Preparing Korea for Global Competition in the 21st Century: An Agenda for Institutional Reform

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The paper offers some thoughts on the institutional reforms that Korea will have to undertake to achieve sustained economic growth in the 21st century. It begins with the discussion of a key institution that contributed to Korea's rapid economic growth in the 1960s and 1970s and then argues that the demise of that institution in the later years has brought about an institutional hiatus with serious consequences to the economy. The paper then concludes that the globalizing world of the 21st century will require Korea to change many of its age-old informal institutions as they are incompatible with the formal institutions necessary for Korea to be competitive in the new world economy. (*JEL* Classification: O1, O5)

I. Introduction

As South Korea (henceforth Korea) enters the 21st century it will be faced with the challenges of competing in an increasingly globalizing world economy. Most of its domestic markets for goods and services will be fully integrated globally, and the emergence of China as a major economic power will be challenging Korea in many of the industries in which it now has a comparative advantage. To prepare itself to meet successfully these challenges Korea will have to undertake reforms in various institutions as well as

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economic policy. The purpose of this paper is to offer some thoughts on what I regard to be the most important institutional reform that Korea will have to undertake to achieve sustained economic growth in the 21st century.

Institutions of a given society affect the path of its economic development by structuring political, economic, and social interactions among its members (Greif 1994; North 1981, 1990, 1991; Williamson 1985).[1] To understand how institutions structure these interactions we need to recognize that there are two kinds of institutions—informal and formal—in any society. Informal institutions consist of sanctions, taboos, customs, traditions, codes of conduct, etc. and are culture-specific and slow to change. On the other hand, formal institutions consist of constitutions, laws, property rights, etc. and can be established in a relatively short period of time. However, formal institutions that are not compatible with informal institutions may be ineffective or, worse, a source of conflict in a society.

This relationship between formal and informal institutions makes designing or reforming a country's formal institutions a task that cannot be guided simply by some general theory, if there is any, or sheer imitation. In fact, Lin and Nugent (1995, p. 2362) conclude, after an extensive review of the literature on institutions and economic development, that:

> ...mere transplantations of successful institutions from DCs to LDCs is, at best, unlikely to have the expected positive effects on performance, and, at worst, may have rather disastrous effects. Where to start and how to bring out the reforms in a country are questions that can be answered only with serious consideration of the country's existing institutional structure and human and physical endowments.

What this observation by Lin and Nugent suggests is that there may not be a ready-made blueprint for "successful" institutions that Korea can import from abroad. That is, institutions successful in the United States, for instance, may not be effective in Korea

[1]Although there is no clear consensus on the definition of institutions there appear to be, according to Nabli and Nugent (1989, p. 9), three basic characteristics that are common to most definitions of a social institution. These are (1) the rules and constraints nature of institutions, (2) the ability of their rules and constraints to govern the relations among individuals and groups, and (3) their predictability in the sense that the rules and constraints are understood as being applicable in repeated and future situations.

because they are not compatible with Korea's informal institutions. Either the imported institutions may have to be modified to fit in with indigenous informal institutions or, alternatively, the informal institutions may have to change to accommodate the imported institutions if the imperative of globalization dictates that they be accepted unmodified.

Globalization is not new to Korea. Although the word globalization was not used to describe the Korean economy of the past thirty-some years, Korea has been engaged in global competition ever since it adopted an outward-oriented development strategy in the 1960s. Korea has successfully exported many of its manufactured products all over the world, and in fact its rapid economic growth has been concomitant with its rapid export expansion.

Korea's participation in global competition was, however, limited only to several major *chaebols* while most of its domestic markets were for many years insulated from the pressure of global competition. Because of this limited participation in global competition the Koreans were spared from questioning whether many of their informal institutions were compatible with new institutions necessary for global competition. But now with the new rules of the game which are likely to involve almost every sector of the Korean economy in global competition the Koreans may have to examine whether they need to make fundamental changes in their informal as well as formal institutions.

In section II of this paper I examine one of the key institutions that contributed to Korea's rapid industrial development in the 1960s and 1970s. In section III I will then argue that the demise of that institution has brought about an institutional hiatus in Korea with serious consequences to the economy. In section IV I will discuss the institutional reform that Korea will have to carry out in order to achieve long-run sustained economic growth in the 21^{st} century. Section V concludes the paper.

II. Institutions for Catch-Up Development

Although the years from 1953 (when the Korean War ended) to the early 1960s is often regarded as a period of "wrong" economic policies and a poor economic performance, it was a time of major institutional changes that laid a foundation for subsequent economic take-off. These major changes were: land reform and redistribution, mass education, and the growth of large private enterprises. Land reform and redistribution and mass education turned Korea into a relatively equitable society; the establishment of a number of new enterprises increased human capital in entrepreneurship and management knowhow; and the Korean army, by training farm hands to become members of a modern army, served as a training center for a disciplined labor force capable of handling mechanized equipment and working effectively in a team. Thus, by the early 1960s, the Korean economy was ready for take-off, and the necessary catalyst came in the form of a political leadership equipped with a vision for economic development and appropriate economic policies.

If the 1950s was a period of building an institutional basis for capitalistic development, the early 1960s found the Korean economy ready to respond to the adoption of stable macroeconomic policies. The course of its development during the 1960s and 1970s was not, however, left to the dictates of markets alone.[2] New institutions were also introduced and tried in an effort to mobilize human and natural resources with the aim of achieving rapid export expansion and economic growth. This may not have been unique to Korea, but what characterizes best the Korean experience is the flexibility with which new institutions were introduced and tried (Ranis 1989; Rodrik 1996).[3]

The adoption of stable macroeconomic policies began with the devaluation of the Korean won in May 1964, followed by the implementation of a floating unitary exchange rate in March 1965. In return for a credit of $9.3 million from the International Monetary Fund, Korea undertook a further series of reforms such as a tight monetary policy, increases in taxation, higher import

[2]Rodrik (1996) argues that Korea followed the "orthodox path" or the "Washington consensus" on policy reform by maintaining conservative fiscal policies and competitive exchange rates but diverged from the orthodox path in the area of microeconomic interventions. It should be, however, noted that monetary policy was rather lax in Korea in the 1960s and 1970s and, consequently, its inflation rate was higher than, or at least comparable to, those in many Latin American countries.

[3]In discussing whether crisis brings about reform, Rodrik (1996) indirectly defines this institutional flexibility. He points out that Korean politicians have changed policies at the slightest hint of a crisis whereas Brazilian politicians have gone through several major crises before doing anything about the problem.

duties on nonessential items, limits on international borrowing, and greater export efforts. These were followed by an interest-rate reform in the fall of 1965.

This description of policy change in Korea, however, illuminates only a part of what happened after the military coup of 1961. First of all, for these policy changes to take place certain institutional changes had to be carried out. Second, the industrial development that followed the policy changes was not a process carried out solely by the private sector. It was strongly influenced by direct government intervention designed to facilitate the progression of the economy through successive phases of industrial transformation (Chang 1993).

The goals of the military coup of 16 May 1961 were to "make anti-communism, which has been considered only a superficial slogan, the foremost national policy" and to "solve the people's economic plight." (Choi 1988, p. 4) These twin goals became the basis for reorganizing the institutional structure of the government and led to the centralization of political power in the office of the president.[4]

It is important to note that all the leaders of the coup were well versed in creating and managing large organizations by virtue of their military experience during the Korean War (1950-3). Furthermore, most of them were exposed to modern organization and management theory by having undergone military training in the United States and were familiar with, and used to, the hierarchical structure of the military organization. They were thus knowledgeable about modern scientific management systems consisting of planning, programming, budgeting, and evaluating and were able to transfer this knowledge to reorganizing the government in order to achieve developmental objectives.

The newly established developmental state needed an effective instrument for carrying out its objectives. Thus, on 22 July 1961 the Economic Planning Board (EPB) was established as a strong and accountable agency for drafting and organizing economic plans. It took over various functions such as budgeting, planning, and

[4]Whatever the true goals of the military coup might have been it did accomplish to bring about changes in institution. This Korean experience confirms North's hypothesis (1981) that institutional changes come from rulers rather than the ruled who always face the free-rider problem.

statistical collection from other agencies and ministries, and to coordinate better all the economic ministries it was placed at a higher level in the structure of administrative hierarchy than a ministry. With increased authority and the consolidation of the functions of various economic agencies in one bureau the EPB became a leading agency for the developmental state.

In 1961-3 the government introduced several measures such as direct subsidies and preferential loans to promote exports. Tariff exemption on imports of raw materials used for manufacturing export products and the exemption of indirect taxes on exports and intermediate inputs used in export production were also introduced. A 50 percent reduction in income tax was also granted on earnings from exports and tourism (Kim 1991). In addition to these incentives, the Korean government created a number of institutions to promote exports. For example, it created the Korea Trade Promotion Corporation (KOTRA), which, with its extensive overseas network, became an effective instrument for promoting exports.[5]

What was perhaps unique to Korea was the Monthly Export Promotion Conference which was established in December 1962 and became to be one of the most important administrative support mechanism for exports. Regular participants included President Chung Hee Park, the Minister of the Economic Planning Board, the Minister of Trade and Industry, the Director of the Korea Trade Promotion Corporation, the Chairman of the Korea Traders Association, and other public officials and private experts concerned with trade. The progress of exports and the performance of exporting firms were routinely reported on, and almost every month the President awarded medals and citations to successful businessmen.

At each meeting of the conference, business representatives presented their problems and opportunities, and government officials were informed, in front of the president, of the problems that businesses faced in dealing with government offices. The conference thus served not only as a forum in which the president, who had real and symbolic power to a greater degree than in most

[5]Another important factor contributing to Korea's export expansion was the absence of effective labor unions—a consequence of government repression—which could have pushed wages above market-clearing levels as in the Latin American economies (Fields and Wan, Jr. 1989). This does not mean that labor markets were free and competitive in Korea but rather that wage rates were closer to their shadow prices than would have been otherwise.

Western societies, could hector businesses to increase exports but also as a place where the president took part in frank discussions about various problems, including bureaucratic red tape, that hindered the achievement of export targets. The conference thus served an important function of institutions: that is, collecting information and making that information available to key decision makers.

The development of heavy and chemical industries in Korea is another clear example of state and private sector co-operation in the management of the economy. It began officially in June of 1973 with the promulgation of the Heavy and Chemical Industries (HCI) Promotion Plan which laid out six industries—steel, nonferrous metal, machinery (including automobiles), shipbuilding, electronics, and chemicals—for promotion at a total investment of US $9.6 billion between 1973 and 1981. These were targeted to become future leading industries with their share of total commodity exports expected to be more than 50 percent by 1980.

The HCI program was a deliberate attempt on the part of the government to change the structure of the economy in response to new developments in the external economic and political environment. First, by the late 1960s Korea was facing import restrictions on its light manufactured exports to the United States and other developed countries. Second, it also began to face challenges from China and the developing countries in Southeast Asia in the export markets for light manufactured goods. Another important factor for the decision to promote heavy and chemical industries was the desire to become more independent from the United States in the area of the military hardware prompted by the Nixon Doctrine of July 1969 that signaled the withdrawal of direct U.S. involvement in Asia (Stern *et al.* 1995).

In the early 1970s there were virtually no Korean firms possessing the technical as well as financial resources necessary for venturing into any one of the heavy and chemical industries. Furthermore, given large economies of scale and high risks inherent in such industries, not many firms, including the *chaebol*, were willing to undertake such projects. Thus to implement its plan, the government handpicked suitable firms and in fact coerced them into undertaking the projects by offering various incentives.

In order to secure a market for the new industries, the government re-instituted import restrictions and rolled back tax exemptions on the import of certain intermediate goods and capital equipment. It also granted higher investment tax credits to businesses which purchased domestically produced machines. A major package of tax incentives for investment in the heavy and chemical industries was provided in the Tax Exemption and Reduction Law of 1975. It included tax holidays, investment tax credits, and accelerated depreciation for the firms investing in the designated industries. These tax incentives had the effect of lowering the tax rate on the marginal return to capital by 10 to 15 percentage points, making the tax rate about a quarter lower than otherwise (Kwack 1984).

The above description of how the Korean government managed the economy during its rapid economic growth differs from the role of government prescribed in mainstream neoclassical economics since it played a much more active role especially in its dealings with the *chaebol*. It guided and supported the *chaebol* while monitoring and controlling their activities to ensure that the resources and opportunities they received would be used productively toward export expansion and economic growth. Thus in its relationship with the private sector the government used both discretionary power and incentives, the most important instrument being its control over the financial system and credit allocation.

To understand how this relationship between the government and the *chaebol* was effective in bringing about economic development in Korea it is best to see it as a relationship in an internal organization and thus as an institutional response designed to overcome market imperfections. As in an internal organization, the relationship between government and business was hierarchical with the government at the top and it was a nexus for a set of implicit contracts. For instance, as long as the enterprises achieved the export targets assigned by the government they were favored with preferential loans. The boundary of this internal organization was not, however, legal and was not clearly delineated as its constituent enterprises might change from time to time. For these reasons and to differentiate it from the private internal organization, the internal organization composed of government and the *chaebol* is called the *quasi-internal organization* (Lee 1992).

The formal institution of the *quasi-internal organization* was compatible with Korea's hierarchical social norms—an informal institution—based on Confucianism. In the writings of Mencius, a Confucian society is bifurcated into people who are trained to govern and those who are to be governed. The idea of virtuous government run by educated people, as prescribed by Mencius, is so widely accepted by the majority of Koreans that the active role of government in the economy is taken for granted. It is thus not surprising that in Korea the public willingly accepted "government instructions" (*jeongbu chisi*)—a *modus operandi* of the *quasi-internal organization*, which intervened directly in decisions at the enterprise level (Cho and Lee 1995).

Since the mid-1980s, however, much of the government-business relationship has changed with the eventual demise of the *quasi-internal organization*. The causes for this are two. The first is that the *chaebol* has become large and successful enough not to depend on the government for credit, and especially with financial liberalization much of the power that the government had over them has weakened. In other words, the business firms that were nurtured to growth by the government have become less dependent on its preferential treatment and thus less subject to its control. The second reason is that with political liberalization and the establishment of pluralistic politics the state has lost its institutional insulation and control over business.

Furthermore, the ascendancy of neo-liberalism in Korea in the 1980s and 1990s has led to the belief that deregulation and liberalization and thus the demise of the *quasi-internal organization* would suffice in creating an efficient market system in Korea. In other words, it was widely held in Korea then that a free-market system was a self-contained, efficient system separate from other social institutions or, if it was not, then necessary institutions would be automatically forthcoming to support its efficient operation. As is discussed below, Korea was not unique in holding this view.

The 1997 financial crisis in Korea has clearly demonstrated how wrong this view was: the demise of the *quasi-internal organization* did not bring about a liberal market order in Korea, but instead it was replaced by a system of politico-business coalitions that were busily engaged in rent-seeking than wealth-creating. The financial crisis is a logical outcome of that system.

III. Institutional Hiatus and Failures of Economic Reform

Many of the recent contributions made by economic historians and "new institutional economists" regarding institutions and economic development have been slow in being integrated into mainstream economics (Nabli and Nugent 1989; Lin and Nugent 1995).[6] It is thus no surprise that capitalism is often viewed as nothing but a well-oiled system consisting only of private property ownership, pure laissez-faire, and self-adjusting market mechanisms (Bruno 1992).

In a provocative article entitled "The Transition According to Cambridge, Mass." Murrell (1995) has criticized the standard reform package prescribed by Western economists, or more specifically those associated with certain major educational institutions in Cambridge, Massachusetts for the transition economies in Eastern and Central Europe. This reform package, which consists of macroeconomic stabilization, the liberalization of domestic trade and prices, current account convertibility, privatization, the creation of a social safety net, and the creation of the legal framework for a market economy, represents and typifies, as the title of his paper implies, the mainstream thinking on economic transition.

This one-size-fits-all prescription is based on the assumption that the market system is very much the same everywhere in the world and that history and institutions bear little relevance to their operation. Economic transformation is, however, a path-dependent process that depends on the initial conditions as well as policies and the external environment (Ellman 1994). Thus history and inherited institutions have a profound and enduring effect on the outcome of a reform package as they are slow to change. In fact, some observers of the reform process in Eastern and Central Europe are pessimistic enough about the speed of change in institutions to believe that successful reform may take a generation. Thus, according to Brzeski (1994, p. 6):

> It will be years, in some cases decades, before the *Rechtsstaat* can create an environment favorable to private activities, especially those involving capital formation. Statutes can be altered easily enough; Western law teams stand by, keen to provide legal expertise. But it will take time for

[6]Lin and Nugent (1995, p. 2304) point out that classical economists such as David Hume, Adam Smith, John Stuart Mill and modern development economists such as Lewis, Kuznets and Myrdal provided important insights on how institutions affected economic development. Until recently, however, much of the economics profession ignored institutions, focusing rather on "mathematically tractable topics."

> the complementary psychological, social, and cultural changes to take root. Perhaps only demography—a generational succession—can bring about those changes.

Several studies that were carried out by the OECD and the East-West Center on the experiences of some transition economies in Central and Eastern Europe and Asia also point out the institutional breakdown or the lack of market institutions as a key factor determining differences in their reform outcome (Lee and Reisen 1994). Naughton (1994), for instance, identifies the absence of institutional breakdown as a critical factor accounting for the relative success of China's economic transition. What he finds notable is that in China many of its institutions have continued to function, albeit poorly, whereas in Russia a number of key institutions such as banking and public finance broke down and ceased functioning effectively.

In a similar vein, Kirkpatrick (1994) points out that in carrying out their reform measures, the transition economies in Central and Eastern Europe failed to pay sufficient attention to the task of institution-building in such areas as creating financial discipline, establishing effective bankruptcy procedures, reforming banking sector and the government administration, and initiating effective governance of state-owned enterprises.

One important lesson that can be drawn from the different experiences in transition is that a functioning free market does not develop overnight once the central planning apparatus is eliminated and the market is freed. That is, the transition to a market economy means more than eliminating the central planning system: It also requires establishing entirely new institutions which in itself is a slow, time-consuming process (Aage 1994; Rana and Paz 1994; Winiecki 1992).[7]

Adoption of the standard reform package in the transition economies of Eastern and Central Europe would have created a demand for institutional change since it had a direct impact on relative product and factor prices, constitutional order (the basic

[7]Establishing new institutions means more than just creating new administrative bodies and passing new laws and regulations. For them to be effective in reducing the transaction costs there must be also "institutional capital"—the accumulated institution-specific human capital of both the individuals who operate an institution and those subject to this institution (Schmielding 1992).

rules of government), technology, and the size of market.[8] But, as demonstrated by their experience, the supply of new institutions has been slow in responding to the change in demand and restoring institutional equilibrium. Indeed, what has resulted is an "institutional hiatus" and a severe contraction in output and employment (Kozul-Wright and Rayment 1995; Ellman 1994).[9]

An institutional hiatus is what also has happened in Korea after the demise of the *quasi-internal organization* (Lee and Lee 1992; Lee 1998). The state has retreated from directing the economy, but such state disengagement has led to more, rather than less, rent-seeking and corruption as the abolition of clearly stated national policy framework has reduced the scope for the exercise of technocratic power of bureaucrats and made it easier for the top politicians and their associates to distribute favors to "paying customers" or their "cronies" (Chang 1998). In other words, new institutions that are conducive to the efficient functioning of a free-market economy have not yet been established in Korea to fill the vacuum created by the demise of the *quasi-internal organization*. What will bring forth new institutions? Will they be established automatically in a market economy?

The supply of new institutions depends on the capability and willingness of the political order for providing new institutional arrangements, which in turn are determined by existing institutional arrangements, existing stock of knowledge, the motivation of elite decision makers, normative behavioral code, etc. (Feeny 1988)[10] But, in a pluralistic polity such capability and willingness may not exist since institutional changes are not necessarily in the interest of the politically powerful. As put by Olson (1996, p. 23), "spontaneous Coase-style bargains, whether through laissez-faire or political bargaining and government" are unlikely to bring about institutional changes that are necessary for long-run sustained

[8]These are the factors that create the demand for institutional change by creating gains to be realized by the change (Feeny 1988).

[9]According to Taylor (1994, p. 85), the blame for this institutional hiatus goes to the "Bretton Woods institutions and their favored consultants" as their policies have little to do with putting institutional prerequisites for modern capitalism in place.

[10]Establishing new institutions has distributional as well as efficiency implications. Bates (1989) shows that in Kenya those who controlled economic institutions regulating commercial farming used their political power to appropriate benefits and avoid the costs of economic change.

economic growth. What makes such changes more unlikely is the innate conservatism of many of informal institutions.

IV. Institutions for Global Competition

One of the latest studies on the future of the Korean economy and institutional reform is a Booz, Allen & Hamilton report entitled *Vision Korea: Revitalizing the Korean Economy toward the 21st Century* (1997). This study, which was sponsored by the Korea Development Institute and the Vision Korea Execution Committee, was carried out between March and October 1997 and is in part based on interviews with a large number of government officials, academics, business executives, politicians, and foreign consultants. It can be thus regarded as a view of the state of the Korean economy and its future widely shared by the Korean opinion makers a few months prior to the financial and economic crisis that struck the economy in November 1997.

According to that report, what the Korean economy has to do to survive and prosper in the 21st century is to become "market-led," "knowledge-based," "entrepreneurial," "regionally integrated," and "globally connected." I agree with this general proposition with its implied prescription for new institutions. And I also agree with many of the report's specific proposals designed to reinvigorate the Korean economy. In fact, many of the proposed changes such as the "devolution to competitive industries," "restructuring of the government," "capitalizing on world-class enterprise knowledge," "modifying the educational system," and "encouraging international exchange" are all recognized widely in Korea as being necessary for revitalizing its economy and equipping it for global competition, and I need not repeat *ad nauseam* their importance for the long-run viability of the Korean economy. Instead I argue here the importance of changing some of Korea's informal institutions since without changing them many of the proposals for change patterned after the successful institutions in other countries may not yield the intended results in Korea.[11] Korea may, for instance, make

[11]One sector in the Korean economy that has gone through major changes since the recent financial and economic crisis is the financial system. But, according to Cargill (1998), an astute observer of the Korean financial system, the most pressing issue is not a reform in the financial

various formal arrangements with other nations to be "globally connected," but it will never be "globally connected" as long as the Koreans remain chauvinistic.

In a study on the relationship between cultural beliefs (informal institutions) and societal organization (formal institutions) Greif (1994) compares the Maghribis—a "collectivist" society—and the Genoese—an "individualist" society—of the late medieval period, showing how different cultural beliefs led to different societal organizations even though both societies faced a similar environment and traded in similar goods. In the collectivist society of the Maghribis individuals socially and economically interacted mainly with members of their own group and contract enforcement was achieved through informal economic and social institutions. They were not, however, cooperative with individuals from other groups. In contrast, in the individualist society of the Genoese individuals carried out economic transactions with members from other groups and contract enforcement was achieved mainly through specialized organizations such as the court.[12] Although the Italians eventually drove the Muslim traders out of the Mediterranean, Greif is cautious not to draw the conclusion that the individualist society of the Genoese was more efficient than the collectivist society of the Maghribis. But he nevertheless finds it intriguing that the former resembles the developed West whereas the latter resembles that of contemporary developing countries and suspects that an individualist society is more efficient in the long run.

Basically the reason for the relative efficiency and long-run sustained economic growth of an individualist society lies, as Greif sees it, in the cultural beliefs of its members that foster the development of formal enforcement institutions which in turn

system but rather a change in the attitude of the members of the financial community, bureaucrats, and policy makers toward fundamental aspects of the Korean financial regime. As he sees it, without such a change a formal institutional change, interest-rate deregulation, IMF bailouts, government bailouts, or other actions will fall short of establishing a stable financial and monetary environments.

[12]These characterizations of the two societies are paraphrased versions of Greif's (1994) general characterizations of collectivist and individualist societies on p. 913. It should be made clear here that *an individualist society is not necessarily a society where only self-interest matters. Public interest may also be valued, but unlike in a collectivist society the "public" in that society is more inclusive.*

support anonymous exchange and thus promote the division of labor necessary for economic development. Furthermore, in an individualist society people are less pressured to conform to social norms of behavior and hence are more likely to take initiatives and be innovative than those in a collectivist society.

In the past thirty-some years Korea has succeeded in transforming itself from a poor, agriculture-based economy into a newly industrializing economy, but to anybody familiar with Korea it is obvious that it is a country of "limited group" or "particularistic" morality or, in Greif's terminology, a society of numerous collectivist associations. One telling sign of this is that in Korea three connections are said to matter in social, economic, and political transactions, and these are the school connection, the family-clan connection, and the region-of-one's-origin connection. The Booze, Allen & Hamilton study (1997, p. 31) also reports that many of the foreigners interviewed in its survey regard the Korean business community as being unreliable and xenophobic, as having questionable business ethics at least in international dealings (i.e. in dealings with non-members of their own collectivist group), and as being the most unprincipled business partners in Asia. These characteristics, which we can readily identify with the Maghribis, are not, however, limited to the business community. They seem to be also shared by the Korean workers as the following statements by their union representatives regarding the possible takeover of ailing Korean companies by foreign firms show: "We don't know what they will be like. Their style is different" and "Do foreign investors want our economy to survive? Once they get profits, they will leave." (*International Herald Tribune*, July 13, 1998, p. 15)

Globalization for Korea means that the Koreans will have to interact and cooperate with people from other countries and especially with those from individualist societies of the West. It also means that the Korean business community will have to become reliable to foreigners, behave in accordance with international business ethical standards, and become open-minded about foreigners and other cultures. In other words, globalization will require that the Korean society become more like an individualist society of "generalized morality"[13] and this will be a society where individuals

[13]Using Platteau's terminology (1994) we might characterize Korea as a

are treated equally regardless of their nationality, the school they attended, and the region from which they come. Only then will Korea become a true member of the world community, thereby extending its scope for the division of labor and thus reaping the fruits of economic growth.

V. Conclusion

In recent years much has been said in Korea about what the country must do to become "internationalized." The rule of law, transparency, fairness in the sense that one's decisions are based on merits and not the connections of school, family-clan, and the region of one's origin are all recognized as the new norms or standards of behavior that the Koreans will have to adopt. Although doing so will not be easy because it entails fundamental changes in cultural beliefs, the imperative of achieving long-run sustained economic growth will dictate that Korea become more like the individualist society as spelled out above. This transformation will take time, but market competition, the globalization of the economy, and self-interest will eventually bring it about. For example, the presence of foreign financial institutions will induce potential Korean borrowers to adopt more transparent, internationally accepted accounting practices if they offer cheaper credit than local Korean banks. Likewise, corporate governance will change in Korea when its enterprises realize that a new corporate governance and a management team made up with the best talents from the entire world, and not exclusively from Korea, gives them a survival advantage in global competition.

There are, however, cases where market competition will not suffice in bringing about necessary institutional reform and thus government intervention will be necessary. One such case is Korea's present educational system which is ill equipped to produce a labor

society of "limited-group morality." In that society a person's moral norms apply only in dealings with "concrete" people—those to whom she is tied through personal, family or ethnic links. In contrast, in a society where "generalized morality" holds a person's moral norms apply in dealings with "abstract" people—even to those to whom one is not necessarily tied through those links. Platteau argues that generalized morality facilitates the extension of the division of labor and thus economic growth.

force necessary for global competition. It is an educational system that overly emphasizes test-oriented education; has led to the establishment of expensive private, out-of-school instruction ("Gua-Woi"); and has in effect hollowed out the formal educational institutions (Woo and Lee 1998). In other words, the students spend most of their time on rote-learning in preparation for college entrance examination at the expense of developing other abilities such as creative thinking, critical reasoning, and social interaction, which are the necessary attributes for success in global competition. What is worse is that this rote-learning education has become increasingly costly as competition for higher test scores has forced the students to engage in additional, out-of-school schooling called "Gua-Woi."

Although this problem with the educational system has been widely recognized in Korea very little has been done to change it. The reason for that becomes clear if we look at the current situation as a case of the "prisoner's dilemma" (Woo and Lee 1998). In that situation all the "players" involved—the students, the parents, and the teachers—recognize that competition for college admission is exhausting and socially wasteful and wish that it be done away, but no individual player has the incentive or ability to behave otherwise. In other words, everybody is trapped in a situation in which she feels helpless with the result that the entire society is trapped in a suboptimal equilibrium. This situation may, however, change as the "pay-off" structure changes as the employers realize that the college diploma is an incorrect signal of the abilities necessary for success in global competition. But this is a long-run solution for which Korea cannot afford to wait, and what is needed now is a third-party intervention to break the prisoner's dilemma. Needless to say, that third party is the government.

As I noted above, changes especially in informal institutions such as cultural beliefs will inevitably raise soul-searching and highly controversial questions about what constitutes Korean cultural identity. Furthermore, if, as remarked by Nee (1998), a poet's insight into the human condition is necessary for finding institutions appropriate to a nation, there is a limit to what an economist can say about how to bring about institutional changes in Korea that are well suited for a global age while maintaining its cultural identity. Perhaps the only thing I, qua economist, can say and hope for at this point is that Korea should adopt at least the rule of law and a "generalized" morality that transcends the ties of family-clan, school, and regional origin. This change will facilitate the effective implementation of the formal institutions necessary for global competition without destroying those cultural characteristics that make the Koreans what they are. Such a change will be forthcoming, however, only when political and intellectual leaders of Korea take the initiative by setting good examples with their own behavior and conduct.

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