Book Reviews

Public Enterprise and Economic Development: The Korean Case. By Leroy P. Jones. Seoul (Korea): Korea Development Institute. 1975. xiii+293 pp.

While framing policies for economic development the public authorities are by and large consciously or unconsciously motivated by their ideological convictions. In a capitalist economy, for instance, the government does not normally resort to socialist techniques even if those techniques promote social welfare. But this general rule, like many others, is not without exception. The book under review gives a clear example of such an exception. Public enterprise, though considered a necessary evil (p. 129), is shown to have performed remarkably well in South Korea. During the short period of ten years (1968-1972), the performance of the public sector in South Korea has been not only far better than in many other countries but the sector has also emerged as a leading sector of the economy (p. 202).

There could be no better justification for the existence of public enterprises than the one offered by the author in the opening chapter of this scholarly work. "Unrestrained", writes the author, "the invisible hand of Adam Smith has never produced economic results quite acceptable to the wielders of political power. Governments exist and to a greater or lesser extent intervene in the production and distribution of goods and services. Public enterprises are simply one means of achieving this intervention" (p. 1).

The general objectives of the study are to ascertain the role of the public enterprise sector in Korean economic growth, to provide a sectoral background for enterprise-level efficiency analysis, and, lastly, to develop a systematic framework for an international comparison of the performances of public enterprise in the development of mixed economies.

The book is in four parts, and consists of twelve chapters and five detailed appendices. Chapter 1, the introductory chapter, considers the significance of public enterprise analysis and summarises the format of the book. Chapters 2, 3 and 4 provide the theoretical background for the subsequent analysis. The means and motives for public intervention, general definitional problems, and a functional definition and explicit statement of Korean public enterprise are discussed in detail in those chapters.

Part Two comprising Chapters, 5, 6, and 7, is the most important part. It analyses in detail the performance of Korean public enterprises, which is compared with the performance of public enterprises in other countries. The analysis considers the effects of public enterprise on key economic variables like savings and investment, employment, balance of payments, distribution of income and output, and capital intensity.

Part Three, consisting of Chapters 8 and 9, is of a philosophical nature. The commitment to achievement of a particular target through a common means (public enterprise) varies among countries according to the ideological beliefs of their leaders (p. 129). The social philosophy of the Korean President, Park Chung Hee, is discussed in this part in order to identify Korea's national commitment. The philosophy is discussed in the context of the general goals of public enterprise, and the special intervention policies in Korea.

The performance of any enterprise cannot be judged independently of the objectives for which it is established. "Functionally identical enterprises may have different motives and hence different target variables for efficiency measurement" (p. 141). For productive activities in which public authorities invariably intervene in almost all economies, the motive for intervention is termed the "basic motive". Basic motive necessitates public intervention under situations where the enterprises are either natural monopolies or otherwise concerned with the provision of collective intermediates or merit goods. In developing countries, the public authorities intervene primarily with "developmental motives." The private sector may not undertake certain activities due to a number of problems, e.g. magnitude of capital requirements, risk, uncertainty, technological complexity, lack of market knowledge, etc. The government, in these cases, may either assist the private sector in different ways under its policy of "entrepreneurial support" or it may itself initiate the activity and assume the role of an "entrepreneurial substitute". In some other cases, the private sector, having initiated some activity, may fail to run it profitably. A "managerial substitution" by the government may not only save the enterprise from a possible bankruptcy but may even return it to private profitability. Yet in certain other cases the government may step in to fill up the gap which is left there due to the disincentive created by the "transitional enterprises" whose experience keeps the new entrepreneurs off these lines (pp. 146-149). Intervention motives behind all these cases (namely, entrepreneurial or managerial substitutions and transitional enterprises) are "existential", i.e. these enterprises may not exist or continue to exist if left purely in private hands.

Evaluation criteria, in cases where objectives require an operational deviation from private behaviour, should be different from those meant for cases in which the objectives can be achieved without any deviation. In cases of enterprises mentioned above if there are no secondary deviations then the criterion of maximization of profits and minimization of losses may be used. On the other hand, if operational deviations are intended, then for evaluation purposes operational performance goals like marginal cost pricing for monopolies and optimal subsidy credit requirements for collective intermediates and merit goods should be specified (p. 151).

In Part Four, Chapters 10 and 11 deal with the effect of environment on the achievement of goals. Environment affects the enterprises directly and indirectly. Direct effect is through the institutional or the control structure which may again be of two kinds—formal and functional (Chap. 10). Formal control may be in the hands of one person while the real control may be exercised by another. What matters for goal evaluation is who exercises the control and how he exercises it. Generalization for this purpose does not hold good and the answer to "who and how" varies from case to case.

Indirect environmental effect is in the form of market structure. The markets in which public enterprises operate have in most cases a great degree of imperfection. These imperfections in the output, labour and capital markets make it hard for public enterprises to produce optimal result even in the long run. While analysing their performance the inefficiencies must be viewed in the light of these imperfections (Chap. 11).

The Conclusion, forming Chapter 12, highlights the salient features of Korean public enterprise. It is proved beyond doubt that this sector emerged as a leading sector in economic development with an average growth rate of 14.5 percent compared to 9.5 percent for the whole economy during 1963-72 It absorbed 30 percent of total investment and performed 40 percent of total financial intermediation. With moderate backward linkages, forward linkages were extremely high relative to the entire non-agricultural economy. The large size of the Korean public enterprise sector is explained as "a pragmatic response to practical necessity of overwhelming market imperfections which would have led to socially undesirable results if left to private sector" (p. 204).

Regarding efficiency, the author considers that the Korean public enterprises are less cost-efficient. But the alternative to relative public enterprise inefficiency is a host of private imperfections. An analysis of performance under the latter situation gives socially undesirable results like income inequality and concentration of power. To improve the cost inefficiency it has been suggested that the public enterprises, where the intended deviation (from private behaviour) is not of operational nature, should be buffered from civil servants' intervention by interposition of a business-oriented holding company between them and the government (p. 210). The degree of contorl on public enterprises should, in general, vary with the extent of deviation desired from the normal private behaviour.

The author has successfully presented an analysis which is both comprehensive and thorough. The treatment of the subject is very logical and the reader is bound to be impressed by the individuality and originality of the author. The analysis is all-embracing in scope and profound in depth. It may, however, be observed that the mere justification of public enterprises as "a necessary evil" (p. 129), leaves much to be desired. An evil, howsoever necessary and inevitable, remains an evil and has to be accepted with reluctance as a temporary measure and stopgap arrangement. No constructive suggestions have been made to remove the market imperfections.

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