

1. Introduction: catch-up

1. THE CATCH-UP

Starting the catch-up process is by itself a great feat for a backward economy. Catch-up, however, is not always an uneventful process. The country might fall into a chaotic stagnation for an indefinite period of time or might even return to backwardness at halfway. Catch-up necessarily involves a certain specific form of institutionalization, but an institutionalization which might well breed the seeds of an eventual catastrophe and possible self-destruction. There may have to be a fundamental restructuring of the initial institutional setting at certain point in time, in order to avoid the possible disastrous end.

Catch-up is very much like taking inter-state turnpikes to travel from a destitute backward state to an advanced state of material affluence. Unless the latecomer is prepared to repeat a more than, say, two or three hundred-year journey of its own (very chancy) industrial revolution and the following natural evolution, it has to take turnpikes. Unfortunately, however, there is neither a ready-made passageway to a turnpike at the point of departure, nor any ready-made ramps connecting to other turnpikes that one may have to switch to at various junctions on the way to the final destination. Once on a turnpike, there is no built-in force to switch automatically to another turnpike or to get off it at the right moment. There is, furthermore, no ready-made ramp connecting to other turnpike or local highway either. What is more, the kinetic energy or the law or inertia is somewhat conducive to keeping an economy driving all the way to possible downfall.

I will give an example. China had a driver named Mao Zedong to get on to the Socialist-Nation-Building turnpike, but found another driver named Deng Xiaoping at an opportune time to switch to the Socialist-Market-Economy turnpike. Those drivers are not just driving. They have to construct passageways and ramps with their own hands. China may still need yet another driver to switch to the Democratic-Market-Economy turnpike in order to reach the final destination. The Soviet Union had drivers called Lenin-Stalin to get on to the Centrally-Planned turnpike. Unfortunately, they could not find a correct new driver at an appropriate time to switch to the next turnpike. The old comrades ignored the warning road signs and

kept on driving along the first turnpike, eventually falling down to chaotic self-destruction. Korea had a driver named Park Chung-Hee to get on to the Export-Oriented turnpike, but by failing to find a correct new driver at an appropriate time to switch to the Democratic-Market-Economy turnpike, it has been experiencing serious turbulences that might signal the approaching catastrophe and possible self-destruction. The real-world driver can be a specific kind of sociopolitical institution or a great mortal, or both (say, the latter on top of the former).¹

In order to understand the initiation of the catch-up process, one may first have to delve into the basic nature of the mechanism of high growth in an economy such as Korea, Taiwan or Japan. That is, one may have to delve into the actual commencement of the catch-up process, the engine of sustained growth, the dynamic interaction between motivating forces, and the interactive and cumulative character of the catch-up process in such a country, and then see whether one can make any generalization.

I contend that the commencement of catch-up in Korea owes very much to the government leadership. I also contend that the Korean government was able to identify the most productive activities for the nation's economy, that is, the international specialization in labor-intensive manufacturing. Furthermore, it was capable of institutionalizing an export-promotion system that could mobilize the energy and effort of each individual member of society. It could channel these mobilized energies into what had been clearly identified as the most productive and most dynamic activities, that is, export activities. The Korean government could maintain the autogenous (that is, self-generating) dynamism of the new system by exposing its people to the incessant price-quality competition of international markets (see Hong, 1994: Ch. 1).

I contend that there may be many different vehicles for catch-up. At the same time, I contend that one has to take a more open-minded view that there may not be either absolutely necessary or sufficient conditions (or pre-conditions) for catch-up.

This chapter presents an overview of the catch-up process, examining first the idea of necessary conditions such as political leadership, social capability, and mobilization of domestic savings. It examines the vehicle for catch-up expounded by Hamilton and List, and then analyses the role of trade in the catch-up process. It delineates the mechanism of high growth and catch-up in East Asian NICs. After examining the so-called NIC phenomenon of outward-looking export-oriented growth, I will make a brief remark on the crisis that Korea has been experiencing since the late 1990s and the necessity of a fundamental institutional restructuring at certain points in the catch-up process.

2. GROWTH POTENTIAL AND POLITICAL LEADERSHIP

Many people believe that an underdeveloped economy has a greater growth potential than an advanced economy because it can readily install the most up-to-date capital equipment and adopt the latest production and organizational technologies. That is, a latecomer has the possibility to make large technological leaps, quickly reducing the existing productivity gap. Furthermore, the less-than-perfect utilization of available resources at the starting point would leave ample room for its productive potentialities to be brought out more fully by the forces generated in the process of growth. There is likely some dynamic interaction between growth and domestic organization that enhances the utilization rate of available human resources. As suggested by Myint (1977), we may well postulate an “open-ended” model.

The distinction between the mere potential for catch-up and the factors actually enabling the realization of such a potential is of course, emphasized. Anybody can see the glaring difference between many African nations and the so-called East Asian tigers. First of all, strong political leadership is believed to constitute an absolutely necessary condition for an underdeveloped economy to commence the process of catch-up. (One may not too seriously dwell on the case of Hong Kong.) It would imply a leadership that can identify the most productive activities for the society and can institutionalize incentive systems to promote those activities. It may also imply a political leadership that can promote an egalitarianism which tolerates unequal rewards proportionate to individual productivity and efforts, and that can keep directing a nation’s energy and talent toward high growth by maintaining an effective consensus (cf. Abramovitz, 1991).

3. ADEQUATE SOCIAL CAPABILITY

Many economists, however, believe that an adequate degree of social capability – in levels of education, in organizing and managing large-scale enterprises, and in organizing and providing financial intermediation through capital market institutions, etc. – is also a necessary precondition for an underdeveloped economy to initiate the process of catch-up. The simple existence of a strong political leadership may not be enough. Poor countries with inadequate social capability may have to build up social capability somehow first before contemplating their catch-up. Building up this capability may be the starting point for molding one’s own destiny and the beginning of the catch-up process.

If a country's social capability happens to be adequate to make a start, then the rate of catch-up may be accelerated by the ever-strengthening nature of that capability, that is, by its interactive and cumulative character (see Abramovitz, 1986). One expects some kind of transition dynamics along the way from a poor country's growth path to that of a rich country. A country, for instance, may begin the catch-up process with simple labor-intensive manufacturing that can be effectively conducted on a modest scale. The capacity to organize and administer large-scale enterprises may simply be the fruit of experience. Furthermore, social capability may anticipate the needs of technology and positively respond to its changing requirements.

4. MOBILIZATION OF DOMESTIC SAVINGS

As Harberger (1998) contends, the more "open economy" is the situation being studied, the less domestic saving has to do with domestic investment. Domestic savings may, however, take on great importance at the initial stage of catch-up when a country does not fully enjoy the benefit of international capital flow. In case of extremely limited foreign capital inflow, one may contend that the initiation of catch-up implies a reduction in the rate of time preference. There should be more work and more saving for the future consumption.

A reduction in the rate of time preference (that is, an increase in patience and more work) and the associated rise in aggregate savings propensity might at first be achieved either by the coercion of a dictator, by the persuasion of societal leadership, or by an external shock.² The success in maintaining a low rate of time preference (and hence a high rate of savings propensity) may, however, depend on the ability to maintain a high rate of return on the extra capital stock that is supplied by the extra savings of the people of the society. That is, the sharper the diminishing rate of return on capital per unit of labor, the more likely would there be the loss of credibility of the political leadership. The society would then very likely return to the high rate of time discount (and hence low saving and less work) economy. The people may have to see tangible and agreeable rates of return on their sacrifice of current consumption and leisure without too much delay.

We may contend that a steady increase in savings propensity crucially depends on the ability of the country to sustain high rates of return on investment, that is, ability to prevent a rapid fall in the rate of return on investments. The promotion of (infant) manufactured exports and the promotion of international price-quality competition might enable a country

to maximize the dynamic learning effect and the rates of return on investment. If this is the case, one may then contend that export-oriented growth through international price-quality competition is conducive to achieving the maximum mobilization of domestic savings potential (see Hong, 1988).

With an enhanced possibility of foreign capital inflow, the high rate of return on domestic investment will induce a large inflow of foreign savings. If export-oriented growth is indeed conducive to maintaining high rates of return on overall investment schedule, then it will also maximize the mobilization of foreign savings, resulting in even higher rates of growth.

5. INSTITUTIONALIZING AN INCENTIVE SYSTEM

A society can waste the enormous potential in energy and intelligence by institutionalizing a system that severely represses people's latent energies or one which channels the available energies into unproductive activities. A society may institute a system (or legal regime) that would let individual energies offset each other, or a system that would channel those energies into the least productive activities.

Baumol (1990) contends that the productive contribution of society's entrepreneurial activities varies much more because of their allocation between productive activities such as innovation and largely unproductive activities such as rent-seeking or organized crime. He contends that this allocation is heavily influenced by the relative payoffs society offers to such activities. Baumol believes that government policy can influence the allocation of entrepreneurship more effectively than it can influence the aggregate magnitude of its supply.

According to North (1994), institutions (that is, formal and informal constraints) define the incentive structure and are the underlying determinants of economic performance. Political and economic institutions are the rules of the game, and organizations such as firms and their entrepreneurs are the players. Institutions and rules are altered by changes in perceptions and beliefs. North contends that the evolving belief system (that is, redefining of mental models) in the context of competition among fragmented political/economic units (that is, in the context of decision-making under uncertainty) does not necessarily produce economic institutions and political structure that result in economic growth.

For an economy to achieve sustained high growth, it may have to institutionalize a system that can maximize the energy and effort of each individual member of the society. At the same time, the system should be able to minimize the rate of return on rent-seeking and other non-productive activities and thereby channel the individual energies into the economic

activities that are most productive for the society as a whole. The system should maintain an autogenous dynamism and also minimize the unnecessary frictions among the members of the society.

6. LIST OF PRECONDITIONS

One may argue that, compared with most other developing countries, Korea was blessed by having been subject to fewer insurmountable socio-political obstacles to institutionalizing incentive schemes to promote export activities. Indeed, by the early 1950s Korea had already eliminated the tradition-bound landlord class through land reforms. It had experienced an import-substitution-oriented regime in the 1950s, but that regime had not lasted long enough to generate extremely powerful vested interest groups entrenched in the monopolistic import-substituting activities geared to the captive domestic markets. Too much emphasis given to these kinds of facts, however, may simply enlarge the list of preconditions, which may in fact be neither necessary nor sufficient for a successful catch-up. Gerschenkron (1962: 50–51) emphasizes the fact that many backward countries managed to start the catch-up process, overcoming the lack of various so-called prerequisites with ingenuity and flexibility, and substituting some deficiencies with other advantages, though of course with difficulties and costly strains.

7. TRANSIENT EXTERNAL ECONOMIES

Hamilton ([1791], 1966) and List ([1885], 1966) are cited as the original proponents of the infant industry argument. But their writings are very rarely read even among those who cite their names. Kemp (1960) even fails to mention List in writing about “the Mill-Bastable Infant-Industry Dogma.” Many economists seem to recognize the importance of their analysis of the growth-stimulating effect of infant industry promotion. The traditional criticism against them, however, seems to be that they failed to clarify the idea of (dynamic and transient) external economies associated with the learning process, and this failure vitiated their approach to the subject. If however, one reads the writings of Hamilton and List carefully, one may well feel that such a criticism is unwarranted. This section fairly extensively reexamines the infant industry arguments of Hamilton and List, even risking a possible criticism of over-quoting them. But I do it because I believe that Hamilton and List really got to the core of development economics.

Scope for Diversity and Human Exertion: “Vent for Surplus”

Hamilton (1966: 254–5) believes that “the results of human exertion may be immensely increased by diversifying its object,” and manufacturing activities furnish “greater scope for the diversity of talents and dispositions, which discriminate men from each other,” and therefore “when all the different kinds of industry obtain in a community, each individual can find his proper element, and can call into activity the whole vigor of his nature.”³ Hamilton not only emphasizes a fuller utilization of the given existing resources, but also the longer run changes in the supply of productive factors.

According to List

Manufactures are at once the offspring, and at the same time the supporters and the nurses, of science and the arts . . . [I]n the manufacturing state there is no path which leads more rapidly to wealth and position than that of invention and discovery. Thus, in the manufacturing state genius is valued and rewarded more highly than skill, and skill more highly than mere physical force . . . manufactures operate beneficially on the development of the mental powers of the nation . . . [T]he competition of . . . talents . . . has a most beneficial influence not merely on the further progress of science itself, but also on the further perfection of the arts and of industries . . . Science and industry in combination have produced that great material power. (List, 1966: 200–202)

The infant industry argument of List is closely interwoven with the theory of development. He addresses the long-run mutual interaction between the promotion of infant manufacturing activities and economic development, involving invention and discovery. He believes that the expansion of manufacturing activity would lead to a more than proportional increase in the amount of human resource that is devoted to the inventive research activity. He apparently understands that technological progress arises in large part because of intentional activities taken by people who respond to market incentives.

List believes that:

the ability of the whole nation to increase the sum of its material capital consists mainly in the possibility of converting unused natural powers into material capital, into valuable and income-producing instruments, and . . . in the case of a merely agricultural nation a mass of natural powers lies idle or dead which can be quickened into activity only by manufactures. (List, 1966: 226–7)

He emphasizes the “vent-for-surplus” mechanism that is brought into play by the promotion of infant manufacturing industry.

External Economy

Modern economists argue that old trade theorists did not emphasize the importance of (dynamic) external economies sufficiently. List, however, clearly understands that the external effects that arise (with some time lag) from infant manufacturing activities cause the investment in those activities to be under-compensated.

According to him:

It is the more difficult to set new business going in proportion as fewer branches of industry of a similar character already exist in a nation; because, in that case, masters, foremen, and workmen must first be either trained up at home or procured from abroad. (List, 1966: 294)

and:

the productive powers of every separate manufactory are also increased in proportion as the whole manufacturing power of the country is developed in all its branches, and the more intimately it is united with all other branches of industry.⁴ (List, 1966: 152–3)

List is emphasizing the possible fact that the growth of every infant manufacturing firm contributes, as an external economy, to expand the size of the entire manufacturing industry that will reduce the overall costs of manufacturing activities in the nation.

Although List failed to give an explicit formulation of external economies, he gets to the essence of (dynamic) externalities (*ibid.*: 300). That is, the entrepreneurs in an advanced industrial country:

can obtain skilled and experienced workmen in the greatest number and at the cheapest wages, the best technical men and foremen, the most perfect and the cheapest machinery, the greatest benefit in buying and selling advantageously; further, the cheapest means of transport, as respects raw materials and also in respect of transporting goods when sold, more extended credit for the manufacturers with banks and money institutions at the lowest rates of interest, greater commercial experience, better tools, building arrangements, connections, *such as can only be acquired and established in the course of generations.* (*ibid.*: 300; emphasis added)

List apparently recognizes the “potential” comparative advantage of a country in (say, labor-intensive) manufacturing as well as the problem of converting its potential advantages into the actual ones by taking care of the (transient) externalities associated with the infant manufacturing activities. List understands that the productivity of a firm depends on how large

the industry is that it is part of rather than purely on the size of the firm itself due to, say, diffusion of new knowledge acquired as many firms grow in the industry expanding their outputs, or due to improvement of the productive environment for industrial activities in general as the size of the industry expands (see Baldwin, 1992).

List apparently understands that the infant manufacturing activities will generate substantial external economies that will accrue, with time lag, to those who are not the initial undertakers of the activities. List further understands that initial advantage can cumulate over time because such an advantage is self-reinforcing due to better flow of information, a more flexible labor market, more specialized suppliers of inputs and technical services, and so on.

Advantages Acquired from Practice and Temporary Encouragement

Hamilton believes that because of:

the *natural disadvantages* of a new undertaking, . . . to maintain between the recent establishments of one country and the long matured establishments of another country, a competition upon equal terms, both as to quality and price, is in most cases impracticable. The disparity . . . must necessarily be so considerable as to forbid a successful rivalry, without the extraordinary aid and protection of government. (Hamilton, 1966: 268; emphasis added)

According to Hamilton:

the strong influence of habit and . . . the fear of want of success in untried enterprises – the *intrinsic difficulties incident to first essays* towards a competition with those who have previously attained to perfection in the business to be attempted – [would make the changes from agriculture to manufacturing] likely to be more tardy than might consist with the interest either of individuals or of the society . . . To produce the desirable changes, as early as may be expedient, may therefore require the incitement and patronage of government [as may be capable of overcoming the obstacles] (Hamilton, *ibid.*: 266–7; emphasis added)

Hamilton believes that the:

existence of assurance of aid from the government . . . may be essential to fortify adventures against . . . [those who enjoy] the *advantages naturally acquired from practice* and previous possession of the ground. (*ibid.*: 269; emphasis added)

List believes that the superiority of one country over another in one branch of industry, say, manufacturing, often arises simply from having begun it sooner:

under a system of perfectly free competition with more advanced manufacturing nations, a nation which is less advanced than those, *although well fitted for manufacturing*, can never attain to a perfectly developed manufacturing power of its own, nor to perfect independence, without protective duties. (List, 1966: 316; emphasis added)

List states (ibid.: 299–300) that: “the reason for this is the same as that why a child or a boy in wrestling with a strong man can scarcely be victorious or even offer steady resistance.”

Hamilton argues (ibid.: 302–3) that according to the U.S. constitution, the National Legislature has the express authority “to lay and collect taxes, duties . . . and provide for the common defense and general welfare.” And according to Hamilton, the “phrase [general welfare] is as comprehensive as any that could have been used.” Hamilton believes that:

it is the interest of the society . . . to submit to a *temporary* expense, which is more than compensated, by an increase of industry and wealth, by an augmentation of resources and independence; and by the circumstance of *eventual* cheapness. (ibid.: 302; emphasis added)

He also believes that:

the internal competition, which takes place, soon does away with every thing like monopoly, and by degrees reduces the price of the article to the minimum of a reasonable profit on the capital employed . . . In a national view, a *temporary* enhancement of price must always be well compensated by a *permanent* reduction of it. (ibid.: 286; emphasis added)

List believes that if:

a sacrifice of value [of exchange, that is, current consumption] is caused by protective duties, it is made good by the gain of a power of production [that is, an increase in the aggregate amount of the productive powers of the nation], which . . . secures to the nation an infinitely greater amount of material goods. (List, 1966: 145)

He also contends that the “sacrifices of material goods for a time [to take care of the transient externalities] . . . are . . . merely reproductive outlay by the nation” (ibid.: 226).

Hamilton and List are often criticized for their failure to understand the second-best nature of tariff protection of infant industries. Hamilton, as well as List, however, seems to have been well aware of the first-best nature of a tax-cum-subsidy approach. Hamilton states (ibid.: 298–301) that pecuniary bounties are “the most efficacious means of encouraging manufactures . . . overcoming the obstacles which arise from the competition of superior skill and maturity elsewhere” because they tend “to stimulate and

uphold new enterprises [undertakings] . . . in the first attempts” avoiding “the inconvenience of a temporary augmentation of price.”⁵

List understands that a “temporary” protection or subsidy for manufacturing industry, designed to eliminate the divergence between social and private rates of returns caused by the transient external economies, would increase the growth rate of an economy.

Export Trade

List does not seem to regard the promotion of infant industry solely as a means for import-substitution-oriented growth. He seems to take an outward-looking approach and expect the eventual international price-quality competition as a natural sequence to follow the promotion of infant industry.

According to List, a manufacturer:

has a hundred times more opportunity for developing his mind than the agriculturist. In order to qualify himself for conducting his business, he must become acquainted with foreign men and foreign countries; in order to establish that business, he must make unusual efforts . . . [T]he continual competition of his rivals, which perpetually threaten his existence and prosperity, are to him a sharp stimulus to uninterrupted activity, to ceaseless progress . . . These circumstances produce in the manufacture an energy which is not observable in the mere agriculturist . . . Manufacturing occupations . . . develop and bring into action an incomparably greater variety and higher type of mental qualities and abilities than agriculture does. (List, 1966: 199)

According to List, bounties:

are to be justified as *temporary* means of encouragement, namely where the slumbering spirit of enterprise of a nation merely requires stimulus and assistance in the first period of its revival, in order to evoke in it a powerful and lasting production and an *export trade*. (ibid.; 315; emphasis added)

One can see that List emphasizes “export trade” rather than import-substitution.

Confederation of Power of Production

List believes (1966: 226) that: “the revenue of the nation are dependent . . . on the sum of mental and bodily powers” and that the:

aggregate of the productive powers of the nation is not synonymous with the aggregate of the productive powers of all individuals, each considered separately

– that the total amount of these powers depend chiefly on social and political conditions, but especially on the degree in which the nation has rendered effectual the *division of labor and the confederation of the powers of production* within itself. (ibid.: 170; emphasis added)

List thereupon visualizes the economic system in which the existing backward economic organization would leave room for the nation's long-run productive potentialities to be brought out more fully by the dynamism generated from the infant manufacturing activities.

The trade theory of Adam Smith may be considered as an attempt to study the long-run mutual interaction between trade and economic development by incorporating the long-run changes in factor supplies (that is, capital accumulation) and their productivity (through the division of labor). Hamilton and List may be considered to have focused on the more fundamental dynamic nature of trade and growth, that is, manufacturing activity as a sharp stimulus to human exertion, the spirit of enterprise, invention, discovery, and the drive for perfection of domestic economic organization (see Myint, 1977). Smith emphasized the division of labor but List emphasized also the confederation of the powers of production within a nation.

8. OUTWARD-LOOKING EXPORT-ORIENTED GROWTH

The role of infant manufacturing in promoting catch-up that was expounded by Hamilton and List, was replaced by the role of export-oriented manufacturing activities in promoting catch-up in the East Asian NICs. The export-expansion of labor-intensive manufactures in a resource-poor developing country enables a full utilization of its abundant labor. Simple assembling activities of imported parts and raw materials with imported machinery can solve the unemployment problem and can also relieve the foreign exchange constraint (see Hong, 1994: Ch. 1).

The expansion of labor-intensive manufactured exports increases the overall factor productivity by reallocating productive resources from a low productivity primary sector to a high productivity manufacturing sector and also by taking advantage of scale economies. However, it is believed that, due to the existence of externalities, the potential comparative advantage of such a less-developed country in labor-intensive manufacturing will not be realized in the form of actual exports unless its government actively intervenes in the market with tax-subsidy measures.

Every labor-abundant underdeveloped country has potential competitive power in the world market for labor-intensive products according to the

Heckscher–Ohlin theory of comparative advantage and specialization. As soon as the governments of East Asian NICs took care of the externalities associated with infant labor-intensive export industries in the 1960s, they began to penetrate into the developed countries' markets for labor-intensive manufactured products.

In order to export labor-intensive manufactures, a less-developed country has to face incessant price-quality competition in international markets. Such competition, however, is believed to result in a rapid accumulation of physical and human capital, a rapid technology transfer through learning-by-someone else's doing, and also a rapid technical progress through global transmission of economic knowledge such as the most up-to-date production methods and product designs. Most importantly, it is believed to result in substantial improvements in the organizational and institutional arrangement of the domestic economic system.

Any economy that cannot implement the continuous restructuring of its production activities in accordance with shifting comparative advantage may drop out of world markets, fall into stagnation, and degenerate into another failure case. The role of government may be crucial not only at the early stages of catch-up, but also at the later phases. For instance, if the external economies associated with knowledge spillovers from high-technology industries are important, the role of government intervention also has to assume a commensurate importance.

International trade based on static and dynamic comparative advantage quickens the pace of technological change and overall economic growth. International specialization introduces new opportunities, new world markets, new products, new methods of production, and new forms of industrial organization that are conducive to maximizing the energy and effort of each individual member of society. The activities of outward-looking firms undermine the market position of inward-looking firms that are bound to be relatively ignorant about new products, new technology, new sources of supply, and new types of organization.

A very simple-minded growth-account-type approach calculates that the rate of contribution of Korea's exports to its growth amounted to an average 37 percent per annum during 1970–79, 24 percent per annum during 1981–90, and 29 percent per annum during 1991–2000 (see KITA, 2001: 19). Any thoughtful economist, however, might be rather bewildered when confronted by these kinds of figures and may not know how to take them.

International competition in world markets brings decisive cost and quality advantages to export-oriented firms, and encroaches not at the margins of the profits of the inward-looking firms but at the foundations of their lives. The outward-looking export-oriented economy may provide

the most favorable climate for industrial innovation and maintenance of a vigorous pace of technological advance, that is, an autogenous dynamism of an economy. Joining world markets with innovative ideas may be the important ingredient for progress and catch-up.

Government intervention can amplify the market system's rewards which propel the innovative export activities of entrepreneurs. The innovative leaders in an export-oriented economy can be either small firms, or large business enterprises, or both. Furthermore, international competition is likely to force the government to institutionalize an economic system that minimizes the rate of return on rent-seeking and other non-productive activities and thereby channels individual energies into the socially most productive activities.

Myint (1977) acknowledges the fact that the "outward-looking approach emphasizes the expansion of external trade as the engine of growth." But he points out its tendency "to underplay the fact that a country may not be able to take full advantage of its external economic opportunities unless its internal domestic economic organization is strengthened and improved." There is, however, the inherent dynamism of international specialization that may take care of the improvement in domestic economic organization. The importance of strengthening domestic economic organization was in fact very much emphasized by List.

9. VEHICLES FOR CATCH-UP

Hamilton and List argued for the promotion of infant manufacturing activities as a vehicle for catch-up. There may be many different vehicles for catch-up. Prewar Japan, to name one example, pursued imperialist colonialism with imported Western technologies for catch-up. In its era of industrial structure policy (1955–74), it pursued a government-guided heavy and chemical industrialization strategy, integrating its economy into the global trade regime armed with an undervalued yen (see Komiya, 1992). The East Asian NICs have been pursuing outward-looking export-oriented growth strategies as a vehicle for catch-up.

Hamilton and List argued for the promotion of infant manufacturing activities without particularly warning against the possible undesirable results when an import-substitution-oriented approach is adopted in pursuing such an object. After all, justifying government intervention in the form of infant industry promotion is one thing, and ranking the alternative forms of intervention is another. If Hamilton and List could have the luxury of the hindsight of our contemporaries, they might well have recommended the outward-looking export-oriented promotion of infant

labor-intensive manufacturing activities at the starting point of catch-up. This is a subject to be examined more thoroughly in the next chapter.

So far, the experiences of the East Asian NICs and Japan have been utilized to demonstrate the spectacular success of outward looking export-oriented growth strategy in generating economic progress. An analysis of the *failure* experiences in these countries, however, will enable us to understand what factors undermine a country's social, organizational, and moral foundation and hence set the stage for economic stagnation and social chaos.

10. THE SHADOWLAND

In the 1990s, Korean people could observe cumulating non-performing assets in their financial institutions, massive bankruptcies of big conglomerates, and rapidly expanding short-term foreign borrowing, culminating in the so-called IMF crisis of November 1997.

The late President Park (in office 1961–79) pursued the export-oriented growth very much in the fashion of a command economy, rationing loanable funds and distributing various subsidies. He was a sort of benevolent dictator with a secular missionary zeal who could, quite fortunately, establish a workable institutional setting to pursue his professed goal of “nation-building through exports.” Absolute power, however, breeds absolute corruption. The specific form of institution that was established by Park became disastrous in his absence.

Wade (1990: 349–50) has enthusiastically endorsed the prescription of enhancing the power and autonomy of the state to “govern” the market for newly industrializing or industrialized countries, assuming the presence of non-predatory, non-malicious and rather benign political leaders whose concerns go beyond using state power to support the affluence of a small group. Wade contends that it was what the governments of very successful economies, such as Korea, Taiwan and Japan, actually did, and believes in the benefits of “governed” market policies. If Wade could have the luxury of hindsight after observing the lethargic stagnation of Japanese economy in the 1990s and “the 1997 crisis” of the Korean economy, he would have recognized the urgency in the NICs of establishing an institutional arrangement that can weather non-benign, ignorant and avaricious bureaucrats and non-benevolent, predatory and malicious political leaders.

The series of rulers who succeeded President Park in Korea did not recognize the urgency for a fundamental institutional restructuring. They were more like the Olson (2000) type rulers. The ruling groups have been indulging in picking up the spoils of the old system handed down from the

predecessor that had apparently outlived its useful life. They say that people can make a larger fortune very quickly during the decline and fall of a regime than they can when they are building up a new regime. To be sure, the contending prospective rulers have appealed to the people with the slogan of “Democracy and Market Economy” in order to get elected as rulers, but it seems that either they have not properly understood the real meaning of the slogan, or have not really believed in it, the slogan they themselves have been propagandizing.

It seems that the institutional setting established by the late President Park did indeed breed the seeds of an eventual catastrophe and possible self-destruction. Korea is now experiencing a shadowland of its own making. This is the subject to be delved into in Chapters 8 and 9.

NOTES

1. One may give different kinds of examples in the context of post-catch-up advanced economies. After nearly a 100-year journey of catch-up, Sweden became one of the most advanced countries. Sweden enjoyed the Social-Democratic turnpike until about 1970, but seems to have been experiencing the decline and fall of the system thereafter. After more than a 100-year journey of government-guided catch-up commencing with the Meiji Restoration of 1868, Japan became a fully-fledged advanced economy by 1980. It boasted its MITI-MOF-led turnpike, but has ended up with the so-called lost decade of 1990s. (MITI represents the Ministry of International Trade and Industry and MOF the Ministry of Finance.)
2. Krugman (1994) argues that the rapid growth of not only Soviet economies but also the rapid growth of Asian NICs was all based on the willingness to sacrifice current consumption for the sake of future production. According to Krugman, the strength of Soviet economies and Asian NICs was simply the ability to mobilize resources, and not the ability to use them efficiently. That is, the growth was not efficiency-driven. A pure input-driven growth, however, is inevitably subject to diminishing returns.
3. Hamilton believes that (1966: 242) manufacturing activities “open a wider field to exertions of ingenuity than agriculture” and that (ibid.: 256) “the spirit of enterprise . . . must necessarily be . . . expanded in proportion to the . . . variety of the occupations and productions” (ibid.: 156).
4. Many contemporary economists contend that, although individual firms may exhaust internal economies of scale at very low level of production and hence operate with constant or decreasing returns to scale, the industry as a whole may enjoy scale economies. It is because, as the overall size of the industry grows, specialized machinery and equipment would begin to be produced, railroads and other transportation facilities would be built, better educational and research institutions would be established for industry, and so on. Growth of a firm contributes, as an external economy, to expand the overall size of the industry.
5. Hamilton believes (ibid.: 301, 336) that the “public encouragement” of the “acquisition of a new and useful branch of industry” leads to “a permanent addition to the general stock of productive labor.” Therefore “bounties and premiums” as well as tariff protections “are productive, when rightly applied” and “particularly in the *infancy* of new enterprises [they are] indispensable” (emphasis added). Hamilton (ibid.: 307) emphasizes the needs for “*the encouragement of new inventions and discoveries*, at home, and of the introduction into [the home country] . . . of such as may have been made in other countries;

particularly those, which relate to machinery” (emphasis added). Hamilton (ibid.: 338) recommends the creation of a fund for paying the bounties and argues that the “commissioners be empowered to apply the fund confided to them to defray the expenses of . . . manufactures in particular branches of extraordinary importance – to induce the prosecution and introduction of useful discoveries, inventions and improvements, by proportionate rewards, judiciously held out and applied – [and] to encourage by premiums both honorable and lucrative the exertions of individuals.”