

3. The agricultural productivity of Japan rose by up to 80 per cent between 1878–82 and 1913–17, making agricultural self-sufficiency possible.
4. After the 1884 Kap-shin coup of Korea, Japan realigned its military system to prepare for war with the Qing dynasty, including the formation of a national army of 200 000. The Qing dynasty sent 2000 troops to Asan Bay after the Dong-hak uprising, the Japanese government sent 1000 troops under the pretence of power-balance, clearly revealing its intention to check the Qing dynasty on the Korean peninsula.
5. In April 1895, Japan and the Qing Dynasty signed a peace treaty, approved the independence of Korea and demanded compensation of 200 million ryang, the then currency unit of Korea.
6. The interim foreign currency income of Japan during 1951–3 amounted to US\$1.4 billion, which contributed decisively to the economic recovery and the reduction of the balance of payments deficit.
7. Under the fixed exchange-rate system, those who work for trade or capital transactions are free from possible damage from unexpected exchange-rate fluctuation. They can concentrate on international transactions without worry and eventually expand global markets.
8. After having recorded a balance of trade surplus in 1965, Japan's current account was also in the black.
9. When the trading partner violates trade agreements, or its behaviour, policies or practices are unreasonable and discriminatory so that they harm or restrict US industries, the USA may take appropriate action.
10. A regulation by which the USA can negotiate continuously over the correction of trade barriers or market-distorting practices of trade partners. It also allows indiscriminate economic retaliatory measures on the partner.
11. The interest rate for loans that ASEAN banks made to businesses of member nations was about 16 per cent, while it was only 5 per cent for yen funds.

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4

South Korea: The Tragedy of Partition and the Response

A country of wonder

Despite its long history and unique cultural traditions, Korea has long remained in the shade of China and Japan, never coming to the fore in world history, and it was not until the outbreak of a fratricidal war that its existence was known. Korea's history is filled with suffering at the hands of external forces. It's national power was depleted and its army disarmed after having paid tribute to the three Chinese dynasties, Yuan, Ming and Ching; the whole nation was left in ruins and a tenth of the population taken prisoner after six Mongol invasions, while the Japanese and Manchu invasions, in 1592 and 1636 respectively, further ravaged the country. During their invasions of Korea, the Mongols burned more than thirty ships, evicted residents from coastal islands, and banned foreign trade. Korea lost its sovereignty because of technological backwardness, an economic slowdown, and the absence of a global perspective. Korea was divided after falling victim to ideological confrontation. It is a country where 2.6 million people were massacred in the Korean War, and at the time of writing it is the only country where the Cold War still rages on.

Once one of the world's poorest countries, South Korea overcame the ever-present danger of war, and political unrest caused by military coup and dictatorship to record forty years of high growth, aptly dubbed the 'miracle of the Han river', thus, drawing the attention of the world. Continuing on the path of uninterrupted growth, Korea's economy was ranked twelfth in terms of size, the country's

GNP exceeded US\$10 000, and it became a member of the OECD, and the country made progress culturally as well as politically. Korea hosted the Olympic Games in 1988, has been designated a co-host with Japan for the 2002 World Cup soccer games, and has set up a civilian government supported by the people.

It is no wonder that foreigners who are familiar with Korea's past consider it to be a country of enigma. Korea has managed to accomplish in just half a century what it took Europeans hundreds of years to do. Since the country's growth has been 'condensed', all the side effects of growth also appear intense and explosive. However, the Korean people coped with these side-effects when they occurred by exhibiting unexpected flexibility and potential. At the present time (late 1990s) South Korea is witnessing the near collapse of its stock market and a drastic devaluation of its currency. The current situation came about when Korea's long-accumulated competitiveness-hampering factors, including high wages, high land prices, high interest rates and high logistics costs collided with the South-east Asian currency crisis that developed in 1997. Nevertheless, I think that once the bubbles are removed and the industries are restructured, the economy will restart the engine of growth.

Development energy accumulated during the oppression

The engine for Korea's economic development has been forming throughout its history. The Korean people moved to the peninsula back in the Old Stone Age, built a nation there before the time of Christ, and founded a united nation in the seventh century, thereby securing homogeneity among its people. In Asia, Korea's history is the second longest following that of China. Despite being connected to a continent, since most of its land is made up of infertile mountainous terrain, the peninsula has maintained its racial purity and a strong sense of identity. With a population of two million a thousand years ago, the country in the 1990s is home to seventy million people, even discounting any specific population inflow. Therefore it could be said that almost all Koreans are each other's relatives.

Throughout its history, as mentioned above, Korea has suffered from incessant foreign invasions, as many as 900 by some accounts. After being invaded by Mongol tribes in the thirteenth century,

Korea was reduced to being a subject of China, culturally as well as politically. Nevertheless, what enabled Korea to preserve its own language and homogeneity was the people's strong spiritual power and sense of identity. However, the ordeals of the people continued. Going through times of extreme hardship caused by external forces, including Japanese colonial rule and the Korean War, Korea accumulated strong internal energy, and a reactionary response burst out in the form of economic development.

In fact, for Korea, development was a matter of survival, not of choice. Small land area, limited resources, long and cold winters, and an increasing population combined to make survival possible only for those who worked diligently. Also, because of a small domestic market, the people had to produce and export all kinds of products to maintain the status quo.

The best resources: human resources

During the process of rapid economic growth, Korea went through a lot of confusion stemming from a change in values and a lack of guiding philosophy. There are some voices within the society that warn against excessive materialism and mammonism. As Japanese colonial rule put an end to the Chosun dynasty that had lasted for some 500 years, the existing order collapsed, depriving Korea of opportunities to establish a foundation for modern industry and national capital. Without experiencing the modernization process that Europe or Japan had gone through, Korea was thrust abruptly into the modern era from its absolute monarchy of over 1000 years.

With the downfall of Chosun and the accompanying collapse of the strict institution of social class, Korea experienced a period of confusing values. Ideological confrontation and war after the liberation from Japan destroyed existing authority. Families with a long tradition and the ruling class of yester-year were no more subjects of respect. Only money mattered in order to survive in a situation where everything was uncertain. The American democracy introduced by US troops penetrated the vacuum of absolute authority, intensifying the trend toward grass-roots capitalism. Those who in the past belonged to the lower class could enhance their social status by accumulating wealth through hard work or education. In economic terms, such a breakdown of class served as a core factor for development.

In short, infinite opportunities were available to individuals. It became widely agreed among people that studying hard was the short cut to making money or gaining worldly success. Combined with a traditional respect for academics, this gave rise to strong educational enthusiasm, which subsequently mass-produced a quality workforce necessary for future economic development. Such enthusiasm still remains strong. The standard of Korean education is very high. Though Korea is not very strong in basic science and technology, it ranks along-side Japan at the top in the world in terms of average educational standard.

Among the remains of its traditional society, one that has had the most impact on modern-day economic growth is the heritage of brilliant inventions and innovations. Korea, in fact, is rich in historically significant inventions. Examples include metal printing (1232), which was 200 years ahead of Gutenberg's; the world's first pluviometer (1442); the world's oldest recording device for rainfall; Palmandaejangkyeong, the world's most advanced woodblock engraving (1251); the turtle-shaped Keobuksun, the world's first iron warship (1592); Hanguk, the Korean alphabet extolled by many linguists as the world's most scientific (1443); the world's first suspension bridge, built over the Imjin River in the fifteenth century, and the North-east Asian maritime trading network formed hundreds of years ahead of Europe by Chang Bo-ko, with Chunghaejin as the hub (828–46). This splendid cultural heritage serves as a well spring of quality human resources.

The economic model of Korean-style capitalism

The Korean economy still exhibits strong socialist elements. The reasons for this are summarized below. First, modern production facilities and economics were introduced by Japan, whose economics was in turn mainly influenced by Marxist economics. Though modern economics was introduced by the USA after the Liberation, Korea came under the strong influence of Japanese economics after the normalization of Korean–Japanese diplomatic ties in 1965. Therefore, the fabric of the Korean economy was mainly based on socialist elements. Second, unlike the basic American ideology of individualism, Japan and Korea respect communitarianism stemming from Confucian patriarchy. Third, the long-standing confrontation with North

Table 4.1 Comparison between US and East-Asian capitalism

	USA	East Asia including South Korea
Basic ideology	<ul style="list-style-type: none"> • Equal opportunities and competition • Material abundance and diligence 	Ignoring individualism Duty and co-operation inside community Materials are a means for human relationships
Economic agents	Importance of individual competition	Importance of harmony within community
Individual	Small government with minimal intervention in business	State duty of national welfare and guidance
Government	Domestic over international	International over domestic
Market	Importance of consumer values (individualistic consumption)	Importance of producer values (communitarianistic production)
	Non-humanistic and contractual relations	Transactions as part of continuing human relationship
State-business relationship	Contractual and formal	Non-constructual and informal
	Decision by majority	Decision by few experts representing community

Source: Song, Byong-rak (1995) *Study on Korean Economy*, 3rd edn (Korea: Bakyong Publishing Co.).

Korea as well as the need to justify military dictatorship enabled socialist elements to take root. Above all, however, there was a tacit consensus deep-rooted among people that all should enjoy a similar standard of living, since they had been equally poor and starving under colonial rule and through incessant wars.

In essence, the way of Korean capitalism is to 'allow private ownership' and solve economic problems through the market system. Therefore, it is very different from Communism, where property is shared and basic economic problems are settled through government control. However, it is true that Korea, like the USA and Japan, recognizes ownership by the government or state-owned enterprises. In solving economic problems, though based on the market system, Korea turns in many cases to government control.

To accomplish high growth in a short period of time, Korea also put emphasis on communal productivity, as did Japan. Consumption-orientated Westerners firmly believed that individual consumption should be encouraged even at the cost of corporate investment, whereas Koreans and Japanese hold the opposite view on investment and consumption. Its historic and cultural background put the Korean economy somewhere between the USA and Japan, though a little closer to the latter. The two largest trading partners of Korea are America and Japan. Such US-Japan-orientated structure has long been maintained, leaving Korea influenced by both countries.

Microeconomic factors of successful economic growth

At any rate, the Korean government was able to push strongly for its export-led economic policy under the unique free economic system and national consensus. Distribution of resources was also efficiently conducted by a market system based on the free capitalistic framework.

Some macroeconomic factors that had brought about Korea's economic surge have been discussed. Now I shall consider the microeconomic factors. First, population. Though rather insignificant in number, a population of forty-five million is enough to surpass critical mass for economic growth. This is interpreted as securing a domestic market that enables the development of new export products. In line with this, South Korea should maintain its export-orientated economic

structure by continuing to tap neighbouring markets in East Asia, including North Korea, while solidifying its domestic market.

Second, high educational levels, together with the willingness to work hard and a spirit of challenge, which are all very important to economic growth. The willingness to work hard stems from the national consciousness and education. Some say that the Japanese education system is old-fashioned and narrow-minded. However, no one denies that it was this very system that enabled the nation to become the world's second strongest economic power. Maintaining order, not troubling others, co-operating, sharing pain, equality, gratitude to society, and national order and authority as an absolute element for survival – all these are learned in Japanese schools. Therefore, rather than relying on a single superior individual, Japanese people exert strong power in groups. Although Koreans are less co-operative and more selfish they, like the Japanese, learn spiritual elements in school.

Third, a high savings ratio. Such a high savings ratio originates from there being insufficient welfare benefits, and uncertainties about the future. In Korea, the social welfare system has not been well established. Accordingly, the people had to provide individually for their later years. There was no choice but to bear the burden themselves in case of accident or disease, which drove them to save desperately for a rainy day. Despite poorly managed housing finance, Korea's home ownership ratio increased considerably

Table 4.2 Savings ratios as a share of GDP, 1994

<i>Country</i>	<i>Percentage</i>
South Korea	36.2 [*]
Japan	31.4
Hong Kong	33.0
Indonesia	30.4
Taiwan	30.8
Australia	21.1
New Zealand	20.4
USA	16.2

Note: ^{*} 1995 statistics.

Source: Bureau of Statistics of Korea (1997) *International Statistics Yearbook*.

because of its high savings ratio. Although less-developed housing or consumer finance significantly reduced the people's consumption level, it resulted in sound household management and made the domestic supply of industrial capital easy.

The depletion of development energy

Like oil that is formed over hundreds of thousands of years, the momentum for economic development of a nation requires a long period to accumulate. Yet, once the economy starts to develop, this energy is depleted within a century or so whether the results are successful or not. Economic development is a cultural product representing the collective will of the people. An individual who has enjoyed wealth for long time is likely to underestimate its value, and accordingly become less pre-occupied with it. As a Korean saying goes, 'Riches are rarely handed down to the third generation'. Similarly for a nation, economic growth comes with a price tag. In bad times, it is easy to reach a national consensus, since people are willing to make personal sacrifices. As income levels rise, however, it becomes more difficult. These are the processes South Korea is going through in the late 1990s.

In the times of confusion and starvation after the Korean War, the whole of Korea was fired up with a collective will to live a better life. As a consequence, any extreme development policy or risky measure was justified and at the same time diligence and frugality became a part of life. As economic development continued and the fruits of growth were enjoyed, determination to pay the price for the maintenance of these was somewhat weakened. Everyone was busy securing his or her own share, which caused a breakdown in organizational harmony. This led to weakened competitiveness and slowed economic growth. Once the determination born of austerity weakens, an economy ceases to grow.

Such events have been experienced in all industrialized countries and are now being experienced in the newly industrializing economies of Asia, including South Korea. That is why high growth cannot continue for ever. The most important factors in economic development are cultural background and business environment. First of all, a national consensus has to be reached. The younger generation, having never experienced poverty, belittles the hard

work of the older generation and refuses existing values, making it hard for consensus to be reached.

Up until the time of writing, the public sector in Korea has been too small to interfere with economic development. Recently, however, this sector has been expanding and the strong entrepreneurial spirit that pursues every possibility to create wealth has been waning over recent decades because of labour disputes and strict government regulations. It is naturally so because there are no rewards for taking risks and facing challenges. Phenomena found only in industrialized countries with mature economies are occurring too early in Korea, causing fear that a condensed decline might follow condensed growth. The real economic agents are entrepreneurs, the leaders who create something from nothing by tapping into new markets and developing new products. If we discourage and denounce them, thereby killing their entrepreneurial spirit, the economy is destined to wither. Unfortunately for Korea, the economy, even before reaching its peak, is showing signs of a weakening entrepreneurial drive: without another nationwide austerity drive, high growth will be hard to sustain.

In the past, a high savings ratio turned most income into industrial funds, enabling the economy to build an expansive production structure. Infrastructure investment, in particular, contributed greatly to boosting the overall productivity of society. For example, fostering social overhead capital (SOC), such as power plants, ports and roads, improved comprehensive industrial productivity and strengthened competitiveness, thus leading to economic growth. As the savings ratio tumbles, while consumer spending and the number of holidays increases, some of the pillars that have sustained economic growth are collapsing.¹

Korea has enjoyed the advantages of being a production base for the world's advanced enterprises: that is, by producing and exporting goods using the Original Equipment Manufacturer (OEM) method, the country has been able to introduce capital and technology while at the same time securing markets. Though it was in the mainly simple processing, Korea was able to introduce all the requisites for production at once, and after acquiring the expertise, it raised capital and produced goods at low prices, finally becoming capable of exploring foreign markets. At the time of writing, Korea is following in the industrialized nations' footsteps by transferring its sunset industries to developing countries. Since most of the developing nations are following the same

Table 4.3 The labour environment of major Asian countries

	Wage per Hour (\$/h)		Unemployment (%)	
	1990	1993	1986	1995*
Indonesia	0.25	0.43	2.8	3.1
Singapore	2.83	3.56	6.5	2.7
The Philippines	0.67	0.78	6.4	8.4
Thailand	0.92	1.04	3.5	1.5
South Korea	3.22	3.66	3.8	2.0
China	0.37	0.36	2.0	2.8

Note: * 1994 statistics for China; and 1993 for Thailand.

Sources: Bureau of Statistics of Korea (1997) *International Statistics Yearbook*; Asia Development Bank (1993) *Key Indicators*.

development pattern Korea adopted, Korea has reached a point where competition with those countries with far lower wage levels is not possible. Let us take the decline of the footwear industry as an example. Even though Korea's footwear manufacturing technology was the world's best, as its wages skyrocketed, foreign buyers changed their supply sources to South-east Asia, where wage levels are incomparably lower despite the region's relative technological inferiority.

Corporations such as Nike or Reebok concentrate only on creating a brand image by designing and marketing products and they sub-contract manufacturing to countries with low wages. Accordingly, footwear businesses in Korea are also moving their manufacturing operations to South-east Asia, but it is highly likely that these facilities will finally be transferred into the hands of the local people. For the time being, the personal relationship that has been built up with buyers will be able to sustain dealings, but as time goes by, those buyers will be connected directly to the local manufacturers leaving Korean firms without a leg to stand on.

Brand creation based on personal technology is a core element for economic development, and a country without technological capacity is destined to fall behind in the long run. Moreover, in the future economics will be a war of value-added, so to sustain continued growth, Korea should nurture hi-tech and high value-added industries, even if only in limited areas, that are capable of competing with any advanced nations. In line with this, large corporations or chaebols (the conglomerates), should close down their fleet management, where

Table 4.4 Value-added comparison of industrial products

Item	Value added (US\$ per pound)
Satellites	20 000
Jet fighters	2 500
Supercomputers	1 700
Aero engines	900
Jumbo jets	350
Camcorders	280
Mainframe computers	160
Semiconductors	100
Submarines	45
Colour TVs	16
NC Machine Tools	11
Luxury Cars	10
General Cars	5
Cargo Ships	1

Source: *The Economist* (1989) 'Technology of Japan', vol. 12, no. 2.

dozens of technologically unrelated enterprises are competing for limited resources at the same time. Rather, they should completely rearrange those businesses and concentrate on one or two competitive sectors in order to survive.

Another stumbling block to economic vitality is a welfare budget which far exceeds the development stage and economic capacity. Up to the present, welfare has not been much of a burden on the public sector in Korea. Its proportion, however, is increasing, thereby burdening the economy. In the welfare states of Europe, up to a half of the gross domestic product (GDP) is earmarked for the government sector, and most of this is for the social welfare budget, including pensions for the elderly and unemployment benefits. In Northern Europe, almost half of pregnant women are single mothers, partly because of the over-generous welfare system. Illegitimate children raised in orphanages are likely to give birth to illegitimate children and abandon them in turn to orphanages, thereby perpetuating a vicious circle and increasingly burdening governments. However, in developing countries, where people are not capable of shouldering such a huge welfare budget, the public sector has not surpassed 15 per cent of GDP.

Table 4.5 Proportion of social welfare expenditure by major nations

South Korea	Japan*	USA	France*	Sweden	UK*
9.9	36.8	29.6	45.0	48.2	29.6

Notes: * 1993, 1992 and 1992 statistics for Japan, France and Britain, respectively.

Source: Bureau of Statistics of Korea (1997) *International Statistics Yearbook*.

As the social welfare system develops, people are burdened with increasing taxes. While such a system is good for the inadequate, it greatly discourages the competent and diligent, which in the end weakens national competitiveness. As a consequence, in some European nations their excessively advanced welfare systems fill them with complacency, and drives competent people to go abroad, thereby stalling growth.

Excessive high tax rates discourage willingness to work. Therefore, high tax rates do not necessarily translate into tax revenue increases. However, tax rates kept at a relatively low level rekindle willingness to work and encourage people to report income conscientiously, thus possibly increasing tax revenue. Singapore or Hong Kong, both of which pursue free trade, are good examples.

The number of government employees continues to increase because of the government's lax management and the public sector expands regardless of efficiency, but so far this situation has not been considered a problem because tax revenues have continued to increase with uninterrupted economic growth. However, the public sector proportion in the GDP of Korea has already exceeded 20 per cent. This will become a huge burden on future economic development and is eroding one of the factors that sustained Korea's continued rapid growth. With the welfare sector excluded, Korea's public sector proportion in GDP is as large as that of Western Europe. This is because even though the public sector share of Western European countries is 50 per cent of GDP, when the welfare sector is excluded the proportion is only 20 per cent.

The engine of Korean-style economic development: entrepreneurship

What enabled Asian nations, including Korea, to sustain their dramatic economic growth was the export-orientated economic policies

led by state-private co-operation. If Korea had pursued economic development centring on import substitution industries, as did South America or other developing countries, it might have failed. Domestic markets are in general smaller than international ones. If a country protects and nurtures only import substitution industries in order to control a small domestic market, the burden will have to be carried by the people, thus weakening national competitiveness. Since finite resources were invested in priority industries which were selected because of their competitiveness, export-driven economic growth policies could succeed. Export industries stabilized domestic prices and built a positive feedback system to reinvest earned foreign currency.

Korea is a representative case among nations that have succeeded with the system discussed above. Whenever Korean economic development is considered, the role of the government is overestimated when businessmen should be given equal, if not more, credit. It was businessmen who enabled Korea to make inroads into the Middle East or Vietnam, not government employees. Corporations were the first to tap into markets – Hanjin in Vietnam, and Samwhan, Daerim and so on in the Middle East – and established a bridgehead for future government entry. In the case of Libya, even before the two countries set up diplomatic ties, corporations such as Dong-A

Table 4.6 South Korea's major economic indicators

	1985	1990	1996
Population (million)	40.8	42.9	45.5
Land size (000s km ²)	99 143	99 273.7	99 313.5
Per capita GNP (US\$)	2 242	5 583	10 548
Gross domestic product (US\$ billion)	94.3	253.6	484.6
Consumer prices increased rate (%)	2.4	8.6	5.0
Exports (US\$ billion)	26.4	63.1	128.3
Imports (US\$ billion)	26.4	65.1	143.5
Foreign reserves (US\$ billion)	7.7	14.8	33.2
Foreign debt (US\$ billion)	46.8	31.7	104.7
GDP growth rate (%)	6.5	9.5	7.1

Notes: 1. Foreign debts were calculated as at year-end.

2. Foreign reserve includes gold.

Sources: Bureau of Statistics of Korea (1997) *Major Economic Indicators of Korea*; Korea Import-Export Bank, *Soeun Survey Monthly* (1987) vol. 2; Bureau of Statistics (1996); 1997 *International Statistics Yearbook*; The Economist Intelligence Unit (1997) Korea.

and Daewoo were contracted for large projects. Such is the importance of businesses in that government-level exchanges are initiated by corporate exchanges. Therefore, in any country, the main forces behind economic development are the corporations. Nevertheless, the government regulates these corporations rather than helps them to fulfil their role. Government regulations on production, various services and exports became the main cause of cost increases. The logistics cost is twice the international standard and, in parcelling out land for industrial complexes, the government is burdening people by setting the price three to four times higher compared to international prices.

As the economy expands and becomes more complicated, creating a need for swift adjustment in the ever-higher interdependency with world economies, it is no longer acceptable for government employees to abuse their power and control the economy. As the economy adopts a precise mechanism, it becomes too delicate, complex and flexibility-demanding to be manipulated by outsiders with only a surface knowledge. As the government changes over time, the Korean government should abandon the role it has played in the past development stage and take the lead in constructing a business-led liberal economic system.

Korean businesses, with their short history, are mainly managed by owners. Social ill-will against this is a factor that further demoralizes entrepreneurs. Professional managers are considered desirable, based on the idea of separating ownership from management. As could be seen in the recent case of Kia Motors, however, so-called professional managers irresponsibly determined large-scale investment, thus endangering the firm's existence, and were busy maintaining their managerial authority through collusive link with unions. In times of crisis, management by a powerful owner might be better. Many industries that the Korean people as well as the rest of the world view negatively have achieved success in the 1990s in large measure because of owner-management.

In income distribution, Korea has a more equal system than many advanced nations, because of its widespread socialist way of thinking. Therefore, compared to the USA in particular, there is a relatively small gap between the starting salary of college graduates and the income level of CEOs (Chief Executive Officers). The income of Michael Eisner, CEO of the Walt Disney Group in the USA, was close

to US\$190 million in 1996, mainly because of a stock option system. Appointed CEO in 1984 when the company was failing, Eisner was given an option to buy shares at the current price in return for successful management. This option would act as an incentive for a CEO to maximize stockholders' property values; he or she would be given a huge benefit in sharing the interest of stockholders.

In this way, the incomes of CEOs are incomparably higher than the starting salaries of college graduates in the USA, but no one complains about it. On the other hand, income in Korea is equally distributed on a downward basis, rooted in the belief that only equality is virtuous and right. It is true that the equalization of income expands buying power, giving impetus to the economy and reducing social discontent. However, if carried to excessive lengths, it can also destroy the entrepreneurial spirit, which requires a sense of challenge, creativeness and superhuman effort.

Readjusting the economic paradigm

The framework of the Korean economic structure is dynamic. Its industries run the gamut from low value-added industries of simple assembly to high value-added ones that require state-of-the-art technology, and from hardware to software. This structure, if properly managed, would be strong enough to surpass the existing economic superpowers and is often cited as a strong feature of the Korean economy as compared to Taiwan. Nevertheless, it would be difficult to maintain such a structure in the future.

To solve the problem of intermediate goods whose imports increase faster than do exports, the Korean government is making efforts to nurture the materials or components industries.² In particular, materials or components where Japanese counterparts monopolize the supply should be produced domestically to ensure technological independence. However, policies for nurturing import substitution industries targeting finite domestic markets run counter to global trends. Materials or components industries should be nurtured, considering the prospects of the assembly industry and as part of industrial restructuring. The Korean economy is trying to reform its industrial structure into a high value-added one and to specialize its industries. Nevertheless, the country faces many difficulties because of the weak competitiveness of each industry

caused by the shortage of source technology and the fleet management system of chaebols, based on their capital and their dominance of domestic market.

Having already reached the limit of growth in the conventional way, the Korean economy is in need of a paradigm shift, in order to spark growth once again. Korea's geo-economic location is at the same time advantageous and disadvantageous. Located as it is between China, with its potential to become the world's largest economy, and Japan, now the world's second-largest economic power. Though it is hard to compare the two countries in terms of absolute scale, Korea is desperately competing with Japan in almost every industry, while China and South-east Asian countries are catching up rapidly. Consumptive factors such as small domestic markets and excessive military expenditure will in the future become a much heavier burden.

Without any external variables, it would be difficult for Korea to compete head-on with the USA, Japan, and China. Therefore, Japan should abandon its hegemonism-based economic strategies, concentrate on several priority fields and make them the world's best, thereby securing overwhelming product superiority. While readjusting its industrial structure by aggressively developing advanced technology, Korea needs, without hesitation, to transfer sunset industries to developing countries, while constructing an interdependent system. To accomplish these goals, the government should be recreated as a provider of long-term vision, information and high-quality administrative service. Large corporations, rather than complaining that the government always turns to political logic in solving economic problems, should also reflect on whether they themselves are overlooking economic logic. Before criticizing government intervention, corporations should first stop embracing uncompetitive businesses as affiliates, and shifting the burden of wage increases to consumers and subcontractors by abusing their considerable market force.

Much criticism has been levelled at the past economic development process of Korea by both domestic and foreign sources, but this much is true. Korea, though a latecomer, has managed to build a number of large-scale industries including steel, shipbuilding, chemicals, electronics and automobiles. A large part of the credit for this should be go to the strong will of the government and large

corporations. The biggest problem of the chaebols in Korea is the indiscriminate expansion into small-and medium-sized industries based on the economic power they have already accumulated. The Korean chaebols should voluntarily reduce unnecessary affiliates and instead, pursue specialization, competing with the rest of the world.

In the late 1990s, the Korean economy is suffering unprecedented difficulties. A flurry of bankruptcies of large corporations leading to the plummeting national credit standing of Korean businesses has shaken the very foundation of the economy. The aftermath of the global financial crisis triggered by the free fall of the Thailand baht caused the won to plummet in value, draining foreign capital from the Korean stock market and causing share prices to tumble. Behind these unsound firms lies a structural problem of the financial institutions including the banks. Political logic mixed with the presidential campaign added fuel to the problem, making it harder to devise a solution. The government is trying to solve the problem of short-term liquid fund shortages through bail-out loans from the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), the Asian Development Bank (ADB) and so on. But such measures will not be effective without solving more fundamental problems. Up to now, the Korean people, as well as businesses, had harboured the false belief that 'conglomerates never collapse'. In addition, preferential bank loans have been made to businesses with large sales and credible collateral such as real estate. Accordingly, businesses have been more occupied with devising measures to gain more loans, including sales increases, real estate speculation and fleet management, rather than enhancing profitability.³ Therefore, the Korean government, before it is too late, should raise the level of its backward banking industry to that of industrialized nations, as well as make businesses clearly understand that a company is destined to be weeded out once it loses competitiveness. And at the same time, the government should carry out bold restructuring measures so as to boost the competitiveness of the overall economy.

The wisdom of turning a misfortune into a blessing

As the hub of global economies moves to Asia, and to East Asia in particular, Korea has a geo-economically advantageous location.

Sharing borders with China and Russia, and with Japan only an hour's flying distance away, Korea is located at the centre of four powers, including the USA and is in a position to make the most of its location. This geo-political location led to the deprivation of Korea's sovereignty at the end of the Chosun dynasty. But today, when the economy takes precedence over everything else, the location gives Korea an advantage of being a logistics centre. Even though advances in transportation and communications overcome spatial constraints, the advantages of position can never be devalued.

In this context, Korea should expand its infrastructure to include large ports, airports, roads and canals, in order to solve the problem of logistics cost, a bottleneck of development. Furthermore, the country should be recreated as a logistics hub of North-east Asia by utilizing fully its natural geo-economic advantages. If Korea combines its role as a logistics centre with its existing economic structure, it will be able to strengthen its overall competitiveness.

However, a strong vision for the economy is needed to realize all this. Korea has so far been suffering from a lack of strong and visionary leadership, thus casting a shadow on its future. Korea still remains in an environment that places political logic above economic logic. Since the local autonomic system came into effect, regional selfishness and political logic have seriously distorted the economy. For example, rival countries are trying to develop a single priority port in order to pre-empt the role of a hub. Korea is currently building Kwangyang port in addition to developing several small ports in the name of equal regional development. Of course, if there were no competition and only balanced domestic development were to be considered, it seems a logical enough plan. In fact, industries such as ports or airports, to which economies of scale and huge pre-emptive effects are applied, are an area of cut-throat competition where only the best survives. The Korean approach is therefore likely to result in a waste of resources.

The world's major shipping businesses unload their transit cargo in a single hub port in each region for managerial and economic efficiency. As a consequence, the rest of the ports are reduced to being used for local trade. Therefore, from an economic-strategic point of view, the Korean government should abandon its political logic and reconsider its port expansion plan. Rather than wasting energy on Pusan and Kwangyang ports, which are geo-economically

disadvantageous, the government should construct an ultra-large port in the metropolitan area, where transportation volume amounts to more than a half of the total. The newly constructed port will serve as a main terminal for major shipping businesses and also compete with Shanghai and Taren. If this takes place, Pusan port will not be reduced to simply a local port.

This must be done to rejuvenate the economy, whose vitality is being drained as it reaches the limit of growth. It would enable Korea to emerge as a logistics power in East Asia. Korea, besides being a logistics centre, would then be able to attract local headquarters of the world's best corporations and venture companies, consequently creating new businesses and maintaining economic vitality.

To make this happen, facility investment is urgent. More urgent, however, is constructing perfect systems. The government should make an effort to remove various regulations completely, construct a free trade system, and try to attract foreign capital. The major markets of Asia are concentrated in North-east Asia, but Asian headquarters of the world's leading multinationals are mainly based in Singapore. Even with its geographic advantages, Singapore is 5000 kilometres away from the East Asia region, giving it a disadvantage in terms of distance. Despite this, local headquarters are stationed there because of the government's aggressive enticement strategy and open environment. For instance, Korea or Japan imposes a corporate tax of up to 34 per cent and has strict regulations, while in Singapore corporate tax is only 16 per cent and it has many advantages as a free port. Therefore, Korea should learn from Singapore, Amsterdam and Antwerp rather than from the USA or Japan.

The birth of reunified Korea and its role

The reunification of the Korea peninsula is a very complicated issue that involves not only the two Koreas but also neighbouring powers, including the USA, China, Japan and Russia. The peninsula will in the foreseeable future be reunified, because both North and South desperately desire it, and Korea must build up its economic power to prepare for the sudden reunification.

The amounts differ vastly according to survey institutions, but a universally acknowledged fact is that Korean reunification will come

Table 4.7 Cost of German reunification

Type of cost	Detail	Cost (bn Marks)
Cost of consumption	East German government budget deficit undertaking cost	30
	East German debt with the US undertaking cost	30
	East German state-owned businesses' debt undertaking cost	100
	Trust Bureau's corporate management cost	250
	Capital transfer cost	40
	Ex-Soviet troops withdrawal cost	13
	Reinstatement, compensation, etc. of victims under the East German System	16
Social welfare cost	500	
Subtotal		979
Cost of investment	Labour productivity and environmental modernization	100
	Environmental clean-up	200
	Transportation network improvement	127
	Energy facility modernization	100
	Educational environmental gap removal	70
	Postal communications field facility modernization	55
	Housing modernization	50
	Medical facility expansion	30
	Agricultural structure reform assistance	7
	Subtotal	
Total		2 618

Source: Sejong Institute (1998) *The Unification of the Korean Peninsula from an Economic Perspective*.

with an astronomical price tag. Some Koreans argue that reunification should be postponed for fear of economic confusion and financial losses. Nevertheless, since the costs incurred by partition is huge beyond imagination, it would be better for the reunification to happen sooner rather than later, as long as it is not accompanied by war. Whatever form the reunification takes, if the South is economically incapable of supporting the North Korean economy, reunification will probably not be sustained.

The most important factors in reducing the cost of reunification are the development of the North Korean economy, and the methods and timing of reunification. The more the North Korean economy is developed through reform and opening, the less the reunification cost will be. The more peacefully and gradually the socio-economic integration is pushed for, the less the cost will be. German reunification was a political victory for West Germany, but it posed a huge economic problem. With East-West integration, the economic system of East Germany went through changes at a rapid speed and the economic losses were enormously large because of the lack of preparation. West Germany spent an estimated amount of up to 180 million marks to convert East Germany into a market economy system during the six years following reunification.

When viewed from a historical perspective, the birth of a unified Korea is inevitable. The time when it happens however, will be when neighbouring countries, including China, regard the reunification of the Korean peninsula as being advantageous to them.

The twenty-first century will be a period of challenge and opportunity, not only for Asia but also for the rest of the world. And especially for Asia, which is in the process of dynamic growth, and for Korea, which is facing reunification in the foreseeable future, an

Table 4.8 Economic potential of reunified Korea

	South Korea	North Korea
Population (million)	45	22
GDP (US\$ billions)	460	35
Per capita GDP (US\$)	10 222	1 600*

Note: * Estimates.

Source: Bureau of Statistics of Korea (1997) *Major Economic Indicators of Korea*.

epochal revolution is expected. If so, what vision of the next century should Korea have? While Korea has never ruled China in the past it has nevertheless triggered rises and falls of Chinese dynasties as well as having been subject to events in China. This relationship will continue in the future, though to a differing degree. Therefore, Korea should be prepared for the time when China reverts to hegemony. Korea should remember the fact that a reunified and robust China has always throughout history looked for external avenues through which to dispense its accumulated energy. Another country Korea should be cautious of is Japan – a country that is steadily reinforcing its military power and is expected to become a permanent member of the UNSC. Preparations should also be made for a possible economic and military confrontation between the three powers of China, Japan and the USA. Changes in power structure will present Korea not only with crises but also opportunities. A powerful Korea may be able to mediate such confrontations among the superpowers by declaring political and economical neutrality. Korea should also make strenuous efforts to become a growth model for less developed countries, and at the same time aggressively transfer its experiences to them, thereby participating in the equalization of world economies. In this context, a guiding vision is the most crucial element for Korea at this time.

Notes

1. Savings ratio continued to decline, from 39.3 per cent to 36.2 per cent in 1995. Consumer spending doubled from 650 000 won to 1 395 000 won in 1990.
2. The trade balance deficit reached US\$15.3 billion in 1996, more than three times higher than the previous year.
3. Trade balance deficit reached \$15.3 billion in 1996, up to over 3 times higher compared to the previous year.

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5 China

China's place in world history

China, stirring from a deep sleep, re-emerged as a true political and economic power based on its long history, vast lands and huge population. Most historians or political scientists and economists have a fragmentary view of Chinese history – that is, they believe modern China was born when the revolutionary movement¹ initiated by Sun Yat-sen terminated the extreme corruption of the late Qing dynasty, and present-day China was founded by the Communist Party. This is a very narrow view. China is too complicated to be described in such a simple way.

Ever since China boldly abandoned its socialist economic system and adopted a market economy, its annual average growth has been an astonishing 10 per cent. Where did this explosive energy come from? It is not an exaggeration to say that the answer lies in its deep-rooted culture, characterized as being commercial and practical. Though almost half a century has passed since the Communist Revolution, such a cultural tradition has remained deeply embedded in the Chinese people. As mentioned above, the economy is closely related to its history and culture, so for a better understanding of China it is necessary to retrace this history.

The unifications of China and its brilliant history

China stretches 5500 km north to south, and 5000 km east to west, and its total land area is 9.56 million km². This vast land is home to

1.2 billion people. Though there are many different ethnic groups in the country, the Han tribe comprises 94 per cent. The country's magnificent 5000-year old culture, which embraced the Huang He (Yellow River) civilization, one of the world's four great civilizations, is evident from the numerous historical remains. An ancient civilization was already established in 2200 BC. A highly advanced civilization that used writing flourished around 1200 BC. In 221 BC, Shihuangdi, or the First Emperor of Qing, unified the continent for the first time and ruled for about fifteen years. The Chinese continent was split into competing regions after his death but was reunified with the founding of the Han dynasty in 207 BC. It was during the Han dynasty that the ancient Chinese civilization reached its peak. Many ideas and classical works, including Simatian's *Chronicle* were products of the period.

The Chinese people have traditionally taken history as a criterion for values, idealizing the past. Therefore, despite repeated unifications and divisions, Chinese history has been able to solidify its basis. Even though the Han ruled the unified continent between 25 and 220 AD, it was not a centralist rule by a firmly established government but rather a decentralized rule by regional lords. The continent's break-up and the ensuing period of chaos were brought to an end when the Sui dynasty reunified the continent in 581. In 618, however, the dynasty collapsed after being defeated by Koguryo in the Great Victory of Salsu.² The Tang dynasty subsequently emerged and by 907 had laid the foundations for China's medieval culture. Although the Song dynasty that succeeded the Tang enjoyed cultural maturity, it was a period of political and military unrest.

The fusion of non-Chinese tribes and territorial expansion

A Mongol tribe conquered Song in 1271 and founded the Yuan dynasty, ruling China until 1368. This was a period of integration with the non-Chinese tribes of the north. Before the Mongol invasion, the Chinese dynasties had been centred around the southern part of the Huang He river. With the establishment of the Yuan, a massive influx of non-Chinese tribes flooded China. Only one million of the 70 million total population were of the ruling Mongol tribe, but nevertheless the tribe ruled the dynasty, based on

a strict racial policy. According to the then racial classification, the Mongols were called 'the northern'; Central Asians and Europeans, 'the colour-eyed'; 10 million northern Chinese living along the Huang He river, 'the Han', and the majority of about 60 million living south of the Yangtze River, 'the southern'.

Political hegemony and military power were under the control of around a million Mongols and the one to two million 'colour-eyed'. The Mongols, without a distinct culture of their own, were very active in absorbing the cultures of others. In addition, they advanced thorough mercantilism, leading China to prosperity. They established the first national monopoly in the sales of salt, alcohol and tea. They developed the Silk Road aggressively, and China witnessed a peak in East – West transactions during this period. It was also the period when Marco Polo visited the continent. His visit provided the opportunity for Europeans to learn about Chinese economy and culture and encouraged East – West transactions. Such transactions subsided after the Yuan dynasty because China, with its advanced culture and economic wealth, did not by that time have any urgent need for foreign trade.

The second rising of the Han tribe

The once-formidable ruling power of the Yuan dramatically weakened because the reign of each king lasted only two to three years, and there were always intense feuds inside the tribes. Also, a number of Mongols were building their own power structures outside the Yuan. To be precise, it was not the Yuan but the Mongol empire that dominated the continent. The Yuan was merely a part of the empire. The area under Mongol control stretched as far as Turkey and Hungary to the west. The Mongols were the most formidable warriors in history, with their unmatched fighting power and uncanny organizing ability. Though few in number, they swept across the Eurasian continent like a raging storm, leaving death and destruction in their wake.

The conquered are naturally hostile to the conquerors. Even so, those invaded by the Mongols bore an unusually intense hatred towards them, because the Mongols were too ruthless in invading and too cruel in dealing with dissidents. Moreover, after conquering a country, the Mongols would place the forces of the defeated before them as human shields when invading another country. The

Mongols themselves stayed behind as supervisors while the invaded were forced to fight until death.

The Yuan attempted to invade Japan twice, with Koryo at the forefront, but, as discussed earlier, these attempts ultimately failed because of typhoons. However, the Mongol invasions forced changes within Japan, resulting in the collapse of the Kamakura Bakuhoo. But the failed invasions also expedited the collapse of the Yuan. Since the Mongols, during the invasions of Japan, placed the Koryo people, one of their invaded nations, at the front as usual, it was Koryo that suffered the most. The relationship between Koryo and Japan deteriorated badly afterwards.

The accumulative effects of such failed efforts significantly weakened the ruling power. In 1355, the Rebellion of the Red Band broke out and in 1368, Zhu Yuanzhang, one of the rebel leaders, expanded his armies and founded the Ming Dynasty which ruled China until 1644. During the Ming dynasty, the Great Wall was expanded and the Grand Canal improved, thus completing the modern civilization of China. Foreign trade was active during this period. The Ming dispatched Jing Hua to the Indian Ocean and Africa with sixty ships and 30 000 crew between 1405 and 1424, and thirty countries became tributary nations as a result. This was a politically motivated action, not trade for real economic interest. If the Ming had pushed full-scale for overseas market exploration, a world civilization might have been formed with China at its centre.

What enabled Europe to lead world history was its pioneering spirit plus sophisticated levels of science and technology. Only a civilization with political capacity and vision can lead history; without these elements, strong national power, a large population and abundant resources are meaningless. Ming's naval expedition proves this: the Jing Hua-led fleet was equipped with all the elements for huge success and was far bigger than that led by Ferdinand Magellan from Europe. Nevertheless, the naval expedition ended being a one-off sabre-rattling exercise without gaining anything of real interest, mainly because of a lack of vision. This is a clear proof of how important the relationship between the will of the rulers and the people; science and technological expertise; and economic expansion are in determining historical outcomes.

The Ming later enjoyed a long period of peace and prosperity, but eventually the dynasty began to decline internally and new forces

from the outside triggered its downfall. For seven years after the Japanese invasion of Korea in 1592, Ming dispatched reinforcements to Korea, thus depleting its national power. As a consequence, the Ming failed to quell at an early stage the unification movement that arose in Manchuria. The Manchus were divided into several tribes, and whenever a stronger tribe tried to unify the rest, the Ming would intervene and prevent this. Taking advantage of a timely power vacuum, Nurhachi united various Manchu tribes and founded the Jin dynasty in 1619. The Manchus conquered Chosun in 1637 to eliminate a potential threat. When peasant rebels led by Lizicheng⁴ captured Beijing in 1644, the Jin quelled the rebellion at the request of Wusanjui, the great commander, and changed its name to Qing.

The Korean peninsula: a catalyst for change

The Korean peninsula had always been an important variable in the political and military structure of North-east Asia. The Sui fell after losing the battle with Koguryo at Salsu, and the Tang, a following dynasty, was able to maintain its reign for a long time in alliance with Shilla by defeating Packjae and Koguryo. Despite its population being seventeen times larger than that of Korea, China could not ignore the peninsula. Korea served as a buffer zone and the mountainous peninsula was hard to attack. Even if successfully invaded it would have been hard to rule, and the peninsula was economically useless because of its infertile soil. Hence, it was better for China to leave the peninsula alone. Nevertheless, starting with the Yuan, China began to invade Korea aggressively. The Mongols, one of the non-Chinese northern tribes, did not have to worry about forces from the rear, and they had a strong cavalry. It was during the three dynasties of Yuan, Ming and Qing that the Korean peninsula was exploited most humiliatingly and completely.

Territorial settlement and the birth of modern China

The Qing set its border at the edge of the combined territories of Ming and Jin, which marks the present-day Chinese border. The border with Russia was settled according to the Nerchinsk Agreement⁵ in 1689. The Qing in its heyday conquered even the

western region (in 1759), expanding the territory, but it was weakened considerably because of an internal break-up. Since a small number of non-Chinese ruled the Han tribe, which was tens of times larger in number, the dynasty could not fully utilize people's potential. Moreover, state management was inefficient and social discipline slack. The Opium War in 1842 brought about the final collapse of the Qing. Before its downfall, the Manchu reign was based on the 'Eight-Flag Army'⁶ who were given fiefs for hereditary and independent use. The national army was comprised of three eight-flag armies — the Manchus, the Mongols, and the Han — totalling 200 000 troops in twenty-four flag armies. However, as time went by, military discipline was weakened and the economic structure became unstable because the fief assigned to each flag army was sold or used as collateral for loans. Consequently, eight-flag armies were neutralized, which gave rise to rebellions by a religious cult called Baijiao during 1796–1804.

Local warlords called Xiangyong successfully quelled cult rebellions, further boosting the status of the Han. In the meantime, Western forces had entered China and begun trading activities. The West had little to sell, but much to buy, including porcelain, silk, spices and tea, thus worsening the West's trade deficit. In the early nineteenth century, China recorded an annual trade surplus of US\$45 million. To offset its trade deficit, the UK sold opium to China that had been cultivated in India, and China's attempt to halt the opium trade led to the outbreak of the Opium War in 1840. As a result the UK took over Hong Kong on the signing of the Nanking Treaty, and China suffered a devastating blow to its prestige. The Taiping Rebellion,⁷ which broke out in 1850, ravaged China until 1864. It was Xiangyong again that quelled the rebellion, not the regular armies, and this left the country under the control of these local warlords. The central government made attempts to adopt Western technology and create modern enterprises through modernization programmes called the Yangwu programme⁸ and the Bianfaziqiang programme,⁹ which ended in failure because of corrupt bureaucrats.

In the meantime, on the Korean peninsula, the Dong-Hak uprising broke out. The Qing and Japan sent troops at the same time, culminating in the Sino-Japanese War (1894–5). Defeated by the Japanese, Qing suffered a humiliating loss of dignity, and social unrest

ensued. Sun Yat-sen initiated a revolutionary movement dedicated to establishing a republican government in 1911, which in turn gave the Manchu armies, reorganized by Yuan Shih-k'ai, a chance to extend their powers. After the fall of Qing, the continent was divided by local warlords. It was in the midst of such chaos that the Communist Party was established in China in 1921.

In the meantime, Japan, after conquering and colonizing the Korean peninsula, attacked Manchuria. Although Chiang Kai-shek seized control of China in 1928, Manchukuo, the Japan-established puppet state, continued to expand along the coastal areas. To cope with Japan's control over the Chinese coast, Chiang formed the Kuomintang–Communist united front with Mao Zedong. However, the Kuomintang government suffered from internal corruption and weak organizing capacity and was forced to flee to Taiwan when the Communists, under Mao, seized control of China in 1949. China, reunified by the Communist Party, reclaimed Manchuria from Russia in return for its participation in the Korean War in 1950. Reform programmes, such as the Baihua programme in 1957 and the Great Leap Forward in 1958, failed, and with the end of Russian aid, China was left to manage the country on its own.

From equality in poverty to inequality in affluence

As Mao Zedong became weaker and internal power struggles became fierce, Mao's closest associates, including Jiang Qing, turned to the public in order to neutralize its traditional bureaucracy and the party structure. This was the start of the Cultural Revolution. A self-sufficient economy, aggressively promoted during the Cultural Revolution, gradually isolated China from world economies. As can be seen from Table 5.1. China's share of world trade showed a continued downward movement from its peak in 1928 to 1977. To make matters worse, the confusion that followed the Cultural Revolution completely devastated China and threw the country into anarchy. It was only after the death of Mao Zedong in 1976 that China finally restored stability and pushed ahead with its practical economic reform with the re-emergence of Deng Xiaoping, who had once been pushed aside. The year 1978 therefore marked the rebirth of modern China. 'Just like what matters in cats is not whether they are black or white, but how good they are at catching rats, what

Table 5.1 China's commodities trade

Year	Total amount US\$ (billion)	Share of world trade (%)
1929	1.4	2.1
1962	2.7	0.9
1970	4.6	0.7
1980	38.1	0.9
1996	290	2.7

Sources: League of Nations (1930/1) *Statistical Yearbook of the League of Nations; General Agreement on Tariffs and Trade, International Trade*, table 2.1; International Monetary Fund, *Directory of Trade Statistics Yearbook*, 1997.

matters to a country is not whether its ideology is communism or capitalism, but how well-off its people are', said Deng, in his 'black-white cat theory'. Based on this theory, he implemented a full-scale reform programme, adopting a market economy with determination and dissolving collective farms.

Such reform efforts changed China in many ways. In agriculture, collective farms were dissolved after 1978 and the farmland was leased for fifteen years, and the term was later extended to thirty years, substantially privatizing the land. Agricultural productivity soared after 1990, when land transaction was allowed. Overall, agricultural production increased more than threefold, from 150 million tons in the 1960s to 460 million tons in 1993.¹⁰ By allowing the farmers to work for themselves, agricultural productivity greatly improved compared to the past, when the farmers were forced into working for the state.

In trade, China's total trade volume in 1996 amounted to US\$29 billion, accounting for 2.7 per cent of world trade, surpassing the record it set in the late 1920s. China's strenuous efforts to attract foreign direct investment led to a record high of US\$111.4 billion-worth of foreign capital in 1993. The amount of foreign capital, that had been showing a downward movement since then, recorded US\$73.21 billion in 1996. In a practical sense, however, it had increased to a record US\$42.35 billion, an amount far surpassing that of other developing countries or ex-socialist countries in Eastern Europe. In GNP, the real growth rate¹¹ recorded an annual average of over 9 per cent from 1987, the year when the reforms began, to

1995. The uninterrupted high growth shrank the number of those living in abject poverty from a quarter of the total population in 1987 to a twelfth in 1994, and increased real income threefold. Boosting such high growth were high savings and investment ratios¹² and the dramatic increases in productivity that followed. Bank deposits of all households as a share of GNP skyrocketed, from just 6 per cent in 1978 to 46 per cent in 1991. Most of these deposits were loaned to the business sector, especially to the state-owned corporations through state-run banks.

The biggest factor that made such high growth possible was China's cultural tradition, characterized as both commercial and practical, but the central government also played its role. It awakened the merchant spirit, which had been dormant for about forty years since the Communist Revolution, by consistently pushing for a policy of reform and openness. Moreover, the government relaxed its control over the entire economy, giving material stimulus to all economic agents and encouraging them to utilize their potential fully.

As mentioned earlier, China's economic success originated from flexible and progressive traits as well as the potential unique to the Chinese people. Compared to the former USSR and the Eastern European nations, China from the start possessed many advantages. First, China was flexible in pursuing rationalization and liberalization.

Table 5.2 China's major economic indicators

	1985	1990	1996**
Population (millions)	1070.2	1155.3	1200.0
Land size (000s km ²)	9597	9597	9597
Gross domestic products (US\$ billions)	294.3	387.8	697.6
Consumer price rate of increase (%)	6.5 [*]	3.1	8.3
Exports (US\$ billions)	27.4	62.1	151.1
Imports (US\$ billions)	42.3	53.3	138.8
Foreign reserves (US\$ billions)	12.7	29.6	105.0
Foreign debts (US\$ billions)	n/a	52.7	116.3
GDP growth rate (%)	16.2	3.8	9.7

Notes: * 1985 statistics.

** EIU's estimation.

Sources: The Economist Intelligence Unit 1997, *China*; Bureau of Statistics of Korea, *Major Economic Indicators of Korea*.

With its large population and vast land area, China has had a long history of stable local autonomy and decentralization. Also, since most businesses, excluding the key industries, were led by small and medium enterprises (SMEs), the role of central officials was rather limited. China was therefore able to be flexible in pursuing rationalization and liberalization.

Second, major economic indicators had already been stabilized. At the time of its opening, China had few foreign debts and almost no inflation. In addition, an export market network had already been well-established by overseas Chinese, providing a favourable environment for the Chinese-style 'formula for growth', which is to introduce capital and technology through the network and re-export of processed goods. In this context, Hong Kong was a treasure and lifeline for China.

The return of Hong Kong and its new role

Hong Kong, a port city with a population of 6.3 million, emerged as a world-class city-state ranking seventh in 'world trade volume' and first in 'world container cargo volume'. This was made possible by the synergy between the British ruling strategy, which maximized *laissez-faire* principles, and Hong Kong's economic impact as China's window to the outside world. At the time of writing, however, it is difficult to predict the future of Hong Kong now that it has been returned to Chinese rule (on 1 July 1997), after 156 years of British colonial rule. One thing is certain, however: the giant Chinese economy has gained further impetus.

Hong Kong has a long history of being an active commercial port, but it was during the Korean War in the 1950s that its true value was recognized. With the United Nations' blockade of China, a war-criminal nation, Hong Kong became the only place through which the West and China could exchange information and conduct transactions. China in fact earned a considerable amount of foreign currency by providing Hong Kong with supplies, including food. If that had not been the case, China might have absorbed Hong Kong earlier.

The UN blockade prohibited China from intermediary trade for about a decade. Towards the end of the Vietnam War, Sino-US relations improved slowly, and President Richard Nixon's visit to China

in 1972 signalled its return to the global market. The USA was willing to join hands with any nation for the purpose of keeping Russia in check. Therefore, when the end of the Vietnam War terminated uncomfortable relations between the two countries, the USA swiftly reversed its attitude and formed an alliance with China. During this process, Hong Kong once again proved its worth.

During the 1960s, when intermediary trade was banned, the manufacturing industries set up by businessmen who had fled from mainland China laid the foundations for the Hong Kong economy. The opening of China in 1979 rapidly expanded economic exchanges between the mainland and Hong Kong, dramatically increasing the trade volume 54.7-fold over eighteen years.¹³ The Hong Kong businesses that had tapped into neighbouring regions such as Guangdong and Fujian utilized cheap labour there and developed light industries. Consequently, Hong Kong achieved high growth as a Chinese intermediary trade centre.

The implications of Hong Kong's success is that even a nation with few natural resources can accomplish high growth as long as an environment for free economic activity is forged. The economic miracle that Hong Kong created from extreme economic backwardness during the fifty years up to the 1990s is a model case of economic development for the underdeveloped world.

In a nutshell, Hong Kong's incredible growth, made possible by maximizing the strength of 'free trade', was triggered by the loss of the mainland in 1949. Those who could not flee to Taiwan with the Kuomintang came to Hong Kong. Businessmen from Shanghai, in particular, set up the textile industry, which provided the basis for the economy.

In China at that time, the basic manufacturing industries were too unstable to export or import. Hong Kong, now an international hub of finance and intermediary trade, had to begin its foreign trade based on simple light industries. At that time, textile products accounted for over-half of total trade volume. As Korea and Taiwan entered the textile industries, Hong Kong diversified the priority industries into toys, wigs, artificial flowers, electronic goods, rubber goods, and so on. In fact, Korea and Taiwan tapped into the international market by selling imitations of Japanese or Hong Kong products at lower prices. Hong Kong noted the trend of the export market, and fostered competitive manufacturing industries accordingly, faster than any other

Table 5.3 Hong Kong's major economic indicators

	1985	1990	1996
Population (millions)	5.5	5.7	6.3
Gross domestic products (US\$ billion)	33.5	74.8	154.8
Consumer price rate of increase (%)	3.5	9.8	6.0
Exports (US\$ billion)	30.2	82.1	183.5
Imports (US\$ billion)	29.7	82.5	198.4
GDP growth rate (%)	-0.1	3.4	4.7

Sources: The Economist Intelligence Unit (1997) *Hong Kong*; Bureau of Statistics of Korea, *Major Economic Indicators of Korea*.

Asian nation except Japan. In Hong Kong, a free trade nation, there are basically no taxes except for some imposed on alcohol and tobacco, which makes it a perfect place for intermediary trade.

In Hong Kong, most of the manufacturing industries are managed on a subcontract system and wages are hourly paid. There are no unions and it was not until recently that the concept of 'minimum working hours' was introduced.¹⁴ In short, the perfect *laissez-faire* system kept the country in order and well-balanced. In addition, because the labour market is completely controlled by supply and demand, the minimum wage level is higher compared to other countries with a legal minimum wage system.

After the Second World War the Hong Kong population surged from 1.5 million to 6.3 million. Even though most were refugees at that time, the per capita GNP in the 1990s is second only to Japan in Asia. The fact that a mere city-state whose land area was too small for farming and whose drinking water was bought from China can reach such high income level proves how strongly market-based free competition among businesses propels development.

The annual average real economic growth rate of Hong Kong during 1961-93 stood at about 7.3 per cent, raising the living standard by more than five times over the three decades. Moreover, since many Hong Kong businesses invested in Guangdong, especially in the Shimchun free trade zone, for re-exports, gross natural product (GNP) has been higher than GDP.¹⁵ The annual average economic growth rate of Hong Kong was just 5.9 per cent but the contribution of productivity improvement to economic development is higher compared to other newly industrializing countries (NICs). In the case of Taiwan,

South Korea and Singapore, economic growth was characterized by productivity improvements stemming from labour increases, while in Hong Kong, already at the economic take-off stage, productivity improvement resulted from income increases. In this sense, Hong Kong had shown the most solid growth among the NICs.

In essence, Hong Kong's economic development is a miracle created by strict *laissez-faire* policies. The government was in a unique situation quite different from other nations. First of all, Hong Kong was a colony. The government, therefore, neither wanted to nor had to create a budget deficit in order to boost employment. The British government always tried to keep the budget in the black, resulting in healthy budget management. In addition, Hong Kong was destined to be returned to China, so everything was managed on a limited basis and the residents were only interested in making money until their planned emigration. All this led to little political desire, and consequently to inactive union activities. Among the total number of workers, union members accounted for just 20 per cent.¹⁶

Second, most Hong Kong businesses are family-based small enterprises. The proportion of manufacturing companies with fewer than ten employees went up from 62 per cent of the total in 1974 to 76 per cent in 1993. In the case of companies with fewer than twenty employees, the proportion increased from 76 per cent in 1973 to 87 per cent in 1993. Wage levels in South China, where most Hong Kong manufacturers were conducting business, was just a twentieth of that of Hong Kong. Moreover, most of the population were refugees, therefore less likely to initiate labour disputes. They were grateful to be living in Hong Kong and interested only in bringing in the families left behind in mainland China. They were therefore easy to deal with. All these characteristics of Hong Kong provided the basis for smooth economic growth. For Hong Kong, a free-trade nation, everything was determined by external variables, so that its only choice was to adapt effectively to swift changes in its environment.

Since Korean or Taiwanese-style government-led industry nurturing could not be applied to Hong Kong, the only choice open to the Hong Kong government was a *laissez-faire* policy. Ironically, such *laissez-faire* attitude by the government was the decisive factor in Hong Kong's economic miracle. The government maintained a balanced budget; currency volume and foreign exchange were freely

controlled; and even a central bank did not exist. Resource distribution as well as wage adjustment were left in private hands. While the government provided only basic public services, such as policing, it regulated land distribution strictly. Hong Kong's colonial administration adhered to a system of land distribution by inviting bids from real estate developers during appointed periods, a system that was expected to continue after the handover. The Hong Kong economy is highly dependent on real estate. Over 30 per cent of state revenue is derived from real estate transactions such as the sales of land, and priority corporations of most business conglomerates are real estate firms. Also, 50 per cent of the aggregate value of listed stock and 30–40 per cent of total bank loans are related to real estate.

Political unrest that had lasted for some time and sluggish world economies resulting from the aftermath of the oil shock kept the economic growth rate at 2.7 per cent. This slowdown turned around only after the announcement of the Sino-British Joint Declaration in 1984, which pledged to maintain 'one country, two systems' for five decades. However, when the USA raised the interest rate and upheld its strong dollar policy in 1985, the Hong Kong dollar, which is pegged to the US dollar, also appreciated. With the subsequent loss of export competitiveness, the Hong Kong economy recorded low growth rate of 0.4 per cent. The rate recovered, but the Tiananmen Square protest in 1989 threw the Chinese economy into recession, which once again lowered the growth rate of Hong Kong, to 2.5 per cent. The Hong Kong economy is therefore swayed by external factors. This is because of its unique economic structure based on intermediary trade as well as the innate limit of being dependent on the giant Chinese economy.

Another factor that limits the Hong Kong economy stems from the fact that it was a colonial state. The only possibility open to the temporary colonial government was to seek practical interests without paying a high price over a short period of time. The flip-flopping monetary policy of Hong Kong is a case in point. Hong Kong adopted the silver standard until 1935. As the price of silver rocketed, the government pegged the currency to the British pound, but as a result of the extremely weakened pound in 1972, the currency was then pegged to the US dollar. When dollar appreciation caused confusion, the government adopted a floating exchange rate

system in 1974. In 1983, when the Hong Kong dollar plummeted to 9.6 against the US dollar, the exchange rate was fixed at 7.8 against the US dollar.

Rather than displaying genuine affection for Hong Kong, the British government was more interested in extracting the most profit from it before the handover. The monetary or infrastructure expansion policies reflect this clearly. The new airport project and port expansion project began hastily on an unnecessarily large scale and at an unreasonably high cost. Though the construction projects were considerably moderated because of Chinese opposition, it would be hard for the British government to escape suspicion that it pushed for the large-scale projects to make a quick profit before pulling out of Hong Kong. National bond issuance is another case in point. Since it maintained a healthy financial structure, the government found bond issuance unnecessary in the past. Yet, as the time of the return approached, the government reversed its position and issued national bonds indiscreetly in the names of various projects. However, because of China's opposition, the government was required to obtain Chinese approval before issuing more than US\$5 billion.

The dollar devaluation which continued from the 1980s led to double-digit inflation, a rare phenomenon in advanced economies. The reasons behind this were the state fiscal and financial policy in addition to industrial readjustment. First, the government pushed for austerity measures in spite of the very low average unemployment rate of 2.1–4 per cent.¹⁷ Second, as a free-trade nation, Hong Kong could stabilize the trade goods market through imports while it was impossible to procure non-trade goods, including services, from abroad. The aftershock of such a situation affected even common consumer products.

In spite of such inflationary impacts, the Hong Kong economy recorded uninterrupted growth, mainly because of an economic structure closely connected to China. The underground economy occupied a considerable part of the total economy. The prosperity of China resulted in huge monetary inflow to Hong Kong, and since most Hong Kong businesses maintained their headquarters in their country while transferring the manufacturing sector to the mainland, both countries made huge profits in terms of value-added.

The following are variables that have influenced the ups and downs of the Hong Kong economy. First, a decrease in a quality

workforce. As the handover of 1997 approached, political unrest produced about 50 000–60 000 emigrants annually. Most of the emigrants were professionals and businesspeople, and consequently, in the labour market for professionals, demand exceeded supply, causing wage rises.

Second, the decreasing proportion of those economically active. The proportion of those who were economically active fell from 66.3 per cent in 1981 to 62.8 per cent in 1993. The range of universal schooling extended to 15-year-olds, thus reducing the number of minor employees. Additional factors, including ageing of the population and early retirement, changed the structure of the labour market, which in turn caused wage increases.

Third, a lower savings ratio and capital outflow. The Hong Kong dollar pegged to the US dollar maintained an interest rate of 1.25–3 per cent. Inflation continuing at 9 per cent, however, made the real interest rate negative. The consequences were a tumbling savings ratio, consumption increases, and a drain on capital. In the case of Hong Kong with its open capital market, bank deposits made in dollars or pounds had the effect of creating the same amount of capital outflow.

The system was an institutional mechanism established by Britain to extract gradually the wealth accumulated in the colony. In fact, the degree of capital outflow was lower than Britain had expected, for the following reasons. First, an uninterrupted capital inflow from abroad to the free trade country filled a possible capital vacuum; and second, underground funds from China helped. This is why inflationary pressure was felt less in Hong Kong than had been expected. It was China that helped the Hong Kong economy to overcome high inflation and low interest rates. In 1996, the amount of trade between Hong Kong and mainland China totalled US\$40.7 billion. China accounted for 91 per cent of the Hong Kong intermediary trade, and Hong Kong's profit in this area was HK\$120 billion, which amounts to 12 per cent of its GDP. In addition, Hong Kong operated about 230 00 joint-venture businesses and 80 000 processing factories in mainland China from 1993. Up to 3 million people are employed by Hong Kong businesses, saving Hong Kong some HK\$200 billion annually in wages. The number of Hong Kong-invested projects in China total some 1500 00. Sixty per cent of foreign loans to the mainland are made through Hong Kong and

the official number of Chinese businesses operating in Hong Kong has reached 3200. Twenty-six companies were listed in the Hong Kong Associated Stock Exchange by the end of April 1997, and funds raised through stock issuance had reached US\$26.9 billion. As mentioned above, Hong Kong and mainland China have been inseparable in economic terms. Such interdependency is expected to grow stronger since the Hong Kong handover.

Chinese-style capitalism put to the test

The Chinese government has guaranteed the free economic system in Hong Kong for the next five decades to 2047. At the time of writing, 68 per cent of foreign investment in China is made through Hong Kong and a considerable amount of Chinese exports move through Hong Kong. As such, maintaining the current system in Hong Kong corresponds with China's interests, and dramatic changes are not expected for the time being. Nevertheless, China faces many problems at the moment – an unstable power structure, deepening inflation, an income gap among regions and a malfunctioning capital market, among others. These do not pose a huge threat in the initial stage of development, but the more advanced an economy gets, the more serious these problems will become.

Problems most urgent to China are as follows. First, the normalization of the capital market and the correction of inefficient monetary policies. Second, the complete guarantee of private ownership. At the time of writing, foreign investors are hesitant to make bold investments because of an incomplete guarantee. Third, the privatization of inefficient state-owned businesses. In fact, the deficit caused by inefficient state-run businesses is hampering the whole economy; privatization was announced as a national goal in the 15th National People's Congress in 1997. Fourth, the equal distribution of income. In China, significant regional differences exist and there is a wide income gap between the coastal areas, including Guangdong and Hugen, and the inland areas, which has created much social instability. If the income disparity becomes intertwined with the ethnic minority issue, it could throw the country into uncontrollable chaos. Fifth, job creation and the rapid reduction in the unemployment rate.¹⁸ In Chinese rural areas, there is huge surplus labour, and fraudulent unemployment is widespread, sowing the seeds of political unrest.

However strictly the Chinese government carries out a policy of separating politics and economics, the free economic system of Hong Kong will surely have a great impact on the mainland. There is therefore an ever-present possibility of fragmentation that will split China along ethnic and regional lines if it fails to control the eruptive demands for rights. If this were to happen, China would not have the means or the desire to care much about Hong Kong, whose population accounts for only 0.5 per cent of the total. In appearance, China has absorbed Hong Kong. Nevertheless, as Hong Kong capital flows into the mainland via the Shimchun special economic zone, Guangdong, China will gradually become more like Hong Kong.

Will Hong Kong become more like China? Or will the reverse be true? Will Hong Kong become a treasure for China, or will it play the role of a Trojan Horse and ultimately break down the giant political system that has absorbed it? The most powerful engine that has driven the Hong Kong economy up to now is the free trade system, which is effective only when it is able to cope flexibly with dramatic changes in the international economic environment. It remains to be seen whether the Chinese government, which is accustomed to control, can keep the engine running. Just as the future of Hong Kong lies in the hands of China, the future of China will depend on how successfully it deals with Hong Kong.

Britain protected Hong Kong within the scheme of global power-balance because of its national interest. However, this protective shield was removed after the handover, thus overshadowing the future of Hong Kong. Moreover, most of Hong Kong's manufacturers have moved to South China, which has brought structural changes to the Hong Kong industry as a whole. The proportion of manufacturing industries shrank from 23 per cent in 1980 to 13 per cent in 1992, while that of service industries went up from 68 per cent to 79 per cent during the same period. The service-orientated industrial structure is the main culprit for inflation. More serious, however, is the fact that since 45 per cent of the Hong Kong service industries are in foreign trade, banking and design – areas that are highly dependent on manufacturing – they are destined to follow in the footsteps of the manufacturing industries, should they decline. To make matters worse, production costs in South China, the production base of the Hong Kong manufacturers, are rocketing.

In spite of all these negative factors, Hong Kong can gain an advantage over its competitors such as Singapore and Shanghai if it makes the most of its accumulated expertise, a well-established network, a free economic structure, geographical advantages, and its interconnection with mainland China. Though Singapore is pursuing free trade, its listed stock reserves are limited, its stock trading commission is too expensive, and it is geographically distant from the North-east Asian markets. In Shanghai's case, efficiency is lowered by administrative regulations.

Considering the easy convertibility of the Hong Kong dollar and the size of the Chinese economy, the two economies can coexist for a considerable period of time, with Hong Kong and Shanghai taking charge of South China and areas north of Mid-China, respectively. In addition, overseas Chinese are making strenuous efforts to tap into China. Therefore, if there are no conflicts in the foreseeable future China is set to emerge as the most powerful economy of the twenty-first century. By meeting the challenges of these turbulent times wisely and effectively, Hong Kong will be able to strengthen its position within China.

The overseas Chinese network and the grand Chinese economic sphere

China is the motherland of Chinese nationals dispersed throughout the world following the opening of its markets. China serves as a hub of the so-called 'Overseas Chinese Network', and enjoys many economic benefits in return. The estimated total number of overseas Chinese is in the late 1990s around 56 million. Most are South-east Asian residents, and they wield great economic power within the region. Chinese nationals, scattered world-wide but united in a unique brotherhood, are using China's market opening as an opportunity to establish a world-wide network. The economic impact of the overseas Chinese network was demonstrated in the Tiananmen Square protest, and it will steadily grow stronger. Since the Hong Kong handover, the network is expected to exert greater influence on the construction of the Grand Chinese Economic Sphere. As already mentioned in the Introduction, in Chapter 8 I shall discuss the overseas Chinese in depth as an independent economic group.

China is making the most of this overseas Chinese network to induce the influx of capital and expertise, not to mention boosting exports. The network is expected to become the hub of a greater network; that is, the Chinese Economic Sphere. According to a report released by the World Bank entitled *The Prospect of World Economies and the Developing World*, the size of 'the Chinese Economic Sphere' – a combination of China, Hong Kong and Taiwan – as estimated by its purchasing power is expected to amount to US\$9.8 trillion by 2002, surpassing the US\$9.7 trillion of the USA and US\$4.8 trillion of Japan. The gap will further widen in the 'Grand Chinese Economic Sphere', an economic sphere in a broader sense that includes ASEAN member nations whose economies are greatly influenced by overseas Chinese. China itself forecasts that if it sustains an annual growth rate of 8.2 per cent, GDP will reach 8.6 trillion yuan by 2010, and US\$6 trillion with a 1.6 billion population by 2050, emerging as an economic power second only to the USA as a single nation.

Arms buildup and the new hegemonism

The purpose of the current arms buildup is to ensure national security and economic strength rather than for territorial expansion or ideological dispersion as in the past. In the 1990s, countries are making large-scale investment in other countries. Military power is a must to protect invested assets and nationals residing in foreign countries. Therefore, every country tries to build up military power corresponding to its national power. Japan is a good example.

However, throughout history, China has always resorted to military hegemony and invaded its neighbours once the warring factions within its boundaries were united. This is the reason neighbouring countries express concern over China's increasing military powers. This attitude has been in evidence again in recent Chinese diplomatic policies. First, 'Multilateral Appeasement Diplomacy' gives priority to economic gains, and practical interests and co-operation with the international community are highly valued in the policy. Second, 'Hegemony Diplomacy' combines the traditional China-centred world view and power logic. Showdowns with two superpowers, the USA and Japan, are presupposed in the policy. What is most important here is that multilateral appeasement is just a means towards

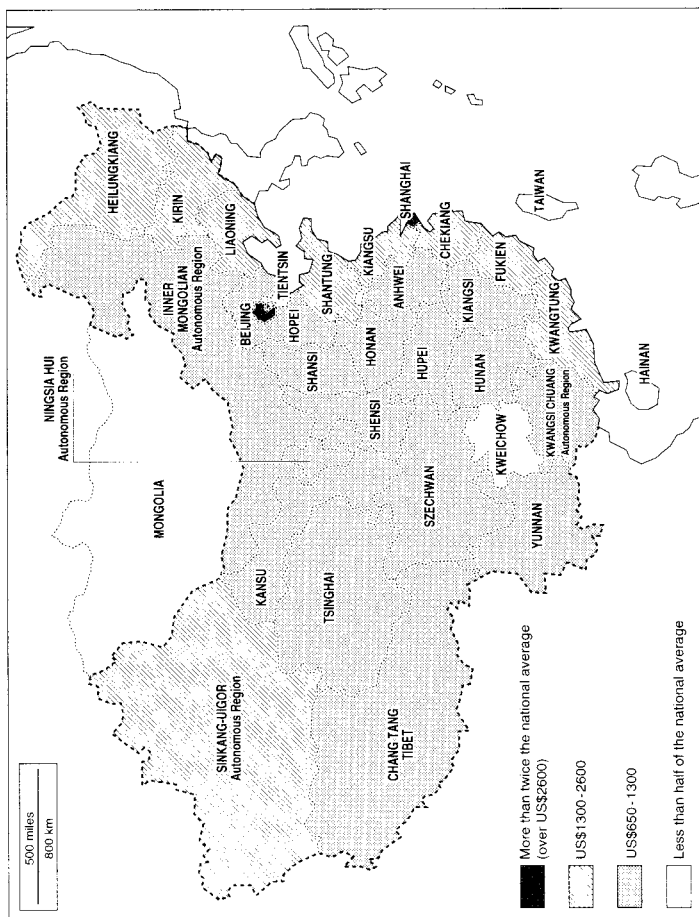
hegemony. In late 1987, China confronted Vietnam over the sovereignty of the Spratly Islands¹⁹ and in March 1988, the two countries finally collided head on. ASEAN nations interpret this as China's southward expansion based on hegemony, forewarning of possible future conflicts.

Ethnic groups and the income gap between regions

In spite of the dramatic growth of the Chinese economy, some observers are sceptical about its future. They point to corruption and the wide income gap between inner and coastal areas, and between urban and rural areas. The urban-rural income gap has been a major problem since the establishment of the People's Republic of China. Farmers and non-farmers are registered separately, strictly regulating population movement between urban and rural areas. In 1993, the per capita consumption level of the urban population was 3.2 times that of the rural population. However, these are temporary phenomena that may occur during the process of high growth anywhere and are not unique to China.

Apart from Tibet and a few other areas, the regional break-up of China seems unlikely, for several reasons. First, China has relatively fewer factors for historical, religious and ethnic break-up compared, for example to the former USSR or the former Yugoslavia. Moreover, the people share the China-centred world view. Second, in terms of a population structure, the Han tribe constitutes an absolute majority. Moreover, since the first unification by the Qing in 221 BC, the whole population has for over 2000 years desperately wished for reunification. Third, the provinces of China are so closely interconnected that in a practical sense no single province can stand alone. Nevertheless, if the problem of income gaps among regions and social classes remains unsolved, serious conflicts might ensue. If the central government tries to solve this by force, it is highly likely to aggravate the ethnic issue as well as resulting in an uncontrollable fragmentation of the country. If that happens, the Chinese economy will be thrown into a long recession.

It was the early privatization movement that enabled China to achieve great economic success, unlike other countries that had converted from Communism to a market economy such as the former USSR or Eastern European countries. Private enterprise produced only



Map 5.1 Income gap between regions, 1992 (per capita income)
 Source: Park, Jung-dong (1996) '21st Century of China', Korea: *Economic Daily*.

1 per cent of the total national income in 1986, but with an annual 65 per cent increase, it reached 14 per cent in 1992. The proportion by state-run enterprises fell from 76 per cent to 48 per cent during the same period. With this trend picking up speed, China made the most of its existing tightly-knit, family-orientated style of management to become one of the world's most competitive nations, and it appears that China's competitiveness will continue to grow stronger in the future. If the 'one country, two systems' policy is enforced successfully it may encourage a great synergy. But all will depend on the wise rule of the Chinese government.

The role and vision of China in New Asia

It is true that China is highly dependent on the USA and Japan in terms of foreign trade. Nevertheless, since China has many other important trading partners, the USA and Japan will not be able to sway the Chinese economy at will. In terms of the Chinese export structure, in 1996, 21.8 per cent of its total exports were made through Hong Kong. Of this total, 17.7 per cent went to the USA; 20.4 per cent to Japan; and 5 per cent to Korea. With respect to imports, Japan, Taiwan, the USA and Korea accounted for 21 per cent, 11.7 per cent, 11.7 per cent, and 9 per cent, respectively. China's trade is divided diversely among nations so it seems to be safe from excessive US and Japanese influence. Therefore the USA can no longer control China by threatening to take away its most-favoured nation (MFN) status, as it has done in the past. Also, China has been moving ahead with its capitalist development, dominating the medium- and low-priced product markets world-wide. Jiang Zemin, president of China, who was given absolute power in the 15th National People's Congress, has announced publicly that his country will go ahead and further develop its market economy through various measures, including privatization. If this is the case, Chinese economic development is expected to speed up. In the future, if China joins the WTO, its influence will grow stronger.

Meanwhile, the Chinese ruling elite is making it clear that China will continue to be ruled under a one-party dictatorship. China will surely try to uphold the dictatorship system, just as South Korea and Singapore did, in the name of economic development. However, new needs emerge after some degree of economic development and

China will have to come up with new ideas for national unity and the maintenance of party leadership. It is highly possible that the country will turn to nationalism and consider Japan as a potential enemy. Japan is also building up its military power on the basis of its economic strength to expand its influence in global politics and diplomacy. As a consequence, the possibility of a conflict between the two is ever-increasing.

If the countries of Asia were to become united, it would create a huge political, military, and economic powerhouse that could drastically undermine the influence of the USA in the region. Hence, the USA is intentionally driving Asia into a confrontational structure between China and Japan. In a worst-case scenario, the whole of Asia will be swept into a strife that could shatter its economic foundation, thereby leaving in ruins what has taken half a century to build. To prevent such chaos, China must do its utmost to maintain peace in Asia.

China seems to be pursuing the conglomerate system as well as fostering import substitution industries, following the Korean economic model that gave rise to condensed growth. However, China is in a different situation from Korea, and many are sceptical about whether the old Korean model is still effective today. Every province of China has attracted foreign capital and fostered its manufacturing industries, which has led to a serious oversupply of medium- and low-grade products. If these products flood international markets, huge market turbulence will ensue and, in particular, the manufacturing basis of South-east Asia is highly likely to collapse.

In the midst of China's indiscriminate export offensive and South-east Asia's desperate counter-attacks, currency values are falling and export prices continue to tumble, thereby worsening trade conditions. If this trend continues, combined with the structural problems of Asia including overcapacity, a result of years of investment, prices will plummet. Also, China has various factors that might stunt its economic growth such as considerable foreign debts, amounting to US\$130 billion; unemployment rate increases following the privatization of state-owned businesses; and the reduction of the status of Hong Kong. Furthermore, if the current Asian economic crisis is prolonged, foreign investment in China may be reduced by over 50 per cent and an exchange rate crisis of huge proportions will ensue. China should therefore realize that its economic policy of dominating

regional economies through an arbitrary depreciation of the yuan could lead to the destruction of the whole of Asia.

Faced with the economic crisis in Asia, China declared that there would never be a depreciation of the yuan. However, in the black markets of Beijing and Shanghai, the dollar is already being exchanged higher than the official rate and some state-owned enterprises are engaged in the unethical accumulation of dollars. In particular, following the bankruptcy of Peregrine Securities in Hong Kong, the possibility of the depreciation of China's currency is increasing. Should the financial crisis of Asia spread to China, it would have grave repercussions, not only for Korea and Japan but for the entire world economy.

Although the Chinese government vehemently denies this, considering the unique relationship between Hong Kong and China, it is quite possible that the dull stock market in Hong Kong will greatly influence China's economy one way or the other. Also, the unhealthy bonds accumulated so far by the financial sector amount to an astronomical US\$200 billion, 20 per cent of China's GNP. If the inefficient financial system is not improved quickly, China's economy will face serious difficulties. Moreover, China's economic growth was based largely on exports and foreign investment. A depreciated yuan will devastate its economy by resulting in a decrease in foreign investment, slow export growth, and massive unemployment.

China's influence will surely increase if there are no unusual changes. In addition, the political map of Asia, and furthermore of the world, will be drawn up by three powers – the USA, China and Japan. In this context, China should be alert to the possible rise of hegemony from within and at the same time carry out reciprocity-based policies as a member of New Asia.

Notes

1. The revolutionary movement: a bourgeois democratic revolution initiated by Sun Yat-sen in 1911, which toppled the Qing dynasty and founded the Republic of China. It began with an uprising in Wuchang in October and an interim government was established in Nanjing with Sun Yat-sen as president. The weak rebel forces negotiated with Yuan Shih-k'ai, a strong warlord of Beiyang with superior military power, and appointed him the new president.
2. The Great Victory of Salsu: a battle where General Euljimunduk won a sweeping victory over the large force led by Emperor Yang of the Sui

- dynasty in the twenty-third year of King Youngyang of Koguryo's reign (612).
3. Uprising of the Red Bands: a religious peasants' uprising initiated by members of the Mile and Bailian cults at the end of the Yuan dynasty (1351–66). The rebels wore red bands on their heads as a sign. Zhu Yuanzhang, a major rebel leader, toppled the Yuan and founded the Ming dynasty.
 4. Lizicheng: the rebel leader of peasants' uprisings of the late Ming dynasty (1606–45). The messenger-turned-rebel-leader captured Shian and founded the Dashun kingdom. He became the first king and called himself King Xinchun. He overthrew the Ming after besieging Beijing in 1644. He killed himself in Hubei after being defeated by the Manchu troops led by Wusanju.
 5. Nerchinsk Agreement: a treaty for territorial settlement signed between the Ching and Russia in Nerchinsk. The territory was settled at the Outer Shinganring mountains and the Argun river.
 6. Eight-Flag Army: a military system set up by the first emperor of the Qing dynasty. Troops were classified into eight groups according to the colour of their flag – Dark Yellow, Stark White, Dark Red, Dark Blue, Light Yellow, White, Light Red and Light Blue.
 7. Taiping rebellion: a large-scale peasants' uprising that broke out in the late Qing dynasty (1850–64). It broke out in Guangxi Province, and Hong Xiuquan became king of the Christian dynasty. The rebellion aimed to rid China of its Manchu rule and founding a dynasty of the Han tribe. The Taiping rebels included Christianity as well as the traditional Chinese world view in order to expand their force. Their policy line included equality between men and women, the impartial distribution of land, and the overthrow of the Qing. The Christian dynasty finally collapsed because of internal strife as well as the defeat by the Zeng Guofan-led allied forces. The Taiping rebellion was the first of the modern peasants' movements.
 8. Yangwu programme: a modernization programme led by Zeng Guofan, Li Hongzhang and others governors of the Qing, in the late nineteenth century. This was a reform movement whose targets included the military, science and communications, ignited by the Taiping rebellion and the Arrow Incident.
 9. Bianfazhiqiang programme: a reform movement led by Kang Youwei, Liang Qichao and others at the end of the Qing dynasty. They tried to strengthen state power through the Chinese traditional political and educational systems.
 10. Among the major agricultural products of 1995, in million of tons rice was 190; wheat and corn 100 each; and sweet potatoes and potatoes 30, each, respectively.
 11. Production growth recorded 3.8 per cent in 1990, 14.2 per cent in 1992, and 10.5 per cent in 1995 respectively.
 12. Savings and investment ratios were 40.2 per cent and 41.2 per cent respectively in 1993.
 13. China's exports to Hong Kong amounted to US\$32.9bn in 1996, 21.2 per cent up on 1990. Exports to Hong Kong, the largest export market of China, surpass those to the USA or Japan. In terms of total amount in monetary value, imports from Hong Kong rank the sixth highest.
 14. Average pay per day was US\$36 and average working hours per week (manufacturing industries) were 43.8 in 1995.
 15. Re-exports from Hong Kong reached US\$153.3bn, 85 per cent of total exports, in 1996.
 16. There were nine labour disputes in 1995. Participants totaled 1347 and the number of days without work was 1.018.
 17. The unemployment rate continued to drop – to 2.8 per cent in 1996 from 4.5 per cent in 1983.
 18. The unemployment rate rebounded from 2.3 per cent in 1991 to 2.9 per cent in 1995.
 19. A set of islets in the South China Sea. They are mere coral reefs but because of a high possibility of there being oil fields in their vicinity as well as their strategic value, the Philippines, Taiwan, Malaysia and Brunei, in addition to China and Vietnam, are claiming sovereignty over them.

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