INDUSTRIALIZATION AND INDUSTRIAL POLICY IN SOUTH KOREA: SOME DEVELOPMENT LESSONS FOR TRANSITING ESTONIA

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Outline

• Introduction

• Korea’s Industrialization Path

• The Role of Korean firms in Industrial Development

• Some Lessons
Introduction

• Industrialization refers to the sustained structural transformation of a traditional economy into a modern economy driven by high – productivity activities in manufacturing

• Mid 18\textsuperscript{th} century – Britain – European countries (Belgium, Switzerland and France)
• 19\textsuperscript{th} century - USA
  20\textsuperscript{th} century – Germany, Russia and Japan - the East Asian Tigers
  Recently – China
  21\textsuperscript{st} century – relevant for poor countries trying to catch up with more advanced economies; advanced economies struggle to maintain their competitiveness

• The rise of China as a workplace of the world makes it harder for late industrializers to enter markets for manufactured products
Introduction

• Industrial policy is one of the most misunderstood areas of government policy.

• There remains large amounts of skepticism about its relevance or usefulness in other contexts. It has failed in SSA.

• Industrial policies range from extremely selective to functional policies
  - Selective policies attempt to pick winners, supporting specific firms, industrial champions or investment projects
  - Functional policies do not pick winners but promote the competitiveness of the entire manufacturing sector, or even the entire supply side of the economy through educational investment

• The modern industrial also and importantly involves technology and innovation policy. (Finland – Nokia; Japan – Toyota & Sony; South Korea – Samsung & Posco).
## Structure of Production, 1950-2005

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Introduction

• 1950: 37% of developing country GDP originated in the agriculture
2005: 16% of developing country GDP originated in the agriculture
1950: 42% of developing country GDP originated in the services sector

• 1950-1980: The average share of manufacturing increased in all developing countries

1950-1980: The share of manufacturing remained high and stable in many Asian economies
Deindustrialization in Latin America

• 1950-2005: The share of manufacturing went down from 29.4% to 16% in advanced economies
The share of services sector went up from 44.6% to 71%
Introduction

• In several Debates Asian Model was recommended to developing countries.

• Asian ‘lesson-making’ represents a grave error in policy-thinking and in the historical understanding of the nature and process of development.

• This study examines the paths of successful growth of South Korea, to identify what we can and cannot learn from the Asian experience.

• There are some very general things that can be learned from the Asian experience
Introduction

• Before the East Asia miracle there were two dominant paradigms for development, one focused on markets, the other on government and planning.

• The first had its intellectual roots in Adam Smith's "invisible hand": markets lead to efficient outcomes. All that government needs to do to promote growth is get out of the way. The basic slogan is "get the prices right."

• At the opposite side were those who had little faith in the market and who looked to government to ensure through the planning process that resources were deployed in a way that promoted economic growth.

• The appropriate question to be asked is not whether government should play a role, but what role and how can it be performed most effectively.
Korea’s Industrialization Path

- The fast growing Asia followed highly unusual and distinctive paths of growth and there was considerable variety across Asia.

- Four Asian ‘dragons’ – Korea, Taiwan, Singapore, and Hong Kong – looked for inspiration to the Japanese export model for lessons.

- In Korea, there was considerable institutional policy learning and collaboration with Japan and rejection of conventional Western policies.

- Korea and Taiwan rejected free market comparative advantage policies and often ignored the recommendations of conventional economists.
Korea’s Industrialization Path

• In 1962, Taiwan and Korea had gross national product per capita levels close to those of the poorer African nations.

• 1960-1970: Korea showed far greater intervention, compared with Taiwan and the laissez faire approach adopted in Hong Kong.

• The government in South Korea financially supported and pushed the large chaebol into specific export areas.

• 1960-1980: Korea and Taiwan remained fairly closed to FDI, compared with the open economies of Singapore and Hong Kong.
Korea’s Industrialization Path

- In Singapore, the government believed that local capitalists were not capable enough to lead industrialization and invited foreign TNCs to lead industrialization

- Korea enforced tightly controlled FDI, protecting local industries and negotiations were in favor of domestic firms and against foreign competitors in local markets.

- Banned many consumer goods and raw materials imports which could be produced locally.

- Korea learned lessons from the Japanese *keiretsu* to which many Korean firms were connected through OEM and joint ventures.
Korea’s Industrialization Path

• Each country had to develop a strong local capitalist class in slightly different ways with Korea relying on its local ‘tycoons’, Singapore on the subsidiaries of foreign TNCs, and Taiwan and Hong Kong on waves of immigrants, rich and poor, fleeing communist China.

• Many Korean directors spoke Japanese rather than English in the early stage of their business development.

• By the early 1990s a significant proportion of world trade and manufacturing had shifted to the East and South East Asia.

• Similarities and differences in approaches to technology acquisition and catching-up among the local exporting firms of East Asia.
Korea’s Industrialization Path

- These so-called latecomer firms faced considerable developing country disadvantages.

- Samsung, perhaps the most successful Korean latecomer firm, reveals an incredible story of catch-up via technological learning

- The firm entered the export market through the assembly of low-cost, simple transistor radios and black and white TVs in a joint venture with Sanyo in 1969.

- Prior to this, its main activities were in insurance, property, paper, and other low-technology products for the local market.
The Role of Korean firms in Industrial Development

- By the mid-2000s Samsung Electronics had become one of the most successful electronics producers in the world.

- In 2007 it registered 2,725 patent in the USA, nearly as many as the world leader IBM with 3,148.

- In 2006 Samsung spent US$5.6 billion on R&D, employed around 123,000 workers, operated 17 R&D centers around the globe

- Only a very few, such as Hyundai and L-G of Korea, and Acer and Tatung of Taiwan, have achieved anything like the progress of Samsung.
The Role of Korean firms in Industrial Development

• 1960 – 1970: Korean firms concentrated mainly on basic assembly, beginning the manufacture of standard, simple goods often supplying foreign transnational corporations (TNCs), mostly from the USA and Japan, under the sub-contracting arrangement called original equipment manufacturer (OEM).

• Within OEM the foreign TNC buyer supplied the design, technology, and necessary training and then distributed the product in the developed country markets under its own brand name.

• 1970 – 1990: Samsung and others learned to not only master the manufacturing process but also to innovate with manufacturing and product improvement.
The Role of Korean firms in Industrial Development

- Following on from improvements to design the firms learned to design new products and begun offering their own ranges to TNC buyers who would then sell under the TNC brand name.

- The TNCs benefited from low-cost design and manufacture and often gained much of the value added.

- From the mid-1990s onwards, firms learned how to produce original product designs from scratch, and they began to rely more on their own R&D to innovate.

- Firms like Samsung had invested in design and R&D for many years both to support manufacturing
Lessons

- The particular paths, models and specific policies of Asian development should not be copied by other developing countries.

- Export led growth: Korea banned imports of ‘non-essential’ items and placed heavy restrictions on FDI.

- In contrast to high-technology and knowledge-intensive production, the focus of exporting for at least the first 20 years was ‘low-technology’ products based on fairly simple manufacturing processes.

- Even today, electronics hardware is the main Asian export staple, rather than software, capital goods or knowledge-based services, where developing Asia remains conspicuously weak.
Lessons

• The Asian export focus on electronics hardware may well now be a ‘boat which has passed’

• Other countries would be wise not to try and imitate or compete with the Asian nations which now collectively represent a formidable world center for production and innovation in this sector.

• If export-led growth is no longer an option for most countries (given the collapse in Western demand—and the strength of China and other Asian exporters), then local demand, regional markets and other developing countries might provide alternative targets

• In Asia, the process of exploiting export-led growth in electronics occurred out of experimentation and trial and error learning. There is no evidence that planners or government agencies chose the sectors or technologies in advance
Lessons

• Electronics ‘emerged’ from small beginnings after other sectors such as foodstuffs, clothing, apparel, toys, and electrical goods had shown the value of low-cost assembly activities for gaining export earnings.

• The Asian growth experience complemented the take-off in world demand for electronics hardware which was itself fuelled by innovations in information and communications technology.

• This suggests that rather than imitate or compete with Asia, the most appropriate approach is to complement, rather than copy the Asian economies (and for that matter the most successful developed countries).

• In fact, this kind of complementary specialization has already occurred as some Latin American and African nations supply raw materials to support China’s recent growth.
Lessons

• Government and businesses need to cooperate closely, but without collusion.

• Economic growth requires the maintenance of macroeconomic and political stability.

• Government policies should be adapted to changing economic circumstances

• The state has to finance industries in which research and development would have high payoffs.

• Support for industry, such as the establishment of research and science centers and quality control standards, is important both in attracting foreign investment and in encouraging domestic investors.