STATE CAPITALISM AND ECONOMIC GROWTH: THE CASE OF SOUTH KOREA

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Abstract:
The impressive growth of South Korean's economy is today a reference model for many countries that aim to find a path of modernization and development for their economies. In this paper we intend to present the main socio-economical factors that led to this genuine economical miracle and to argue the aplicability of this model in today's global world. The development of a country is related to many social, political and economic factors that cannot be thoroughly reproduced, but being aware of a certain type of economical logic can be an important lesson for many developing countries.

Key words: *state capitalism, intervention, export oriented industrialization, chaebol*

JEL classification: *P52*

1. Initial data

After a tumultuous recent history that includes a period of Japanese occupation between 1910 and 1945 and a devastating war with North Korea between 1950 and 1953 which resulted in the deaths of 1.2 million people from both sides, South Korea was one of the poorest countries in the world with a annual income of 67 dollars per capita (ranked 101 of 125 countries). At the end of the Second World War and until the 60's, North Korea's economy was more advanced than South Korea's because Japan was interested to develop the northern side in order to expand its occupation to neighboring China. Also, North Korea owned significantly more mineral resources and had a higher degree of industrialization. Today, South Korea is rated as one of the most dynamic and advanced economy with an annual income of 30,000 dollars per capita, ranked as the 15th largest economy in the world after gross domestic product (and fourth in Asia, after China, Japan and India). At the same time, North Korea's economy ranks as only the 125 in the world, the country being affected by hunger and poverty. How was this spectacular economic performance possible in such a relatively short period of time?

2. Economic Development

The analysts agree on the fact that the initial moment in the development of the Korean economy was the coming to power of the General Park Chung-Hee in 1961. He came to leadership through a military coup and won three successive elections until 1972 when he declared martial law, suspended the constitution and named himself president for life. Until 1979, when he was assassinated, he imposed a five-year economic development plan directed by the government as a result of which the income per capita has increased 10 times. The national economic development has been considered a matter of national security, the country could not afford the luxury of a free economy since it had to defend itself from the military menace and communist propaganda of the North Korea. It should be noted that the war between North and South Korea did not end, it just was suspended in 1953 by a truce that ended hostilities.

The ideology behind these actions was that the democracy is ineffective in the face of significant challenges such as those involved by the reforming the economy of an underdeveloped economy and obtaining fast growth.

The radical economic reform measures aimed primarily at the industrialization of the country by setting up companies, many of them state owned or heavily subsidized from the state budget. These measures were taken in order to impose them on the international markets and achieve significant exports. There were created steelworks, shipyards, chemical factories, electronics and automotive companies. The Korean economic development was centered on export. The international trade made possible the accumulation of foreign currency which was subsequently and strategically used to acquire high-technology equipment from abroad. The foreign currency was considered vital because it was meant to help increase the country's competitiveness on the international markets. Thus, the state encouraged the exporters by offering them incentives such as import licenses conditioned by export performances, tax exemptions for machinery and raw materials and generous loans[235]. A state agency was established to promote export with the primary goal to find export markets, help the antrepreneurs sell their products and remove obstacles, especially in the beginning.

South Korea's economy has been characterized as "state capitalism," a system in which the state is in the midst of economic activity. The state intervenes in the banking sector directing the loans, it owns key segments of the industry and the economy is driven by the bureaucracy. Government incentives, loans by state banks and major investments made by state corporations play an important role. As Ioan Ciobanu and Ruxandra Ciulu has shown, “the South-Korean economic miracle challenges even the neoclassical model. State intervention in the economy has been one of the key factors for success. Due to a planningsystem based on strict regulations, it orients allocation of resources based on objectives defined by the central. The real issue is to know in what conditions interventionism is necessary in the economy and by what means it can be exerted”[236].

An important part of the export-oriented economic policies of South Korea was conducted through bank lending. The government nationalized the banking sector obtaining control of all the forms of institutional credit. The banks became agents of government economic development plans granting long-term loans in order to stimulate production, facilitate the export of goods and services and invest in infrastructure. This has enabled the government to act as a "manager-entrepreneur" financing the companies that were able to achieve the highest exports and those who managed to substitute imports with domestic production. State subsidies took the form of preferential access to credit and long periods for the loans . If private firms did not invest in sectors considered important, the government would take the initiative and establish state companies to do the job. Also, a bad management of private companies could potentially lead to their nationalization by the state, their restructuring and then privatization[237].

As part of the development process, South Korea decided to normalize relations with Japan. As a result, the country received significant compensation in financial,

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[235] Cho, Philip (2011), Economic Development of South Korea under Park Chung Hee(1961-1979), [online], available at:<http://www.slideshare.net/noblepylon/economic-development-of-south-korea-under-park-chung-hee-196179-7328748>, [Accessed March, 16, 2013]

[236] Ciobanu, Ioan, Ciulu, Ruxandra, (2010), Secrets of the South-Korean economic miracle, Analele științifice ale Universității „Ioan Cuza” din Iași, [online], available at: <http://anale.feaa.uaic.ro/anale/resurse/mngmk3ciobanu.pdf>, [Accessed February, 28, 2013], p. 194.

[237] Chang, Ha-Joon (2012), *Samaritenii cei răi. Mitul liberului schimb și istoria secretă a capitalismului*, Iași, Editura Polirom, p. 22

credit and technology transfer for the years of Japanese occupation. In the same time, the country has strengthened its traditional relations with the U.S., president Park Chung-Hee sending Korean troops to Vietnam to fight alongside the U.S. In exchange for this support, the United States provided assistance and economic aid which were used for the development of the country. All the currency coming from aids and exports was so important that any spending for things that were not considered economically strategic was prohibited by law. Household consumption was limited to domestic supply and even trips abroad were restricted to business and education travels, vacations in other countries being prohibited for this reason.

Another important element in the Korean economic scenario was represented by the chaebols, business conglomerates owned by family members. They worked together with the government and supported the development efforts, therefore they found in the Korean state a strong supporter of their business through state-guaranteed loans. Chaebols such as Samsung, LG, Hyundai and SK played a fundamental role in forging new sectors in industry through the introduction of latest technologies and by finding new markets for these Korean products. Although many of these conglomerates had a dark history – after the Japanese colonial period a few Korean businessmen gained control of former nippon companies that grew into chaebols and thrived during the Syngman Rhee's corrupt regime – they were the main partners of the state in implementing growth plans through this type of "guided capitalism". Furthermore, the chaebols were able to protect the national economy from unfavorable foreign investments. If foreing antrepreneurs would be allowed to establish companies, their profit would return in their native countries. Foreign direct investments (FDI) can be easily transformed in cash and quickly shipped from the country. Furthermore the foreign subsidiary can use its assets to borrow from domestic banks and transfer the money out of the country[238]. Thus, unconditionally acceptance of FDI can have a negative impact on the long term development of a country. As a result of their remarkable growth, in the late 80's the chaebols became financially independent, eliminating the need for state support and preferential loaning.

All these economic measures led to spectacular results. From 1961 until today exports increased 100-fold (from 3.3 million dollars to 33 billion dollars) and the average income per capita increased 14 times. In 1996 South Korea was accepted in OECD, (The Organization for Economic Cooperation and Development), a forum of rich countries with solid economies.

3. State capitalism versus economic liberalism

Economic liberalism is today the most popular doctrine among economists. Adam Smith's theory, often formulated in its improved variant of economic neoliberalism, is promoted by the governments of wealthy countries as the only way for a country's progress. The basic principles of economic liberalism include free markets, free trade, economic competition, private ownership of enterprises, reduced state intervention and regulation, monetary stability with anti-inflationist policies, foreign investments[239]. Rich countries have created lending institutions like the World Bank or the International Monetary Fund which condition their financial help provided to developing countries by implementing liberal economic policies.

The major problem, however, is that rich countries have not become rich by adopting this kind of measures and policies. The Korean analyst Ha-Joon Chang argues

[238] Loungani, Prakash, Razin, Assaf (2001), How Beneficial is Foreign Direct Investment for Developing Countries?, *Finance and Development*, vol. 38, no2, pp. 6-10.

[239] Gwartney, James, D., Stroup, Richard, L., Lee, Dwight, R. (2008), *Liberalismul economic*, București, Editura Humanitas, p. 36.

that even wealthy countries in the Western World have used, at some point in their history, growth strategies that were contrary to the neoliberal logic.

Whether we talk about protecting domestic production (especially young industries), about overtaxing specific import goods, reducing or even canceling import taxes on raw materials used in domestic production, export subsidies for domestic products to make them more competitive on foreign markets, public companies or public-private partnerships, state aid, nationalization of key enterprises when they encounter difficulties, drastic restrictions on foreign investments, licensing and patent protection, all these have been used by countries such as UK, USA, Germany at some point or other in their development. Once the industries of these countries became competitive on global markets, state protection was useless. On the contrary, promoting the liberal ideology of free trade and equal competition was more in advantage for these countries since they were now interested to sell their goods without encountering obstacles. As such, they became fervent supporters of the free trade. South Korea is perhaps the best example. "The secret of its success lies in a judicious mix of protectionism and free trade, the protected domains constantly changing, as new industries grew and established industries became more internationally competitive... This is how almost all of today's wealthy countries got rich and this is the common denominator of almost all successful stories in the developing world. Protectionism does not guarantee development but development is very difficult in his absence "[240].

But North Korea was not the only country that apllied with success the model of state capitalism. Countries like China, Russia and Saudi Arabia achieved remarkable economic success by putting into practice the mix of free market and state intervention. While many western countries with free market and minimal state from America and Europe have entered the global recession determined by speculative practices of deregulated banks and private equity funds, state capitalism economies have maintained their growth and climbed a few places in the GDP rankings.

4. Conclusions

Is then state capitalism the economic model of the future? The answer most analysts favor is: not really[241]. State intervention in economy by influencing bank loans, protecting domestic companies through import taxes, state aid and state ownership of important sectors of the economy could be a recipe for developing economies, a strategy for the modernization and industrialization of a country. A strong government, a concentrated effort and a clever vision represents undeniable assets for a young economy. To sacrifice the present for a prosperous future could be a good way to follow. But, as the South Korean case demonstrates, once achieved this goal the state must reduce its influence and withdraw from economy. If this doesn’t happen, we are facing the risk of numerous problems: high levels of debt, excessive investment, external surpluses, banking crisis, diminished private sector, endemic corruption, foreign capital leaving the country. Countries that today are competitive have deregulated their markets, liberalized their economies, but they did it selectively and gradually.

State capitalism’s suporters argue that it can provide stability and growth. For example, China Mobile is a huge state-owned company with 600 million customers, Russia’s Gazprom is the biggest natural gas company in the world and Saudi Basic

[240] Chang, Ha-Joon (2012), *Samaritenii cei răi. Mitul liberului schimb și istoria secretă a capitalismului*, Iași, Editura Polirom, p. 84.

[241] Schuman, Michael (2011), State capitalism vs free market: Which performs better?, Time Magazine, [online], available at: <http://business.time.com/2011/09/30/state-capitalism-vs-the-free-market-which-performs-better/>, [Accessed March, 9, 2013]

Industries Corporation is one of the world's most profitable chemical companies. In Russia, the government holds significant parts of the shares of country's most strategic firms such as Gazprom, Aeroflot, Sukhoi, Gazprom and Sberbank. In 2009, two major chinese state-owned enterprises (SOE), China Mobile and China National Petroleum Corporation made profits of 33 billion dollars, more than China's 500 most profitable private companies combined.

But this economic model which favors SOE over private companies has many weaknesses. State companies use capital less efficiently than private companies (in many cases they boast themselves building huge headquarters), they waste money and grow more slowly. State-owned companies are not so innovative and do not produce new ideas as private firms and small start-ups. State capitalism depends upon the government's compentence and usually produces corruption, inequality and eventually discontent. "For emerging countries wanting to make their mark on the world, state capitalism has an obvious appeal. It gives them the clout that private-sector companies would take years to build. But its dangers outweigh its advantages. Both for their own sake, and in the interests of world trade, the practitioners of state capitalism need to start unwinding their huge holdings in favoured companies and handing them over to private investors. If these companies are as good as they boast they are, then they no longer need the crutch of state support"[242].

Therefore, it is important not to confuse the path with the destination. An omnipotent state is a powerful support for the economy of a developing country. But too powerful a state (and not knowing when to withdraw) can be as harmful as an ultraminimal state. Not to mention that an omnipresent state is the number one enemy of democracy, a value which has no equivalent in money.

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[242] The Economist, (2012), Jan., 21, The rise of state capitalism, p.12.