

The Korea Business Interview Series:

Professor Ha-Joon Chang

"23 Things They Don't Tell You About (Korean) Capitalism "

Professor Ha-Joon Chang is Professor in the Faculty of Economics, University of Cambridge, and author of the international best-seller *23 Things They Don't Tell You About Capitalism*.

The Korean economic miracle was not achieved through policies of free trade or hands-off capitalism. But, in the last decade, the Korean government has jumped on the global free market bandwagon, deregulating industries and signing free trade agreements with many other countries. One voice that has consistently spoken out to remind people of forgotten history is Professor Ha-Joon Chang. Having lived through the Korean economic boom, and studied and taught development economics in Europe, Professor Chang brings a much-needed alternative perspective to the mainstream.

With a knack for explaining complicated concepts in easy-to-understand language, in his latest book, *23 Things They Don't Tell You About Capitalism*, Professor Chang helps KBC listeners understand the connections between global generalities and their specific applications to Korea.

You may not, in the end, agree with all of Professor Chang's conclusions, but you can't deny that he points out many truths of business and economics that others often overlook. His compelling perspective makes the debate richer and this interview contributes to an understanding Korea and Korean business today. Listen to the interview first, and then go out and buy the book. It's available in at least eight languages.

Transcript of the interview by KBC's Tom Tucker
on *September 2, 2011*.

Tom: Hello there, and thank you for joining us today at KoreaBusinessCentral.com. I'm your host, Tom Tucker, and I'm delighted to bring you this edition of the Korea Business Interview Series. Today's guest is Professor Ha-Joon Chang.

Professor Chang graduated from Seoul National University before heading to the University of Cambridge to earn a Master's and Ph.D. there. He has remained in the United Kingdom as a Professor at Cambridge, having gained an international reputation as a leading heterodox and institutional economist specializing in development economics.

He had served as a consultant to the World Bank, the Asian Development Bank and the European Investment Bank, as well as Oxfam and various United National agencies. Most recently, Professor Chang authored the book *23 Things They Don't Tell You About Capitalism*, an international bestseller and the focus of today's interview.

Professor Chang, thank you for sharing with us today. It's a pleasure to have you.

Professor Chang: Hi, it's my pleasure to join you.

Tom: Our introduction covered some of the highlights of your career. As a Korean and as an economist who personally lived through much of the extraordinary economic development of Korea over the decades, can you tell us about your background in Korea and what brought you to Cambridge to study?

Professor Chang: Yes. I was born in 1963, so I literally lived through the miracle years, seeing the country being completely transformed. One of my childhood memories is that basically all of the mountains were bare. They were just typical Korean soil color, yellowish red, and a few trees here and there.

Today I can barely see any bare patches in Korean mountains. There were only two bridges on the Han River in Seoul when I was born. Today are 30-31, something like that. It has been a huge transformation as we all know.

So living through it, you kind of take it for granted. It's only after I moved out of Korea, and certainly only after I started studying the economic development experiences of many other countries, not just today's other developing countries, but also other countries in the past, I came to realize that I basically lived through one of the most extraordinary transformations in human history. So that really colors the way I understand economics, and especially Korea's economic development.

I went to Cambridge to study in the early 1980s when Korea was still a very poor economy, a military dictatorship, institutions were poorly developed and so on, and I was taught this standard pre-market economics full of American or British produced textbooks, which bore very little resemblance to the reality I was seeing around me.

So I got interested in kind of different approaches that would be more, in my view, realistic and help me understand what's going on better. Then I came across a group of economists who were working on that kind of thing at that time in Cambridge. So I basically applied there and got there and never left.

Tom: Let's talk a little bit about your book, *23 Things They Don't Tell You About Capitalism*. In the book, you introduce nearly two dozen observations you refer to as "things" that go against

mainstream free market thinking. I'd like to jump in and get your opinion on how some of those things apply to Korea.

For example, Thing #7: Free market policies rarely make poor countries rich. Most people would agree that the Korean economic miracle was achieved under policies that combined the market with a high degree of government involvement and this is in line with Thing #7, which asserts that free market policies rarely make poor countries rich.

Also with Thing #12, where you claim that governments can, in fact, pick winners. In light of this and other equally dramatic examples of government-directed success in East Asia, what are the main lessons of Korean modern economic history that can teach other developing countries today?

Professor Chang: Yes. In the last three decades, the dominant free market ideologists told developing countries that they need free market and free trade in order to develop. Initially, those who were preaching that view tried to use Japan, Korea, and other East Asian countries as examples of how free market and free trade develop the economies.

For those people, any success must have, by definition, come from free trade and free market but when people looked at the Korean and other East Asian experiences more closely, they realized actually that wasn't the case. They had heavy protectionism, a lot of government intervention and so on.

Of course, not everything that the East Asian governments did were successes. There were failed policies but on the whole these examples show that you need a judicious mix of market and government in order to succeed.

The best example, and even more dramatic than South Korea, is Singapore. When you read things like *The Economist* magazine or *The Wall Street Journal* you only hear about this free trade policy and welcoming attitude towards foreign investment, which it of course has, but you will never hear the fact that all the land in Singapore is owned by the government. 85% of housing is supplied by government-owned housing corporations, and more than 20% of GDP is produced by government-owned enterprises. So Singapore is an ultimate combination of the most extreme free market elements with some of the most socialist elements.

The lesson of which, together with other East Asian economies, is that you also need to be pragmatic. I often tell my students, "Look, if anyone tried to invent a successful economy on the basis of an economic theory, that person could have never invented something like Singapore because it flies in the face of all known theories." It doesn't matter – free market economies, Marxist economies.

Basically, I would say there are two lessons from East Asia. One is that you need a judicious mix of market and government. As a country, you need to be pragmatic. And to add one more thing, I would point out that in the book in Things #7 and #12 in particular, I also point out that actually it wasn't just the East Asian countries that use protectionism and government intervention to develop their economies but also most of the rich economies today, including the United States and Britain, which most people think developed on the basis of free trade and free market.

Tom: Let's talk about Thing #2: Companies should not be run in the interest of their owners. In Thing #2, you point out that stockholders in today's corporations are the least committed to the long-term success of a company because of their ability to sell quickly and leave.

However, in Korea, we see that the main stockholders of the leading companies are the families who have run those families for generations and that these are surely the least mobile of all the corporate stakeholders.

How does this observation about Korean corporate ownership structure impact your position that companies shouldn't be run mainly in the interest of the stockholders? Can we perhaps say that Korea is an exception and that the Korean chaebol ought to be run in the interests of their ownership families, specifically, for long-term success?

Professor Chang: I wouldn't necessarily say that. Yes, these founding families are immobile groups so they have a big stake in the long-term future of the company. But on the other hand, today these families, even including their allies own, I don't know, 10% or 20% of the company so they do not represent the whole company.

But more importantly, some readers might have guessed from reading the chapter, I happen to hold this view known as the stakeholder view of corporations rather than shareholder we all tend to view.

My view is that shareholders are of course an important group in the company but they are not the only group that has a stake in the prosperity of the company. Workers, professional managers, suppliers, and even local communities that host the companies should have a stake in the long-term prosperity of the company and they should also be given a say in the management of the company.

So basically we need to have a more balanced view. It's important to recognize that these founding families have an important stake and they have contributed a lot to the development of their companies and the national economy eventually. But at the same time, they do not even represent the whole shareholding group, and the shareholders are also only one of the many stakeholders.

So in approaching this stuff we need to take a more balanced view. Recently, the fight has been between people who say, “Well, these families own only about 20% of the company and they are actually a minority shareholder or they should be basically suppressed,” and others who say that, “No, these families have founded the company and they have a long-term stake.” But I think that is only part of the story.

Tom: Thing #5, you say, “Assume the worst about people and you get the worst.” In Thing #5, you advocate policies that assume the best about people on the assumption that people and companies will often do the right thing, especially when they feel a patriotic duty.

Today in Korea, we find the government talking a lot about how the Korean chaebol have an ethical obligation to support the small to medium size companies in order for everyone to grow together. Is that what you mean about bringing a moral element into the discussion of economic development?

Professor Chang: That would be one dimension of it. I’m of course talking about something much more general, but from setting general rules in the society down to organizing production on the shop floor.

But yeah, when it comes to the chaebols and SMEs, I think it’s not just a moral obligation that these chaebols have towards the rest of the Korean economy, because they have developed on the basis of certain sacrifices by the general population.

By protecting these companies from foreign competition, Korean consumers had to bear the cost. They had to buy second- or third-rate products. The Korean taxpayers had to finance a lot of subsidies that went to these chaebols. So it’s not just a moral obligation coming from being Korean that they have a duty to serve the rest of the society, but because their very history is pointing in that direction.

Now we need to contemplate exactly how this is going to be done. Some people believe that these companies should serve the society by paying more taxes, or others argue that they should more directly help small- and medium-sized companies and so on. I am open to discussion on that. The exact methods need to be worked out.

But helping SMEs develop is going to have to be an important part of it, not simply because there are far more SMEs than chaebol companies but also because if Korea is going to move to the next stage of this development, it needs to develop high-tech SMEs that can supply sophisticated materials and parts and components.

If you look at Korean trade statistics, except for importing oil and food which we don’t have, the only area where we have huge deficits is basically in those areas, like advanced materials, high-tech parts and components and machines which are mostly imported from Japan. This is why we

have such a huge trade deficit with Japan just by the fact that we seem to be having a surplus with almost everyone other than oil-producing countries. So this is a very important area not simply because of this historical obligation but also because of the future strength of the Korean economy.

Tom: The Busan Savings Bank scandal is only the latest in a constant stream of corruption stories that fill the news in Korea these days. In Thing #22, you advocate heavier regulation in the financial markets even as you encourage that we assume the best about people when making policy.

In line with this, regular presidential pardons of government officials and rich businessmen emphasize the good in people, giving them a second chance to contribute to society. Am I right in guessing that this isn't your idea of assuming the best in people, but would it be right to suppose that more regulation will just lead to more corruption?

Professor Chang: Yes. Pardoning chaebol leaders isn't exactly my idea of assuming the best of people. But in chaebol regulation and corruption, first of all we have to point out that deregulation also creates a lot of corruption in the private sector. Look at all these cases of Bernie Madoff that otherwise stand for all the corruption in the rating agencies.

So it's not necessarily true that by deregulating you will get rid of corruption, that corruption just moves to another location. But of course if you have this regulation you also need to compliment it with regulation of the behavior of the regulators. What is going on in Korea especially, but also in other countries, is that the regulators basically are working for their next job.

So it's not only about getting some kind of brown envelope today but that they bend and stretch rules to basically make themselves more eligible for private sector jobs in the future. We need to regulate that aspect as well.

Of course, that regulation shouldn't be designed in such a way that you constantly suspect and monitor everyone. That kind of thing doesn't work, as has been proven by the old socialist system. When you begin to suspect that everyone is a potential spy, the whole society rots from the inside.

I'm not saying that you have to introduce that kind of surveillance regime, but on the other hand, it is important that these people are given certain sets of rules of behavior that they have to observe.

And of course that has to be complemented by paying these people better because very often you get to meet these investment bankers who get paid ten times, twenty times better than you are and then it's natural that these people are tempted either to take some bribe or basically do them favors so that they can be employed after retirement. There's no simple solution.

While it is important to believe in the goodness of human beings and also try to build institutions and incentive systems to bring the best out of people, you have to set certain rules because not everyone is entirely honest and people can be nudged in this way or the other, depending on how you design the incentive mechanism.

Tom: Thing #18: What's good for General Motors is not necessarily good for the United States. To paraphrase, the title of your chapter on Thing #18 it seems safe to assume that you don't believe that what's good for Samsung, LG, and Hyundai is necessarily good for Korea.

Other than the SME issue we talked about, in what other ways does the success of the Korean chaebol negatively impact Korea as a whole? Considering how the interests of the chaebol are often linked to the interests of Korea, what should be done about the close intermixing of government and business in Korea or is this a good thing?

Professor Chang: It's actually a tricky balance to strike because if the government becomes too distant from the private sectors, as used to be the case in some developing countries in Africa and Latin America, they work at cross opposites so it's not very productive. On the other hand, if the government becomes too close with business, it basically gets captured by business interests.

Now in the miracle years, scholars argue that in countries like Japan, Korea and Taiwan, they managed to strike that balance more or less right so the government was close to business but not beholden to it.

Unfortunately, this balance has shifted, especially in Korea with the growth of these large chaebols, and frankly some of them have been more or less buying off government officials in direct and indirect ways. This is a serious problem of this systemic – well, I can only call it corruption even though some of it may not actually break any law.

We need to do something about this because when the whole nation's policy gets swayed by policies of particular companies, however important they are, they are not the same as the country. Their interests do not necessarily coincide with national interests and we need to address this issue. I think we have seen increasing problems in this area in Korea and there is a lot of public pressure for getting this right again, so I hope that our leaders do things to correct that.

Tom: In Thing #17, you assert that more education in itself is not going to make a country richer. A recurring topic amongst Korea watchers is the high emphasis that Koreans place on education.

However, criticisms of the Korean system generally fall into two categories. One, that Korean education is too competitive, and two, that it's based too much on rote memory. You bring in a further observation that excessive education fervor is really a means of signaling one's qualifications in a competitive environment rather than a proper contribution to the economy.

Surely this applies to Korea in spite of all the praise that U.S. President Obama repeatedly heaps on Korean teachers, students, and schools. What's Korea doing right in terms of education, what is it doing wrong, and what should be done about it?

Professor Chang: Well, what's certain is that Korea is producing very high quality output at the end of the education system at least up until the high school level. We score among the highest in standardized tests, especially in subjects like mathematics and sciences, so we are good at producing quality products.

But the problem is how we are doing it – I recently read a news report from Korea saying that secondary school students in Finland, which has equally good or sometimes even better scores in those tests than Korea, they study only half the amount that the Korean students do.

So we are producing basically the same kind of output by inputting twice the time, so there is something fundamentally wrong there. And beyond the university level there is a problem with quality, too.

Now I'm not entirely against rote learning itself. Very often it's a way of absorbing what's already there. If you memorize the times tables, you don't have to work out the multiplications from principle every time. But some rote learning is essential and efficient, but the trouble is in putting so much emphasis on it.

It happened partly because we were so short of teaching resources in the earlier days, so it became kind of educational culture because we tried to expand our education very quickly in the 60s and 70s with very little resources, so rote learning was really the only way to do it. Now it has become, in a way, too successful. Now it has become the educational culture which is what makes the quality of our educational output at beyond the university level not as good because basically too much learning from rote learning makes it less likely that the students will challenge intellectual authority.

Innovative things can be done only when you challenge the conventional wisdom, challenge the intellectual authority. Korean students are less willing to try that than the equivalent in some other countries. So that is the problem. Of course, it's not easy to change because you not only have to tell the students to think and then view it differently, but you also have to change the teachers. You also have to change the overall educational culture and system, and in the end, the whole society, so it's not going to happen quickly. A lot of people are working at it and I hope one day we will have university systems which are equally good in terms of relative quality as our lower-level education.

Tom: Thing #9: We do not live in a post-industrial age. The Korean economy was built on manufacturing and, as you explain in Thing #9, you are a proponent of a strong manufacturing sector, not only for developing countries but also for advanced nations. But today we find the

emergence of new service forms, such as business process outsourcing, which exhibit many characteristics of assembly line manufacturing but without the tangible factors. Why is it necessary to actually create tangible output in order to keep a country strong?

Professor Chang: It's essentially because productivity growth in goods is inherently faster in manufacturing because far more of it is open to mechanical and chemical manipulations than in services.

One of my favorite examples is the difference between golf balls and baseballs. Baseballs are produced in very low-wage countries like Haiti and the Dominican Republic because no one has found a way to mechanize its production, whereas golf balls are produced in the U.S., Canada and these countries with a highly mechanized and very efficient process.

Don't get me wrong; I'm not implying that all services are destined for low productivity goals. Some services as you have just mentioned, like the IT services, are open to the faster productivity growth.

But there is a limit to how much productivity you can raise in service sectors and that's mainly why I'm worried about overemphasis on services weakening countries' economies. An emphasis on manufacturing is not necessarily the same as wanting more and bigger things. After all, computers used to be as big as a room in the 1950s, but now they fit into our hand. But I agree that given the concerns with the environment and our health, we need to refocus our minds on developing technologies that use less material, less energy, less space and that's the new challenge.

Tom: You point out that efficiency in services is growing more slowly than in manufacturing because of intrinsic limitations of services. But if we divide services into information and material types, we see that low efficiency growth applies only to material services.

Efficiency in information services, such as the IT sector, is in many cases growing much faster than in manufacturing. Do you agree with this? Would you say that the Korean economy is exceptionally well prepared for the economy of the future with Korea's strong position in manufacturing and its world-class IT sector? How do you feel about this?

Professor Chang: One thing I have to point out is that efficiency in the IT sector depends not just on the software, but the hardware. Much software would not have been written if the computers had limited computational powers that they used to in the past. These two sectors have to develop together.

In that respect, Korea has important advantages because it has an advanced computer industry. It has produced quite a lot of software writers and online game companies and so on. But this kind of human resource advantage unfortunately may soon disappear unless we get the smartest students into engineering schools again because, as I discuss in the book with actually the Korean

example in Thing #20, we have excessive applications to medical schools in Korea because these youngsters already are worried about job insecurity and they don't get into engineering professions as they used to anymore. So there is kind of a twist in the tale.

Tom: Let's talk about Thing #8: Capital has a nationality. You point out in Thing #8 that even in today's multinational corporate environment, companies still revert to their home countries and regions when it comes to the important things.

Today the Korean chaebol are trying harder than ever to globalize and one way they've been doing this is to bring Western executives into their boardrooms. We've interviewed a couple of them on Korea Business Central and you probably won't be surprised to hear that their experiences were not unqualified successes, due in large part to cultural and communication barriers.

If the idea of the global corporation is a myth and trying to make one's boardroom international is a business distraction, what should be the focus of Korean companies as they seek to become world leaders?

Professor Chang: For a country like Korea, which does not set global norms, nor does it lead in global culture and material standards, going global is a difficult business. If you become too global, you lose your distinctive character which means that you are going to be seen as offering basically a second rate, third rate imitation of the global leader.

On the other hand, trying to keep your character too much you cannot go global. So this is a dilemma in bringing in foreign executives, and Koreans going out into the bigger world where they're working for foreign companies, and these are all necessary.

But in the end, I think we would need the production of a new generation of managers who have a strong Korean identity but are also comfortable in global – and I mean truly global, not just American or European – culture, because in the end you can globalize your identity only when you have a strong identity. If you don't have a strong identity to start with, you cannot really make it global and still offer something different from the dominant countries.

Now this is a huge challenge. Having lived in England, I know how difficult it is, but it is possible. We are seeing this younger generation coming up who are becoming more and more like that because even people of my generation, many of whom studied abroad and so on, still are not truly globalized in their outlook. It's not their personal failure; it's the history and country of background that makes it inevitable.

When we were younger, we couldn't even travel abroad because of a foreign exchange shortage and our government had very strong control on foreign travel. When I went to Cambridge to study at the age of 23, that was the first time that I went out of the country. Today we have a lot of younger Koreans who have from a very young age international exposure and I think that

generation will grow up very different from even our generation, not to speak of older generations.

Tom: Briefly, let's talk a little bit about free trade. In one of your books, *The Bad Samaritan*, where you advocate an anti-free trade position, we found that to be quite interesting. As you know, Korea has been negotiating and signing free trade agreements with many countries as fast as it can, not only under the current conservative administration but even under the previous liberal government.

From this, it seems that free trade is a position that has broad support across the political spectrum in Korea. What is it about free trade that you oppose and are you opposed to it for countries at all levels of development or just for developing countries?

Professor Chang: To begin with, even for rich countries I believe that there might be a need for temporary protection in certain sectors in times of big structural adjustments. But I would argue that that is more of an exception. Basically, my problem with the free trade argument is that free trade is largely, although not completely, good if it is conducted between countries at similar levels of development.

The example of earlier European integration when the core European economies, the twelve richest economies, were integrating with each other is a very good example of how free trade can promote economic development by expanding markets, increasing competition, etc.

The trouble is when free trade is between countries at different levels of development. This means that the relatively backward economy cannot develop high productivity sectors because there are already competitors from abroad that will wipe your companies out.

If Korea opened its automobile market in the, say, 1970s, Hyundai would have been wiped out by Japanese companies. If the Japanese had opened their car market in the 1950s, they would have been wiped out by American and European companies. It is this kind of free trade between countries at different levels of development that I have a problem with.

And that thinking comes right from the United States itself. If you go to the guy who invented this argument – called the infant industry argument, namely the argument that the governments of relatively backward economies need to protect and nurture their young producers before they can grow up and compete in the world markets – this argument was developed by none other than the first ever Treasury Secretary of the United States, Alexander Hamilton. That's the guy you see on the ten dollar bill.

So this thinking has been behind the economic process of just about all of the rich countries today. When you become rich and can compete with other countries on the same terms, free trade and

more competition is usually better, but not when you are backward and trying to build up new industries.

Reflecting on the Korean situation, the problem with my compatriots who want free trade agreements with the United States is they have an inflated sense of Korea's development. Of course, we have commendably achieved world-class status in some industries like automobiles, shipbuilding and some parts of electronics, but on the whole we are not a fully-developed country.

When you look at manufacturing productivity, per capita income and so on, our level of development is only about 40-50% of the richest developed countries like the U.S., Switzerland, Sweden, Germany, and Japan.

In that kind of situation, having free trade – of course, in the short run might give us some advantage by giving us a bigger automobile market – but someday we are not going to be under that circumstance. We are not going to be able to develop the new generation of industries that we need in order to take our economy one level forward.

If Korea's income level and productivity was at 85-90% of U.S. or Switzerland, I wouldn't be against free trade agreements with these countries. But at the moment, we are not at the stage when we will benefit in the long run from free trade agreements with those countries and that's basically been my consistent line against free trade agreements with the U.S. or the European Union.

Tom: Well, we've had a chance to talk about some very interesting and compelling topics, and it's been a pleasure and a treat to hear your thoughts on these various things. As we wrap up today, I'd like to hear what's next for you in terms of maybe your next book project, and also in leaving, what final thoughts or things or observations would you like to share for those who listen here at Korea Business Central?

Professor Chang: On my next project, I'm still kind of dealing with the consequences of my latest book. It has already been translated into eight languages and it is coming out in twelve more, and as a result I get requests from news media in Greece, Portugal, Latvia and what have you to conduct interviews and write for them and so and so. I'll probably need to do this for another several months and then I can think about a new project.

Now in terms of final reflections, a lot of things I have said today probably will have kind of shocked or at least mystified some of your listeners. But first of all, it's always better to have a different take on the same thing. That gives you a deeper understanding. I'm not necessarily claiming that I am always right and other people got it completely wrong. But it's always better to have different perspectives.

And then secondly, especially for the people working in the business sector, I think it's better to listen to a less ideological take on things because a lot of discussions in economics are very

ideological, but I operate with examples and history and so on. So that will hopefully give the listeners and the readers a more realistic perspective on the Korean economy and the world economy.

Tom: Well, it certainly has been very interesting and it is good to hear other opinions, and it is good to hear opinions that often times are counter to what many of us have been taught or maybe believe as we progress through our own careers in business and economics.

Thanks again, Professor Chang of the University of Cambridge, for speaking with us today. It's been a real pleasure.

Professor Chang: Thank you.

Tom: Professor Chang is the author of *23 Things They Don't Tell You About Capitalism*, which is available just about everywhere and it's now available in several languages, as the Professor just told us.

This has been the latest in our ongoing Korea Business Interview series. I'm your host, Tom Tucker, inviting you to improve your business results in Korea by joining KoreaBusinessCentral.com today. Thanks for listening, and have a terrific day.