among trade, finance, machinery, electronics, and engineering.[53] A fourth, the Lucky Group (the one hundred thirty-fourth largest firm in the world according to *Fortune's* 1978 ranking) includes Bando Trading Company, Honam oil refinery, Yochun petrochemicals, plus electronics, nonferrous metals, insurance, and securities.[54] These organizations are similar to Japanese zaibatsu except that in the prewar period the Japanese zaibatsu groups included their own bank and in the postwar period rebuilt around their own bank. Korean *chaebol*, on the other hand, "must rely on government-controlled credit institutions. This is a central fact in government-business relations in Korea and has an important bearing on the extent of private economic power."[55]

In Taiwan, large-scale enterprises, if not true zaibatsu, are very important, although there is some evidence that the culture of business in China resists conglomerate integration more than in either Japan or Korea.[56] The

52. Lim, *Government Policy*, p. 46.
53. See "Chaebol Case Studies," in Jones and Il SaKong, *Government, Business, and Entrepreneurship*, pp. 343–64.
54. "Lucky Ltd.," *Ekonomisuto* 58 (April 1980), pp. 124–25.
55. Mason et al., *Economic and Social Modernization*, p. 286.
56. See S. G. Redding and G. L. Hicks, "Culture, Causation, and Chinese Management" (University of Hong Kong, February 1983), p. 5.

Tatung Group, however, would appear to be a true zaibatsu. In 1977 it was by far the largest of some eight hundred Taiwanese home electric-appliance manufacturers, and it has since branched out into electronics, communications, construction, building materials, and publishing. The chairman of the Tatung Group, Dr. T. S. Lin, began his enterprise in 1942 under Japanese rule. A graduate of the engineering department of Taiwan Imperial University, Lin founded the Tatung High School for Engineering and the Tatung Institute of Engineering. He has allowed small amounts of outside capital into his group in order to obtain new technologies, including 8 percent from Tōshiba, and has entered into joint ventures with Nippon Electric and Fujitsū. In 1972 Lin expanded to the United States, and in 1980 his plant in Los Angeles was the largest electric-fan manufacturer in the country. Companies similar to Tatung include Formosa Plastics (headed by Wang Yungching, allegedly the biggest capitalist in Taiwan), Yue Loong Motors (in 1983 Yue Loong exported the first of its "Sunny" cars to the Middle East), Far Eastern Textiles, and Taiwan Cement.[57]

(Are zaibatsu, of either the Japanese or the more attenuated Korean and Taiwanese type, an inherent feature of capitalist developmental states? More research on this subject is indicated, but it seems that zaibatsu are important for unleashing entrepreneurship—and it was entrepreneurship that provided the dynamic growth element in all of these economies.) By permitting the growth of zaibatsu in Japan and Korea and encouraging their growth in Taiwan, the government helped reduce risks, encouraged greater investment than would have occurred without the zaibatsu, and ensured that private activities would be aimed unintentionally toward developmental goals. The reliance on zaibatsu as the locomotives of an entire economy meant that antitrust concerns were relegated to a lesser priority or, more accurately, that capitalist developmental states took as their standard for antitrust intervention the size and degree of oligopoly of their international competitors. There are undoubtedly trade-offs involved in adopting such a standard, but then there are also trade-offs in antitrust intervention that is oriented exclusively to domestic competition.

### Foreign capital

One element of the Japanese model that appears to be contradicted by the Korean and Taiwanese cases is the degree to which the Japanese have

57. See the series "Ajia no biggu bijinesu," in *Ekonomisuto* 58 (February 1980), pp. 96–97, 58 (May 1980), pp. 96–97, and 58 (November 1980), pp. 96–97; and *Free China Weekly* 24 (June 19, 1983), p. 4. For a survey of the five hundred biggest firms in Taiwan, see *T'ien Hsia (Commonwealth: A Business Monthly)* (Taipei), September 1, 1982, pp. 49–61. The ten biggest firms in the country are analyzed in *T'ien Hsia*, November 1, 1981, pp. 43–48.



prevented foreign participation in their economy. Japanese bureaucrats, historically, have been close to paranoid on the subject of the dangers of an invasion of foreign capital. By contrast, the Koreans and Taiwanese have given virtuoso performances in how to use foreign and multinational capital without at the same time becoming subservient to it. This is a large and complex subject, and we can hope here only to signal its importance and some of its ramifications.

Postwar Japan did not totally exclude foreign investment or foreign borrowing; loans from the World Bank and from American commercial banks were important during the 1950s. Moreover, if Korea and Taiwan enjoyed large amounts of American aid, Japan probably profited more than either of them from American offshore procurement contracts and military expenditures. At the same time Japan was concerned to separate foreign money and technology, both of which it needed, from foreign-ownership rights and manufacturing facilities because it wanted to preserve its own large domestic market as a proving ground for its new industries. The domestic markets in Korea and Taiwan are significant, but they have not had the same magnetic power as Japan's for either foreign or domestic manufacturers. Foreign firms in Korea and Taiwan are producing primarily for export, whereas foreign firms in Japan would have liked to produce for the domestic Japanese market.

Moreover, just as the Korean and Taiwanese domestic markets are not large enough to sustain high-speed growth, their domestic savings capacities are smaller than Japan's. They had to internationalize in order to attract the needed savings. At the end of 1981 South Korea and Taiwan were the fourth and seventh most indebted non-OPEC, non-Communist, less developed countries (the leaders were Mexico, Brazil, and Argentina).[58] Even so, in 1982 South Korea enjoyed a debt-service ratio of 13.3 percent, below the international average of 15 percent, and it had prospects of increasing exports enough to lower its debt-service ratio to 11 percent during the five-year plan of 1982–86. Korea is not one of the countries whose liabilities threaten the solvency of the international banking system—and Taiwan is even less so.

But the issue of Korea's export prospects raises the question of the other side of the trading coin. North America and Western Europe are the world's largest markets, and access to them is indispensable for any manufacturing and exporting country. By the 1980s Japan, thanks to its highly nationalistic policies, had become the only advanced industrial nation in the world that, for all intents and purposes, did not import any products it manufactured and exported so successfully (for example, automobiles). This situation, combined with the sheer size of the Japanese economy, contributed powerfully

58. Based on reports of the Bank for International Settlements, Country Exposure Lending Surveys.

to the global trend toward protectionism (or, at the least, toward international cartelization) that appeared in the 1970s and 1980s. South Korea and Taiwan are not immune to these trends, but their access to the American and Western European markets is less threatened because of their longer histories of internationalization and market access. The lessons in this development seem to be that the neomercantilism practiced by Japan is not an inherent feature of the capitalist developmental system (Korea and Taiwan have not overindulged in it), but that the controls exercised by Korea and Taiwan over foreign investment are probably necessary to avoid neocolonialism.

Many important aspects of the three capitalist developmental states discussed in this chapter have not been even touched upon in this sketch of their features—for example, the large public sectors in all three economies and the differing measures adopted by each nation to try to keep them efficient or to get rid of them. The model presented here does not aim at comprehensiveness or econometric detail. Its intent is threefold: to illustrate how economic performance is related to political arrangements, to argue for the essential rationality of the soft authoritarianism–capitalism nexus in terms of comparative development strategies, and to explore the range of subtle and specifically political problems that must be addressed and solved in implementing the strategy.

If these goals have been achieved in even a tentative manner, we may then conclude by asking what are the future prospects of the model for the three successful cases or for potential emulators? Superficially, it would be possible to argue that to the extent that the model implies export-oriented growth, its future prospects are poor because changes in the international environment have lowered the chances for dramatic expansions of exports. This is superficial, however, because it implies that the environment is the main determining factor in the model. If that were so, there should today be many successful capitalist developmental states and not just a few in East Asia. It seems instead that the particular political economies of the capitalist developmental states have managed to adapt more effectively and more rationally to any given environment than either their purely absolutist or their purely capitalist rivals. Thus, as a matter of batting averages rather than absolute growth rates, it would follow that in a world in which all economies may grow more slowly in the future, the capitalist developmental states will still outperform the others. This is because they have discovered ways to surmount the rigidities of zero-sum domestic competition without falling into the trap of authoritarian displacement of the market and private enterprise.

# The interplay of state, social class, and world system in East Asian development: the cases of South Korea and Taiwan

Hagen Koo

The growing literature on East Asian economic development is dominated by conventional economic analyses that stress the comparative advantages of the East Asian NICs and how they have reaped the benefits of these advantages through the workings of world market mechanisms (Westphal, 1978; Little, 1982; Balassa, 1982). Recently, however, scholars have begun to pay close attention to the role of developmental states in guiding and directing export-oriented industrialization through strategic intervention in the economy (Amsden, 1979; Hofheinz and Calder, 1982; Haggard and Moon, 1983; Wade and White, 1984). Although this statist approach reveals important dimensions of the East Asian development pattern, it tends to overstress the independent role of the developmental state, paying insufficient attention to other, equally important sociopolitical forces such as social classes and core-periphery relations in the world economic system.

Here I take a more comprehensive, albeit somewhat eclectic, approach, using an analytic framework advanced elsewhere (Koo, 1984a). This approach assumes that development in a Third World country is shaped by the interplay of state, social classes, and world system. The focus of analysis is not the individual factors but the *interaction* among these three sets of variables. If we do not examine these variables in their dynamic interaction, I believe, we cannot delineate the specific ways in which each set of variables influences the development process. Dependency mechanisms, for example, cannot be specified until we have investigated the ways in which external forces are linked to internal class structure. Similarly, class relations in a peripheral nation cannot be adequately understood unless we consider the influence of international capital and core states. Finally, the role of the state in economic development cannot be fully understood without its being situated in the contexts of class structure and world economic

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