Export-Led Growth for Pakistan: Lessons from the Experience of Korea

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Once again, looking at the dire situation in which Pakistan's economy finds itself, the cry for a vigorous export-led growth strategy is being raised. "If Korea and other East Asian countries could do it, so can we," appears to be the mantra among our policymakers. The unspoken subtext is that Pakistan simply has to follow the Korean example, and that it is well within Pakistan's capabilities to do so. It seems almost unpatriotic to demur.

But the view invites some skepticism. First, "Be Switzerland" or "Be South Korea" is not a strategy. Moreover, the experience of countries, decades ago and in another part of the world, cannot be directly grafted on to a development strategy for Pakistan. Lessons from others' experience requires some nuanced adjustments before becoming workable for our country. I will try to bring out what I see as the principal lessons culled from the literature and my decade-long experience of running the World Bank's economic program for Korea and some of the other East Asian "tigers." That can provide the basis to discuss which of these experiences are useful for us, and how they may have to be molded to suit Pakistan's circumstances.

Understanding what Korea did to become Korea requires us to look, however briefly at some factors— e.g., cultural and social— that one would not ipso facto consider economic, but which turn out to have a crucial bearing on economic performance. Let me mention two

1. Broad internal unity. Korea benefits from a single national language and a culture that minimizes strife between different religions. There have been changes in the relative importance of the different religions— Christianity now appears to be followed by a larger part of the population than Buddhism— but this has not occasioned violent pushbacks.

The internal situation in Pakistan, especially from a security point of view, would be regarded by Koreans and other East Asians as unstable and largely hostile to investment. They notice that even domestic investors are loath to invest. This hardly encourages an external investor to take risks in the country. Korean businessmen told me they have no idea of how to handle matters in a country in which religious extremists can spread fear and cause major disruptions. Churches, temples and religious institutions are active in Korea, but there is no attempt at coercive conversion. And Koreans of all religious persuasions (and even the estimated 50 percent of the population without any) do not believe the road to nirvana or heaven is paved with murderous or self-destructive acts.

2. The international environment. When Korea began its export drive, the United States was relaxed about running deficits with it. The US wanted to build up South Korea as a democratic counterpart against North Korea, and Korea's exports were small potatoes compared with the United States' external position. Korea was therefore permitted to maintain a mercantilist policy, namely, to encourage exports while restricting imports. That situation has changed. With the US and many Western countries running deficits on their external balances, the emphasis has changed to "leveling the playing field."

Turning to the more direct economic aspects, five broad policies had the greatest salience.

1. Support for export-driven economic development came from the highest political circles. President Park Chung-hee's favorite maxims were "nation building through exports" and "exports first." The president, and in his absence the prime minister, chaired monthly meetings of the country's leading exporters in which the exporters' performance was measured against targets that had been set. At these meetings decisions were taken to dissolve impediments to exporting (e.g., non-availability of shipping space, lack of foreign-exchange for key imports, threats of labor problems, harassment by tax officials, intrusive government inspections that disrupted production, and so on). The morning meeting was followed by a three-hour lunch for major participants, at which the president/prime minister were present, and the morning's discussion continued. Participants at these meetings told me the president and the prime minister had been thoroughly briefed on the key issues, and their interventions were focused and decisive.

The export targets were not simply handed down ex cathedra. There was a fair amount of discussions between the government and the chaebols, and trade associations were also regularly consulted to ascertain what incentives were needed to attain targets. But the chaebols also understood the unspoken rules of the game, namely, that setting too easily-attainable targets could incur the displeasure of the authorities and invite sanctions.

2. The penalty for a business serially missing export targets could be harsh. Korean policymakers adhered to the view that if failures were not penalized, failures would persist. The principal punishment was denial of access to bank credit. This could be financially crippling. Successful exporters received bank credit at a rate of 4 percent a year, compared with 30 percent in the "kerb" market. Because of the subsidy, it is estimated that during the period of Korea's most rapid growth the real interest rate for exporters averaged minus 7 percent.

Moreover, most Korean businesses were highly leveraged, so the absence of bank credit meant a business might not be able to pay its wages, its utility bills, its taxes, and other expenses. The owners could go to jail. In order to avoid this, the chaebol was forced to sell one of its component enterprises, and only a successful exporter was permitted to bid. In such a narrowed market (i.e., an oligopsony), a purchaser could more or less compel acceptance of his own (low) price. The president of Daewoo Heavy Engineering commented "it was said we would be willing

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to export even our favorite aunts to meet the target!" Reward and punishment were transparent, and it was clear that they would be enforced.

3. Korea was prepared to go to considerable lengths to avoid disrupting its economic plans. Here are a few examples.

(a) After the initial war with North Korea, South Korea avoided a hot war even when heavily provoked by the North. There were occasional border skirmishes, but no full-scale war. Provocations, for example, included the North's digging a tunnel under the border separating the two countries and was designed to infiltrate troops. Another serious incident occurred on January 21, 1968 when a platoon of North Korean soldiers managed to get across the border and even reach the South Korean president's residence and office. The South did nothing major to respond to these provocations.

(b) Korean ambassadors were given two essential terms of reference: (i) increase Korean exports to your host country, (ii) prevent your host country from recognizing or getting close to North Korea. The ambassadors were summoned twice a year to Seoul where these criteria provided a critical metric in the assessment of their performance.

Korean policymakers believed the country could not have political independence until it acquired a large measure of economic independence. Until that occurred, Korea could not afford to antagonize the United States, which was its principal provider of security, technology, finance, trade, and diplomatic support. Until that time, Korea would mostly have to fall into line with whatever the United States wanted. At times, Korea even acted as a mercenary for the United States; for example, over the course of the Vietnam War, Korea provided 350,000 elite troops to fight alongside the Americans.

(c) Korea understood that an export policy that underpinned the development drive could not be insulated from the rest of the policy framework. Thus the export drive was supported by appropriate fiscal, monetary, educational (especially technical), transportation, labor, urban, and other policies. Pakistan's export policy has in practice consisted chiefly of devaluing the nominal exchange rate from time to time and crossing one's fingers.

4. Korea understood that a vigorous export drive need not necessarily be based on indigenous materials. Korea has no natural resources to speak of. The export policy had to fit the reality of Korea's meager natural resource base. As Kim Dong-jin, advisor to President Park Chung-hee, summed up: "All we had was the hard work and brainpower of our people." Korea's spectacular development was driven primarily by economic policies and disciplined hard work.

Korea's export growth was founded on three elements:
(a) import raw materials and semifinished items;
(b) add value by a disciplined and technically competent labor force; and
(c) export the finished items at a competitive exchange rate.

5. Korea undertook the collateral policies that an import-based export strategy required. If a country bases its export strategy on items that are not indigenous, it must adopt policies that offset the disadvantage of importing a significant amount of inputs (the imported component of Korean exports often exceeded 40 percent). Korea followed the following recipe.

1. unwavering support from rulers to ensure the primacy of export policy ("a do what it takes to boost exports" attitude from the president downwards);

2. prompt and adequate rebate of any taxes on the imported component of exports.

- the import coefficients were reviewed every six months;
- taxes on the imported component of domestic items that went into exports were also rebated;
- the rebates were "generously" calculated, i.e., officials were not unduly upset if import coefficients were somewhat overestimated;

3. the REER was kept slightly undervalued, chiefly by providing implicit subsidies to exports. The principal subsidies comprised favorable tax rates, easier availability of land, lower electricity prices, freer access to foreign exchange to import key components and hire foreign experts. As described above, the most important incentive was the provision of a highly subsidized interest rate from banks (4 percent versus a free market rate of 30 percent). During Korea's most rapid GDP growth, the real interest rate to exporters was estimated at minus 7 percent. Because Korean enterprises were highly leveraged, reducing the interest cost provided a major boost to profitability.

4. major exporters were permitted to sell some of their output domestically, even though the imported inputs going into these products were given the same rebate of the import duty that they would have attracted had the product been exported. This raised the profitability of the item to above what it would have obtained in the international market. The overall return per unit to the enterprise would then be a weighted average of that on the external and domestic sales. The domestic sales were passed off as "seconds," even though they were as good as the top exported versions;

5. although the nominal exchange rate was determined in different ways, both the Purchasing Power Parity and the real effective exchange rate showed relatively small variances over time. Thus, for the most part, Korea was able to maintain external competitiveness because policymakers consistently adjusted the incentive system to support exports;

6. earnings from exports and other foreign-exchange earning activities enjoyed a 50 percent reduction in the income tax rate;

7. imports of machinery and equipment for export industries were exempted from tariffs;

8. the Koreans experimented with lower electricity rates for factories that exported more than a certain proportion of their output;

9. transport costs in Korean ships could be subsidized, reducing fob cost and increasing the competitivity of exports;

10. for some large, strategic items (e.g. freighters, oil tankers, off-shore oil rigs, etc.) the contract could include a government guarantee to indemnify the purchaser in case the item did not perform to specifications. Steel required to construct such items was provided to the manufacturing enterprise (Hyundai and Daewoo for much of the time) at a discount.

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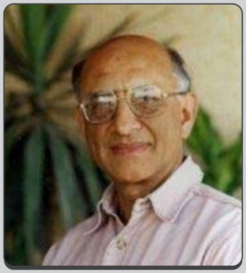

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