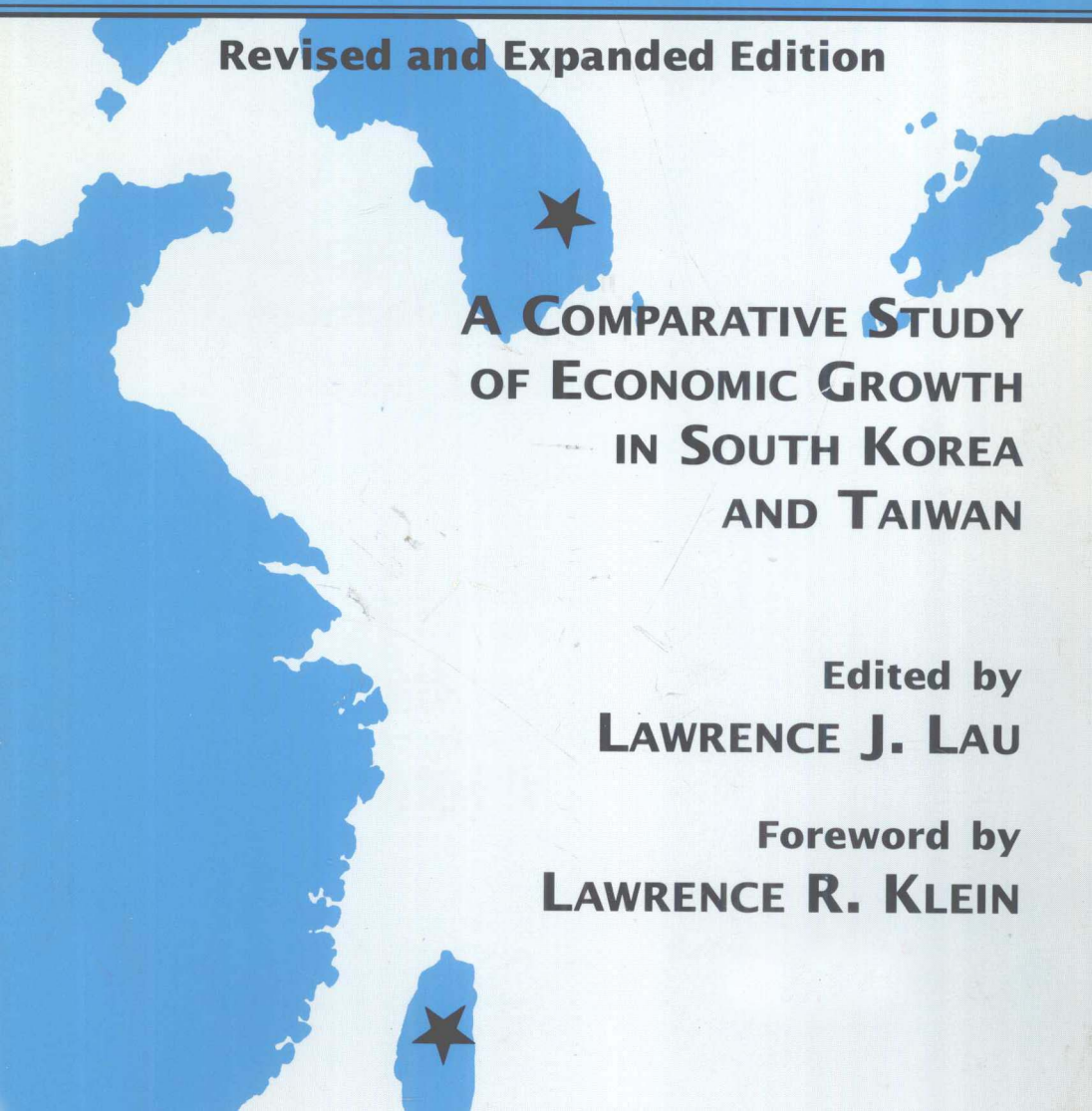


**EXECUTIVE SUMMARY**

# **MODELS OF DEVELOPMENT**

**Revised and Expanded Edition**



**A COMPARATIVE STUDY  
OF ECONOMIC GROWTH  
IN SOUTH KOREA  
AND TAIWAN**

**Edited by  
LAWRENCE J. LAU**

**Foreword by  
LAWRENCE R. KLEIN**

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—— *Executive Summary* ——

# **Models of Development**

A Comparative Study of Economic  
Growth in South Korea and Taiwan

*Revised and Expanded Edition*

Edited by  
Lawrence J. Lau

An International Center for Economic Growth Publication

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# Contents

<b>Foreword</b>	5
<b>Preface</b>	9
<b>Summary of Conclusions</b>	11
<b>An Overview of <i>Models of Development</i></b>	15
Taiwan's Success Story, 1965–1981	16
South Korea's Success Story, 1965–1981	18
Comparison of Taiwan and South Korea, 1965–1981	20
The Economy of Taiwan in the 1980s	24
The Economy of South Korea in the 1980s	26
Concluding Remarks	27
<b>About the Contributors</b>	31

## Contents of the book *Models of Development*

Chapter 1	Introduction <i>Lawrence J. Lau</i>
Chapter 2	The Economic Development of the Republic of China on Taiwan, 1965–1981 <i>Ramon H. Myers</i>
Chapter 3	The Economic Development of the Republic of Korea, 1965–1981 <i>Sung Yeung Kwack</i>

- Chapter 4    Economic Development in Taiwan and South Korea,  
                  1965–1981  
                  *Tibor Scitovsky*
- Chapter 5    The Economy of Taiwan, 1981–1988: A Time of Passages  
                  *Lawrence J. Lau*
- Chapter 6    The Economy of South Korea, 1980–1987  
                  *Sung Yeung Kwack*
- Chapter 7    Conclusion  
                  *Lawrence J. Lau*

# Foreword

South Korea and Taiwan have continued to make unusual economic progress since the original publication of this study, and the favorable comments that I made in the foreword to the first edition have not changed in a fundamental way. These two economies are outstanding in the sense that they are very promising cases for elevation from developing-country status to developed-country status. In fact, many people who are familiar with the use of the concepts “developing” and “developed” already assume that these two economies are, in fact, developed.

There are some interesting pieces of information that lead one to this conclusion, apart from observation of such achievements as high output/income levels, strong international trade accounts, and the excellent quality of their manufactured goods. Both countries are selling world-class goods in sophisticated lines in international markets.

Their strong positions in world trade were formerly associated with favorable currency exchange rates, which were essentially pegged to the U.S. dollar. During the past few years, both the New Taiwan dollar and the South Korean won have been allowed to appreciate, just as the currencies of “members of the club” would have done in similar circumstances. It is true that the respective central banks and treasuries moved very cautiously toward currency appreciation, and it is also true that they were talked into this action by the United States; nevertheless the currencies did appreciate, and both countries continue to enjoy healthy export-led growth. Both took the requisite steps and realized substantial rises in the value of their currencies against the U.S. dollar—approximately 40 percent in the case of the New Taiwan dollar and 25 percent in the case of the South Korean won. Both countries have

performed better with appreciating currencies than their leaders thought was possible.

In the face of increased competitiveness from the United States, Western Europe, Japan, and Australia, as well as from the other newly industrialized economies, both countries continue to realize significant trade surpluses, service their debts, show strong real growth, and hold domestic prices to steady trend paths. These achievements exhibit a kind of economic maturity. They will find it ever harder to grow through exporting alone.

Although their prices are rising along a moderately increasing growth path, it does not appear that Taiwan and South Korea are approaching a condition of accelerating inflation. But times have changed. Work forces in these countries put in a very strong effort at low wages in order to gain a foothold in international commerce through competitive pricing. It is only natural that workers now demand much better wages so that they can better enjoy the fruits of their labor. Wage increases are now higher, and the only way that prices can be kept at competitive levels is to have strong productivity gains. There is, therefore, a real challenge to worker effort and ingenuity, together with entrepreneurial guidance, to overcome the rising exchange value of their currencies and continue to sell manufactured goods in world markets. During the first few years of meeting the challenge under the new conditions, these two countries have been wonderfully successful, and there is every reason to believe that success will continue.

Taiwan and South Korea have been pressured by the United States to liberalize trading policies, to import more U.S. goods, and to look more than in the past toward domestic economic expansion. South Korea attained a measure of high international economic status through its sponsorship of the Asian Games in 1986 and the Olympics in 1988. Taiwan has repeatedly been called upon by the United States to contribute, along with other "advanced" countries, toward the resolution of the LDC debt problem. South Korea has been paying off its foreign debt ahead of schedule. It is their mature responses to these extraordinary requests and pressures that, more than anything else, place these two economies in the most advanced international classification.

Taiwan and South Korea are following the Japanese economic route in many respects, and the similarities are also striking in the case

of education. We educators have come to appreciate the high level of achievement of the scholars from Taiwan and South Korea; both countries operate impressive educational establishments domestically. The performance of their students in international competition and in absolute levels of scholarly achievement is quite impressive. Scholarly achievement played a very positive role in elevating Japan to the world's highest economic status, and I can perceive the same forces at work in Taiwan and South Korea. In many respects, the student flow that I personally encounter at the higher education level in American universities reminds me of the similar performance of Japanese students during the 1950s and 1960s.

The fact that a second edition of this book is called for is indicative of the point that world readers in the field of economics are deeply interested in the two success stories being analyzed in the present study. There is a great desire to know as much as possible, in subtle detail, of the factors that made possible the economic achievements of Taiwan and South Korea. Many third world and centrally planned economies want to emulate these two cases.

Lawrence R. Klein  
Nobel Laureate in Economics



# Preface

We are very pleased to publish this executive summary of the revised and expanded edition of *Models of Development*. In South Korea, Taiwan, and throughout the world, significant changes have occurred since the first edition of the book was published in 1986 that make this an important publication.

In the past four decades, Pacific Basin countries have compiled extraordinary records of economic performance. The experience of the “four tigers”—Hong Kong, Singapore, South Korea, and Taiwan—provides a sharp contrast to the stagnation or decline experienced in many other developing countries. Of the four, South Korea and Taiwan have political, demographic, and geographic qualities that are more representative of third world countries in general and thus provide better examples for other developing countries. The particular focus of this book is on economic policies that can be adopted in other social and political settings.

We are confident that this edition will have the same broad appeal of the first edition and that the experiences of South Korea and Taiwan will be of interest in many other countries. Indeed, the first edition has been translated into Spanish and into Chinese in both the People’s Republic of China and the Republic of China on Taiwan.

Nicolás Ardito-Barletta  
General Director

International Center for Economic Growth

Panama City, Panama  
September 1990



# Summary of Conclusions

In the past four decades, the “four tigers”—as Hong Kong, Singapore, Taiwan, and South Korea are known—have compiled extraordinary records of economic performance. Of these countries, South Korea and Taiwan have demographic, political, and socioeconomic qualities that are more representative of third world countries in general. This work focuses on the economic successes of those two countries and on the economic policies responsible for their successes.

1. The economic success of Taiwan and South Korea is attributable to three essential factors:

- reliance on private enterprise
- establishment of the rule of law in the economic sphere
- the existence of domestic and international competition

The simultaneous presence of these three factors is important: reliance on private enterprise without competition, for example, may lead to private monopolies, with their associated inefficiencies.

2. In important policy and policy-related areas Taiwan and South Korea had some key similarities, as well as some differences:

- Both Taiwan and South Korea featured export promotion as the cornerstone of economic growth.
- Both adopted realistic interest rate policies. South Korea, however, was not as successful as Taiwan in mobilizing domestic savings for investment; foreign capital provided

an important source of investment funds. In the 1980s, however, the South Korean savings rate increased significantly and exceeded investment, and the current account went from a deficit to a surplus position.

- Both countries had fiscal budget surpluses and maintained realistic exchange rates.
  - South Korea's currency was subject to more frequent devaluation, and Taiwan had more stability in prices and growth of real GDP.
3. The philosophies behind the development strategies of the two countries were different in important ways. One striking difference is in their fundamentally different views on the role of government.
- The South Korean government took a very active role in controlling market forces, while the government of Taiwan tended to rely more on the workings of the free market.
  - Both countries implemented a variety of economic controls, but government influence over economic affairs was much more overt and pervasive in South Korea, where the economic planning structure was larger, more centralized, and more elaborate.
4. One outcome of the difference in development strategy is that South Korea generally has a higher level of industrial concentration—fewer firms per industry—than Taiwan.
- In Taiwan the most important factor in the prevalence of small businesses and low industrial concentration was the absence of a policy to encourage large enterprises and the government's willingness to let market forces take their course after securing conditions conducive to economic growth.
  - In South Korea, however, the government consciously encouraged large businesses—and high industrial concentration—at the expense of small. Credit, for example, was subsidized and

allocated to large enterprises; tax incentives and disincentives in favor of large enterprises were common.

5. Taiwan's free-market orientation has produced a more equitable distribution of income than exists in South Korea. Taiwan's more equitable distribution stems from six factors:

- land reform, which improved land distribution and encouraged increased productivity
- high employment, which increased labor's share of income
- an increasing level of education, which helped reduce income inequality
- tax policies aimed at redistribution
- social welfare, health, and education spending designed to benefit lower-income groups
- a small average business size, which eased entry and limited excessive profits

6. In the 1980s, both economies saw increased economic liberalization and democratization. Prospects for continued growth in both countries remain good. The unrest both are experiencing is similar to what Japan experienced in the 1960s. The only dark cloud on the horizon is the rampant speculation on the stock exchanges and property markets. As we go to press in September 1990, the Taiwan Stock Exchange Average Index has lost 70 percent of its value since the beginning of the calendar year.

