KOREA'S COMPETITIVE EDGE

Managing the Entry into World Markets

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Introductory Note

THIS STUDY IS BASED ON A SURVEY of 113 Korean exporting firms that Yung Whee Rhee and Garry Pursell conducted in the summer and early fall of 1976. The survey had two parts—one financial, the other descriptive—and was extremely detailed, with the questionnaire running to some 500 pages. The firms in the sample were much larger than average Korean firms: they had average annual sales of $32 million, compared with $0.5 million nationwide, and average work forces of more than 2,500, compared with about fifty nationwide. The research is part of a larger project examining export incentive policies in the developing countries, a project under the general direction of Bela Balassa. Only the results from the descriptive part of the survey are reported here. Those from the financial part will be published later.

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Korea's Competitive Edge

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Introduction

KOREA'S REMARKABLE EXPORT GROWTH is the envy of much of the developing world. The country's exports—worth $52 million in 1962, the year the export drive began—passed $100 million in 1964, $500 million in 1968, $1 billion in 1970, $10 billion in 1977, and $20 billion in 1981. More than 90 percent of the exports in 1981 were manufactured goods, roughly a sixth of the manufactured exports by developing countries. Traditional export products, such as wigs, plywood, footwear, and textiles have led the way. But by the mid-1970s Korean exporters had diversified their array of traditional products and moved into the export of ships, electronics, and iron and steel products. Korean exporters have also been diversifying their markets. In 1974 Japan and the United States took more than 70 percent of Korea's exports. In 1980 that share was down to 44 percent, as Korean exporters broke into new markets in Europe, the Middle East, and the rest of the developing world. The rapid growth of trade—with exports growing almost 25 percent a year in constant prices, imports 17 percent a year—led the growth of the Korean economy at 9 percent a year during most of the 1960s and 1970s.[1]

Why has Korea been so successful in managing its entry into world markets and in acquiring and then maintaining a competitive edge in those markets? Balassa (1976, 1982), Westphal (1978), and several others have promoted the view that Korean incentives have been close enough to being right much of the time to enable Korean producers to exploit the country's comparative advantage in export production. In essence, the officials manipulating the policy tools were able to devise incentives that, on the average, eliminated discrimination against producing for export. Producers suffered no substantial disadvantages by producing for the export market; they could let profit guide their decisions about whether and how much to produce for the export market, whether and how much for the domestic market. Korea was thus able to reap the benefits of an outward-looking development strategy: export growth was dramatic, import substitution was efficient, and import restrictions were gradually lifted.[2]

For the basic incentives, access was automatic for all production and commercial transactions related to exports. But the determination of those incentives and the administration of systems to ensure access to them were not simple tasks for the export bureaucracy. The incentives and the systems ensuring access to them had to be adjusted through continuing evaluation by the government in response to changing circumstances at home and abroad. When the incentives were wrong, the government had to adjust the incentives to make them right. So, without the right process of setting, implementing, and maintaining incentives, Korea could not have had the right incentives. The process thus deserves as much attention as do the incentives.

Westphal (1978) and Mason and his colleagues (1980) have stressed the importance of institutions inherited from the predevelopmental era, the commitment of the political leadership to growth, and the pragmatic approach of the bureaucracy to policy implementation. But as Krueger (1981) writes, the interactions between the choice of policies and the other important economic and political variables are not well understood.

Coupled with the right policies, Korea's heritage of social, political, and economic institutions has been important in the country's industrialization—as has the cultural background of Koreans. Korea in 1960 may have been labeled as an economic basket case incapable of sustained development, but the country was no stranger to industry. When the country shifted gears in the early 1960s, considerable industrial experience accumulated over the preceding five or six decades lay just beneath the surface of the foundation of Korea's industrial takeoff. Nor was the Korean worker lacking the latent talent needed for industriousness on the job. Reasonably well educated and often highly experienced, the Korean worker had another important attribute: adherence to Confucian beliefs, which place a high value on loyalty, punctuality, hard work, and respect for authority. True, the same colonial experience, the same characteristics of Koreans, the same Confucian beliefs could be blamed for inhibiting economic development before the 1960s. But coupled with the right policies, those underlying forces were unleashed to promote rapid development.

Korea's political leadership believed, from the beginning of the export drive in the early 1960s until the middle of the 1970s, that outward-looking policies for trade and industry were essential for the country's development. The government continually affirmed its sustained commitment to exporting as the engine of economic growth. As a result, the policies for export promotion had a permanence that has reassured firms that the rules of the game would not suddenly be reversed. The pragmatic implementation of policy also was instrumental in Korea's success in exporting. With exporting as the prime national objective, few other policies were allowed to conflict with outward-looking economic policies. And with so much attention given to the success of exporting, it was possible to retreat from policies that proved ineffective.

Jones and Sakong (1980) have contributed to the understanding of Korea's economic growth by exploring in detail the relations between business and government. In their view, the institutional framework for economic decision-making is crucial to a country's development—and fundamental to that framework is the relationship between business and government. They stress the organizational and behavioral aspects at the heart of economic decisions, emphasizing the government's dominant role as the most important aspect. They also describe the government's compliance mechanisms that selectively guide the behavior of entrepreneurs and managers.

Many of these studies point to the importance of the institutional setup for economic decision-making, but none of them explores the dynamism and inner workings of that setup. The incentives may have been right, but what administrative arrangements enabled them to be right? The political leadership may have been committed to economic development, but how was that commitment translated into action by the bureaucracy and by firms? The relations between business and government may have been close, but why were they close and what were their underpinnings?

More and more the institutional setup for economic decision-making looms large in explaining why some economies export successfully. Take Japan, Korea, Hong Kong, and Singapore. What appear as common to their success in exporting, in addition to their outward-looking development strategies, are an active private sector, weak labor organizations, and an efficient bureaucracy that has created a climate conducive to the conduct of business. Also common to their success is a set of strong institutional mechanisms that support the alliance of business and government in the effort to export. Those mechanisms naturally differ from economy to economy because they emerge from different backgrounds and in different circumstances. For example: In Korea the government has had control of the banks, whereas banks in Japan have been heavily influenced by the private sector, especially the trading companies. In Korea (as well as Japan and Singapore) the domestic market has been selectively protected, whereas in Hong Kong there has been little protection of the domestic market. And in Korea direct foreign investment has been important in only a few sectors, whereas in Singapore it has been important in many sectors. What bears restating is that each of these economies has developed institutional mechanisms appropriate to its historical background and circumstances—mechanisms that support the alliance of business and government in the effort to export (see Hofheinz and Calder 1982).

Foreign resources have also been a factor in Korea's success in exporting. The mix of foreign and domestic capital, and its role in the rapid growth of the 1960s and 1970s has been analyzed by Frank, Kim, and Westphal (1975) and by Krueger (1980). Korea has relied heavily on flows of foreign capital resources, though these inflows have for the most part been debt, not equity. But less is known about importance of foreign and domestic actors in two other activities that firms must engage in to compete internationally: acquiring and mastering technology, and marketing overseas. The success of Korea on the international marketplace has depended first and foremost on the efficiency of firms in production, a subject adequately analyzed in many earlier studies of Korea. But it has depended, too, on the ways Korean firms acquire and master technology and on the ways that firms market (or let others market) their products overseas—processes that have some of their elements described in Westphal, Rhee, and Pursell (1981). Involving different costs and benefits, the methods firms select for acquiring technology and for marketing overseas clearly impinge on the ability of those firms to export.

Our intention in this book is to broaden the discussion of Korea's competitive edge by developing the two foregoing themes: the first has to do with the intricacies and inner workings of the main institutions for export promotion in Korea; the second with the selectivity possible in acquiring technology and in marketing products overseas. In chapter 2 we describe the system of export incentives in Korea. In chapter 3 we examine the way exporters regard two key institutions of the Korean incentive system—the export targets and monthly trade promotion meetings—and we spell out some of contributions of those institutions to informational efficiency and to the effectiveness of the entire system of export promotion. In chapter 4 we examine the ways of acquiring technology that Korean exporters regard as important for their main products and processes—and what is involved in mastering new technology. In chapter 5 we examine who does what in marketing Korean exports. In chapter 6 we explain the probable causes of Korea's setbacks in the late 1970s, speculate about some of the challenges Korean exporters face in the 1980s, and detail some of the lessons of Korea's experience for other developing countries.

Notes to Chapter 1

1. The Republic of Korea, or South Korea, will generally be referred to in this book as Korea. The numbers in this paragraph are from appendix B, which gives basic economic data on Korea for 1962–81. For the improvements in national welfare associated with Korea's economic growth, see Mason and others (1980).

2. All this is consistent with the conclusions of empirical studies of the effect of foreign trade regimes on the economic growth of developing countries: countries with outward-looking strategies have had better export performance and better economic growth than countries with inward-looking strategies; the trade regimes under outward-looking strategies have been close to free trade regimes for export products (World Bank: Balassa and associates 1971, 1982; Organization for Economic Cooperation and Development: Little, Scitovsky, and Scott 1970; National Bureau of Economic Research: Bhagwati 1978 and Krueger 1978).

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Export Incentives

MOST DEVELOPING COUNTRIES IMPOSE TARIFFS on imports to raise revenue and to protect the domestic market. Many of these countries also place quantitative restrictions on imports to give additional protection to local industries producing for the domestic market. These policies have three main consequences for would-be exporters. First, the prices that goods can be sold for on the domestic market are higher than those on the world market. Second, the prices that must be paid for imported intermediate inputs are higher than world prices. Third, the balance-of-payments equilibrium can, because of reduced imports, be maintained at an exchange rate more unfavorable to exporters than otherwise. All three consequences reduce the profitability of exporting relative to that of producing for the domestic market. The profitability of exporting is further reduced if the exchange rate is not adjusted when domestic prices rise faster than world prices: the increasingly overvalued exchange rate further reduces the prices producers receive in domestic currency for their exports.

To remove these biases against exporting, a government need only open its borders to free trade and let its currency float to its equilibrium exchange rate. For many developing countries, such liberalization would be desirable as a policy for the medium and long term. But in the short term these actions would allow imports to displace much local production, including that by infant industries being temporarily protected, and increase the deficit in the balance of payments. Nor do the developing countries find it easy to allow their exchange rates to float to the equilibrium level. Their financial markets are not competitive. Their financial institutions are not well developed. Their