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**DRIVING ENGINE OR RENT-SEEKING SUPER-CARTEL?
THE BUSINESS-STATE NEXUS
AND ECONOMIC TRANSFORMATION
IN SOUTH KOREA:
1960-1999**

VOLUME I

By

Soo Chan Jang

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ABSTRACT

DRIVING ENGINE OR RENT-SEEKING SUPER-CARTEL?: THE BUSINESS-STATE NEXUS AND ECONOMIC TRANSFORMATION IN SOUTH KOREA: 1960-1999

By

Soo Chan Jang

This study examined the correlation between the structural characteristics of the business-state nexus and the success or failure of economic transformation during economic development in South Korea. This study incorporated the “statist developmental model,” “structural dependency theory” and “organizational theory of corporations” into one “combined model of business-state nexus,” assuming that business-state interactions could be understood only in the context of broad institutional and material resources held by both the state and private actors. It was presumed that the internal structure of the state,¹ the organizational characteristics of corporations² and the share of capital control by big business influenced the strategic choices of both Chaebol and the state concerning economic transformative programs. This model empirically determined where equilibrium of two seemingly contradicting concepts, “state autonomy” and “embeddedness,” existed. It was hypothesized that this equilibrium was positively associated with goal-seeking and developmentally-driven collaboration between business-state. When the equilibrium was disturbed, the rent-seeking collusion of business-state prevailed, leading to the failure of transformative programs.

The “combined model” was tested against five major economic transformative programs between 1960-99: 1) Export-oriented transformation (1962-67); 2) Heavy-

chemical industrialization (HCI)- drive (1973-79); 3) Industrial rationalization and restructuring HCI (1980-86); 4) Market-deepening programs (Chaebol reform) (1987-97); and 5) Financial sector and corporate restructuring (1998-99). This study utilized a controlled historic comparative analysis with the methods of agreement, similarity and difference. This study concluded that 1) The findings of the “statist developmental model” were largely confirmed in the context of the first two transformative programs (1960-1979). However, from 1980 on, the outcome of transformative programs could not be understood without reference to the organizational characteristics of big business and its authoritative power of capital investment. 2) In contrast with common belief, this study found that the breakdown of cohesive developmental machinery was primarily accountable for the degeneration of the business-state nexus into a rent-seeking collusion, rather than the increase of capital in the hands of Chaebol. 3) The Chaebol’s weak capital and financing structure offset the influential power stemming from sheer size and diversification. Thus, Chaebol were not as powerful as portrayed by previous literature. 4) Chaebol’s weak capital structure and financing dependency allowed the state to reclaim its autonomy decisively and quickly during economic crisis (1980-81, 1998-99), leading to the reestablishment of “equilibrium.” In conclusion, the variables in this combined model acted quite differently in conjunction with other variables during different historic periods.

1. The internal structure of the state consisted of three broad variables: 1) institutional foundations of meritocratic bureaucracy (openness, competitiveness and transparency of the recruitment system and transparency, fairness and comparability of the reward system); 2) policy making regime (degree of institutional autonomy, power concentration, and coherent cohesiveness); and 3) political leadership (coalition politics and policy priority).

2. The organizational characteristics of corporations concern 1) sources of capital mobilization (financing structure); 2) capital structure; 3) degree of business diversification; and 4) capital size.

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Dedicated to my wife and children,
whom I love.

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TABLE OF CONTENTS

LIST OF TABLES	xiii
LIST OF FIGURES & GRAPHS	xxi
LIST OF ACRONYMS	xxiii
LIST OF KOREAN TERMS	xxvi
CHAPTER I: INTRODUCTION	1
THEORETICAL CONSIDERATIONS	10
(1) Previous Studies on State Autonomy and Development	11
(2) The “Combined Model of the Business-State Nexus” and Economic Transformation	19
MEASURING MAIN VARIABLES	39
JUSTIFICATION OF THE RESEARCH METHOD AND DATA SOURCES	45
PLAN OF THE STUDY	50
CHAPTER II: THE CHANGING BUSINESS-STATE NEXUS (I): THE INTERNAL STRUCTURE OF THE KOREAN STATE	55
COLLECTIVE POLITICAL LEADERSHIP	59
(1) Changes in “Coalition Politics”: From “Developmentalist” (1962-79) to “Region-based” Coalition (1987-1999).	59
(2) Coalition Politics and Representative Bureaucracy	70
(3) Presidential Elite Assignment in Economic Machinery and Institutional Autonomy	74
POLICY-MAKING PROCESS & POLICY COORDINATION SYSTEM ...	86
(1) Policy Coordination System during Developmental Era: Focusing on	

the EPB	87
(2) The Coordination System in Change: Shattering Bureaucratic Coherence	95
(3) Empirical Examination of the Policy Coordination System: MCM, CEM and CEVM	105
(4) The Legislative Branch and its Relations with the Executive	110
INSTITUTIONAL FOUNDATIONS FOR BUREAUCRATIC COHERENCE: RECRUITMENT AND REWARD SYSTEM	122
(1) The Recruitment System	122
(2) The Reward System	129
CONCLUSION	135
CHAPTER III: THE CHANGING BUSINESS-STATE NEXUS AND DENSE INDUSTRIALIZATION	166
BUSINESS-STATE NEXUS (1948-1960): RENT-SEEKING COLLUSION	169
(1) Institutional Aspects of the Business-State Nexus	169
(2) Capital Resources Held by the State and their Distribution: Original Capital Accumulation	171
(3) Evolution of the Chaebol: 1948-1960	176
REVOLUTIONARY TURNAROUND IN THE BUSINESS-STATE NEXUS: AN OUTWARD-LOOKING STRATEGY AND ITS SUCCESS (1961- 1971)	178
(1) Institutional Restructuring and State Dominance over the Business- State Nexus	179
(2) Resource Control and Manufacturing Incentive Structures Toward Transformative Programs	184
(3) Transformative Programs and Standards for Licensing and Credit Allocation	191

(4) The Growth of Big Business during the First Export-drive	198
THE BUSINESS-STATE NEXUS UNDER THE BUREAUCRATIC- AUTHORITARIAN REGIME: DEEPENING INDUSTRIALIZATION (1972-1979)	200
(1) Institutional Rearrangement for HCI Programs: Intimate and Direct Linkage of Business-State	201
(2) Heavy-Chemical Industrialization (HCI) Programs: Manufacturing Incentive Structures and Financing HCI	208
(3) HCI programs and Chaebol Growth	220
THE BUSINESS-STATE NEXUS UNDER A LIMITED DEVELOPMENTAL STATE: BALANCED GROWTH WITH STABILITY AND “SLOUCHING TOWARD MARKET” (1980-1987)	225
(1) Restructuring the Policy Coordination System for “Balanced Growth with Stability” and Financial Liberalization	228
(2) Industrial Restructuring with Financial Liberalization	235
(3) The Government’s Financial Control and “Industrial Structuring”	250
(4) Full-fledged Chaebol and Their Growth	255
CONCLUSION	257
CHAPTER IV: THE PARADOX OF MARKET DEEPENING UNDER DEMOCRATIC REGIMES (1987-1997)	303
DEMOCRATIZATION AND ITS EFFECTS ON THE BUSINESS-STATE NEXUS	312
THE OVERALL STRATEGIC INTERACTIONS OF BUSINESS-STATE OVER MARKET DEEPENING	326
(1) First Period: 1987-1989	327
(2) Second Period: 1989-1992	331

(3) Third Period : 1993-1994, 1995-1997	338
CHAEBOL AS AN OBSTACLE TO MARKET DEEPENING	344
(1) Aggregate Economic Concentration (General Economic Concentration)	345
(2) Ownership Concentration (Structure of Ownership and Control) ..	347
(3) Conglomerate Concentration: Diversification of Business Lines ...	352
(4) Market Concentration	354
CHAEBOL REFORM POLICIES AND THEIR OUTCOMES	357
(1) Policy Measures against Aggregated Economic Concentration ...	358
(2) Core Business Line Policies: Against Diversification	360
(3) Reform of Ownership Concentration	366
(4) Improvement of Monopolistic and Oligopolistic Market Structure	373
CHAEBOL REFORM FAILURE AND ECONOMIC CRISIS	378
CONCLUSION	384
CHAPTER V: ECONOMIC RESTRUCTURING UNDER THE IMF BAILOUT PROGRAM: REPOSITIONING THE KOREAN STATE IN THE BUSINESS- STATE NEXUS 1997-1999	414
CHANGING DYNAMICS OF THE BUSINESS-STATE NEXUS UNDER CRISIS	417
(1) The role of the crisis	417
(2) Crisis Politics and its Effects on Institutional Rearrangement	421
(3) The Role of Weak Capital and Financing Structure under Crisis .	424

(4) International Force and Reform Incentive during Crisis	426
(5) Critical Changes in the Business-State Nexus	428
REFORM PROGRAMS AND THEIR PROCESSES	431
(1) Financial Sector Reform	432
(2) Bank Restructuring	436
(3) Progress Report & Results of Financial Restructuring	444
CORPORATE RESTRUCTURING	448
(1) Approach to Corporate Restructuring	449
(2) Mid-sized Chaebol Restructuring	453
(3) Restructuring of the Top 5 Chaebols	457
(4) The Daewoo Problem	469
(5) Main Policy Targets (Five Plus Three) And Reform Results	475
(6) The Outcome of Corporate Restructuring	489
CONCLUSION	492
CHAPTER VI: CONCLUSION	509
GENERAL FINDINGS	509
FINDINGS CONCERNING VARIABLES	515
(1) Internal Structure of the State	516
(2) Organizational Characteristics of Big Business Groups	520
POLICY IMPLICATIONS AND PROSPECTS OF THE BUSINESS-STATE NEXUS	523
THE QUESTION OF TRANSFERABILITY OF THE "COMBINED MODEL"	525

APPENDIX 528

BIBLIOGRAPHY 555

LIST OF TABLES

Table 2.1	The Ratio of Votes Obtained by Major Presidential Candidates in Different Regions over Time	138
Table 2.2	Presidential Election Campaign Agenda by the Elected Presidents (1963-1992)	140
Table 2.3	Data on Top Governmental Officials of Different Regimes According to Their Regional Origins	141
Table 2.4	Elite Assignment at Power Apparatus Across Different Presidencies According to Their Birth Places	143
Table 2.5	Elite Structure in Economic Ministers According to Their Career Background Before Appointment to the Position (1963-1999)	144
Table 2.6	Average Duration of Service by Individual Ministers and Vice Ministers in Major and Minor Economic Agencies	146
Table 2.7	The Economic Elite Structure in Change (1963-1999)	147
Table 2.8	Comparison of the Conference of Economic Ministers (CEM) and the Conference of Economic Vice-Ministers (CEVM)	149
Table 2.9	Foreign Capital Inflow: 1966 to 1972	151
Table 2.10	The Probability of Higher Post Appointment among EPB Bureau Directors ..	152
Table 2.11	Foreign Borrowing: 1993-1997	153
Table 2.12		

Civil Service Personnel According to Their Functions	154
Table 2.13	
The Results of Deliberation on Bills in the Ministerial Cabinet Meeting	155
Table 2.14	
Legislation Passed in the National Assembly	156
Table 2.15	
Proportion of College Graduates Relative to Total Employees Across Government and Private Firms	157
Table 2.16	
Comparison of the Ruling Party and the Government in Initiating Statutes in the National Assembly	158
Table 2.17	
Rates of Competition for Select Government Examinations	159
Table 2.18	
Recruitment Patterns for Mid and Upper Managers	160
Table 2.19	
Ratio of Recruitment Through Open Civil Service Exams: 1961-1998	161
Table 2.20	
Comparison of Compensation Between Government Employees and Non-agricultural Employees	162
Table 2.21	
Average Time Between Promotions For Civil Servants: 1974-1998	163
Table 2.22	
Average Time Between Promotions for Civil Servants at Each Level: 1978-1998	163
Table 2.23	
Home Ownership by Civil Servants: 1978-1999	164
Table 2.24	
Korean Government Capability over Time	165
Table 3.1-a	

Changes in Business-state Nexus Across Different Time Periods (1948-1998)	263
Table 3.1-b	
Changes in Business-state Nexus Across Different Time Periods (1948-1998)	264
Table 3.2	
Changes in the Ten Largest Chaebol on the Basis of Sales, 1960-1997	266
Table 3.3	
Opportunity Cost of Capital (1946-1960)	267
Table 3.4	
Foreign Exchange Market Distortions, 1955-1965	267
Table 3.5	
The Weight of Korea Development Bank Relative to Total Bank Loans	268
Table 3.6	
Changes in Top Ten Chaebols between 1961 and 1993	269
Table 3.7	
Foreign Capital Inflow: 1966 to 1972	271
Table 3.8	
Cost of Foreign Capital	272
Table 3.9	
Interest Rates on Various Loans	273
Table 3.10	
Sources of Corporate Funds in the Manufacturing Sector	274
Table 3.11	
Structure of Capital Mobilization from External Funds (Share Rate)	275
Table 3.12	
Loans and discounts of the Korea Development Bank, by Industry: 1961-1971	276
Table 3.13	
Loans and Discounts of Deposit Money Banks, by Industry: 1961-1971	277
Table 3.14	

Exports and Korean Economy in the Early Phase of Development (1954-1976)	278
Table 3.15	
Exports by Principal Commodities	279
Table 3.16	
Goal and Achievements of the Fifth Five-Year Economic Plan	280
Table 3.17	
Distribution of Policy Loans to HCI Programs	282
Table 3.18	
Priority Rationing of Finance to Five Strategic Industries by Korea Development Bank in Each Period	283
Table 3.19	
Foreign Capital Inflow during HCI-Drive (1972-1979)	284
Table 3.20	
Distribution of Commercial Loans from Foreign Lenders (Arrival amount as standard)	285
Table 3.21	
Interest Rates of Various Loans during Heavy-Chemical Industrialization-Drive (1972-1979)	286
Table 3.22	
Policy Loans and Various Interest Rates	287
Table 3.23	
Progress of Heavy-Chemical Industrialization in the 1970s	289
Table 3.24	
Growth of Big Business Groups in Terms of Total Value-added in the 1970s	289
Table 3.25	
Share of Thirty Largest Chaebols in Mining and Manufacturing: 1977-1997	290
Table 3.26	
Changes in the Ratio of HCI to Total Assets Before and After HCI Drive	291
Table 3.27	

Investment Plan and Business Participation During HCI-Drive: 1972-1979 . . .	292
Table 3.28	
The Number of Subsidiaries of the 30 Largest Chaebols Over Time	294
Table 3.29	
Average Debt/Equity Ratio in Manufacturing, 1961-1997	295
Table 3.30	
Debt-to-Equity Ratios of the Top Ten Korean Chaebol (ranked by sales, excluding financial industry)	296
Table 3.31	
Investment Readjustment in Major Heavy & Chemical Industries (1979-1980)	297
Table 3.32	
Exports by Principal Commodities (Top Ten Items): 1973-1987	298
Table 3.33	
Structure of Bank Credit according to Borrowers	299
Table 3.34	
The Relative Weight of Small- and Medium-Sized Enterprises as Compared with Big Business	300
Table 3.35	
Variety of Attractions for Promotion of Saving (1980-87)	301
Table 3.36	
The Ratio of Equity Capital to Total Assets Across Different Countries	302
Table 4.1	
The Ratio of Export Volume by the 7 Largest GTCs to Total Export Volume	391
Table 4.2	
The Ratio of Economic Concentration in the Hands of the Top 10 or 30 Chaebols (Manufacturing Sector)	392
Table 4.3	
Internal Share Holding Rate of Top 30 & Top 5 Chaebols: 1983-1999	393
Table 4.4	

Korean Corporate Sector	394
Table 4.5	
Corporate Sectors in Korea, USA, Japan, & Taiwan	396
Table 4.6	
Market Structure of Korean Manufacturing (%)	398
Table 4.7	
Market Structure of Korean Manufacturing in 1990s	399
Table 4.8	
Percentage of Market Concentration Caused by Top Chaebols in Manufacturing Sectors (in which Chaebols participated) in the 1980s	400
Table 4.9	
Market Domination by Top 30 Chaebols According to Commodities	401
Table 4.10	
Trend of Youngnam Elites in Government-run Banks	402
Table 4.11	
Trend of Youngnam Elites in 6 Major Commercial Banks	403
Table 4.12	
Trends in Youngnam Elites in the Central Bank and Financial Supervisory Institutions	404
Table 4.13	
Trend of Slush funds by Korean firms over time	405
Table 4.14	
Defining Characteristics of Economic Cycles Between 1986 and 1997	406
Table 4.15	
The Total Amount of Capital Investment across Affiliated Firms by the Thirty Largest Chaebols	408
Table 4.16	
Exports by Principal Commodities	409
Table 4.17	
Cross Debt-guarantees by Thirty Largest Chaebols	410

Table 4.18	The Ratio of Corporations (Owned by the 30 Largest Chaebols) Listed in the Stock Market	411
Table 4.19	Major Acts and Decrees in the Context of Regulatory Policy over Chaebol . .	412
Table 5.1	Major Economic Indicators during Economic Crisis	496
Table 5.2	Financial Stability in Corporate Sector	498
Table 5.3	Profitability Rate of the Korean Corporations During Crisis	499
Table 5.4	Balance-sheet Positions of Commercial Banks	500
Table 5.5	Profitability of the Banking System	502
Table 5.6	The “Big Deals” Agreement among Big Five Chaebols	503
Table 5.7	Trend of Debt/Equity Ratios of Top Five Chaebols: 1996-1999	505
Table 5.8	Thirty Largest Business Groups during Economic Crisis	506
Table 5.9	Changes in the Number of Industries Involved in by Chaebols	508
Table A.1	Major Economic Indicators	529
Table A.2	Variety of Attractions for Promotion of Saving	531
Table A.3	Comparison of Government Efficiency and Transparency in the 1990s of Asian	

Countries	534
Table A.4	
Foreign Borrowing between 1962-1998	537

LIST OF FIGURES & GRAPHS

Figure 1.1	Changes in Structural Characteristics of Business-State Nexus & Major Economic Transformative Programs	539
Figure 1.2	Strategic Interactions of Business-State with Institutional and Material Resources	540
Figure 2.1	Procedure for Drawing up a Bill by the Executive	541
Figure 4.1	The Real Picture of Economic Concentration and Reform in Fair Trade Act . .	542
Figure 4.2	Cause of the Economic Crisis	543
Graph 2.1	Presidential Speeches on Economic Issues	544
Graph 2.2	Presidential Speeches on Political Issues	545
Graph 2.3	Comparison of Salaries in Government and Private Industry	546
Graph 3.1	Ratio of Policy Loans to Total Money Lent	547
Graph 3.2	Interest Rates on Various Loans: 1961-1997	548
Graph 3.3	Sources of Corporate Funds in the Manufacturing Sector	549
Graph 3.4	Structure of Capital Mobilization from External Funds	550
Graph 3.5		

Number of Subsidiaries of 30 Largest Chaebols	551
Graph 3.6	
Share of 30 Largest Chaebols in Mining and Manufacturing: 1977-1995	552
Graph 3.7	
Ratio of Sales by Top 3 Chaebols Relative to GNP: 1963-1996	553
Graph 3.8	
Average Debt/Equity Ratio in Manufacturing: 1961-1997	554

LIST OF ACRONYMS

ACLPG	Act for the Concept of the Land as Public Goods
ACS	Army Chief of Staff
ANSP	Agency for National Security Planning previously the KCIA
B-A	Bureaucratic-Authoritarian
BIS	Bank for International Settlements
BOK	Bank of Korea
BSC	Bank Supervisory Commission
BST	Bureau of Science and Technology
CCEJ	Citizens' Coalition for Economic Justice
CCID	Civilian Council of Industrial Development
CEM	Conference of Economic Ministers
CEVM	Conference of Economic Vice-Ministers
CFE	Center for Free Enterprises
CFIT	Composite Financial Income Taxation
CGRC	Corporate Governance Reform Committee
CNPB	Chief of National Police Bureau
CPB	Chief of Police Bureau
CPHCI	Committee for the Promotion of Heavy-Chemical Industrialization
CPI	Consumer Price Index
CRCC	Corporate Restructuring Coordination Committee
CSIP	Capital Structure Improvement Program
DCIP	Deliberate Council of Industrial Policies
DJP	Democratic Justice Party
DONTA	Director of the Office of National Tax Administration
DRP	Democratic Republican Party
DSC	Defense Security Command
ECA	Economic Cooperation Administration
ECPT	Extended Conference for the Promotion of Trade
ECSNS	Emergency Committee for Safeguarding National Security
EMG	Economic Ministerial Gathering
EPB	Economic Planning Board
EPCS	Economic Policy Coordination System
FDI	Foreign Direct Investment
FKI	Federation of Korean Industries
FKTU	Federation of Korean Trade Unions
FSC	Financial Supervisory Commission
FSS	Financial Supervisory Service
FTC	Fair Trade Commission
GAAP	Generally-Accepted Accounting Practices

GARIOA	Government Aid Relief in Occupied Area
GMM	Governing Ministerial Meeting
GTC	General Trading Company
HCI	Heavy-Chemical Industrialization
HCI-PE	HCI Planning Executives
HPS	Head of Presidential Secretariats
IMD	International Institution for Management Development
KAMCO	Korean Asset Management Corporation
KASMEs	Korean Association of Small- and Medium-sized Enterprises
KCIA	Korean Central Intelligence Agency
KCSMI	Korea Council of Small/Medium-sized Industries
KCTU	Korean Confederation of Trade Unions
KDB	Korea Development Bank
KDI	Korea Development Institute
KDIC	Korea Deposit Insurance Corporation
KEF	Korean Entrepreneurs Federation
KERI	Korean Economic Research Institute
KIPA	Korea Institute of Public Administration
KOTRA	Korea Trade Promotion Corporation
KSE	Korea Stock Exchange
KTA	Korean Traders Association
KTUC	Korean Trade Union Congress
LDP	Liberal Democratic Party
LG	Lucky-Goldstar
MCM	Ministerial Cabinet Meeting
MDA	Ministry of Domestic Affairs
MIB	Medium Industry Bank
MOA	Ministry of Agriculture
MOAF	Minister of Agriculture and Fishery
MOC	Ministry of Commerce
MOC	Ministry of Construction
MOCI	Ministry of Commerce and Industry
MOCT	Ministry of Construction and Transportation
MOE	Ministry of Education
MOEF	Ministry of Economy and Finance
MOER	Ministry of Energy and Resource
MOF	Ministry of Finance (merged with EPB into MOEF, Dec. 1994)
MOFA	Ministry of Foreign Affairs
MOGA	Ministry of Government Administration
MOL	Ministry of Labor
MOR	Ministry of Rebuilding, previously the Ministry of Construction
MOST	Ministry of Science and Technology
NBFIs	Nonbank Financial Intermediaries or Non-banking Financial Institutions

NCNP	National Congress for New Politics
NDRP	New Democratic Republican Party
NIF	National Investment Fund
NPL	Non-performing Loan
NSO	National Statistical Office
OBS	Office of Bank Supervision
ONTA	Office of National Tax Administration
PCC	Policy Coordination Council
PCDIP	Public Corporation for Development of Industrial Parks
PES	Principal Economic Secretaries
PSEA	Presidential Secretariat of Economic Affairs
PSPD	People's Solidarity for Participatory Democracy
RDP	Reunification Democratic Party
RNFTS	Real Name Financial Transaction System
RNRETS	Real Name Real Estate Transaction System
RPLL	Repatriated Liquidation Law
SEC	Supplies Economic Cooperation
SCENSM	Standing Committee for Emergency National Security Measures
SMEs	small- and medium-sized enterprises
SMS	Small- and medium-sized (firms)
SNU	Seoul National University
SSC	Securities Supervisory Commission
TOR	Terms of reference
TPLCS	Tripartite Panel of Labor, Capital and State
ULD	United Liberal Democrats

LIST OF KOREAN TERMS

<i>Beejakum</i>	Slush funds
<i>Chaebol</i>	Large Korean business conglomerates
<i>Haengsi</i>	Exam for highest position in civil service
<i>Jeopdaebee</i>	Entertainment expenses
<i>Teukchae</i>	Special recruitment for civil service
<i>Teukseoung</i>	Internal promotions in civil service
<i>Tongchijakum</i>	Ruling funds
<i>Yushin</i>	Refers to the period of 1972-1979, during which President Park abandoned procedural democracy and adopted a B-A regime.

Geographical terms:

<i>Busan</i>	City in southeast Korea, in <i>Kyoungnam</i> Province
<i>Cheju</i>	Island and Province south of Korean peninsula
<i>Chungbuk</i>	A central province (northern half) Also: <i>Chungchung-bukdo</i>
<i>Chungnam</i>	A central province (southern half) Also: <i>Chungchung-namdo</i>
<i>Chungchung</i>	Region including <i>Chung-nam</i> , <i>Chung-buk</i> , and <i>Daejeon</i>
<i>Daejeon</i>	City in <i>Chungnam</i> Province
<i>Honam:</i>	Region including <i>Jeon-nam</i> , <i>Jeon-buk</i> , and <i>Kwangju</i>
<i>Jeon-buk</i>	Region in southwest Korea (northern half) Also: <i>Jeonla-bukdo</i>
<i>Jeon-nam</i>	Region in southwest Korea (southern half) Also: <i>Jeonla-namdo</i>
<i>Kang-won</i>	Region in northeast Korea
<i>Kyoungbuk</i>	Region in southeast Korea (northern half) Also: <i>Kyongsang-bukdo</i>
<i>Kyoungnam</i>	Region in southeast Korea (southern half) Also: <i>Kyongsang-namdo</i>
<i>Kwang-ju</i>	City in <i>Jeonbuk</i> Province
<i>Taegu</i>	City in <i>Kyoungbuk</i> Province
<i>Youngnam</i>	Region including <i>Kyoungbuk</i> and <i>Kyoungnam</i> Provinces, <i>Taegu</i> and <i>Busan</i>

CHAPTER I

INTRODUCTION

Perplexity is often a valid starting point for a research inquiry. This study is a response to the puzzling fact that the South Korean economy, which grew so fast and efficiently during the last three decades, stumbled so heavily in 1997 but speedily rebounded in 1999. What sort of forces were behind the “economic miracle” in the 1960s-1980s, the “meltdown” in 1997, and the “rebound” into a booming economy in 1999? The developmental literature runs short of breath in trying to keep up with the roller coaster ride of the recent Korean economy. Korea has often been depicted as the archetype of successful state-led industrialization with phenomenal sustained economic growth and relatively equitable income distribution during the last several decades. Nonetheless, the Korean economy has occasionally come apart at the seams, e.g. in 1979-1980, and 1997-1998, while crossing the thresholds of industrialization. For instance, the Korean GNP contracted 6.2% in 1980, while the already high inflation rate climbed to over 20%. In addition, gross capital formation shrank by 32.3% from 1979 to 1980. Then the economy surged back after two years of readjustment. After attaining a stellar performance between 1984 and 1996, the Korean economy stumbled heavily again in 1997. GNP shrank 5.8% in real terms in 1998, the worst negative growth in 18 years. Korea’s foreign shipments registered negative growth for the first time in 40 years. Worse yet, the unemployment rate recorded an unprecedented 6.9%, compared with the average of 2.6% in the 1990s. However, the economy dramatically turned around at the end of

1998 and settled into an upswing by 1999, claiming over an eight percent growth rate in the first half of 1999. Although it is too early to be sure that the Korean economy is firmly anchored onto a long-term development track again with a “new Korean model” (Refer to Table 5.1), Korea was clearly successful in handling the currency crisis and subsequent reform programs. At any rate, the wide oscillation of the Korean economy between splendid growth and devastating breakdown presents interesting research questions for political economists.

To date, there have not been any models which have been able to satisfactorily explain both the success and failure of the Korean economy during different phases of industrialization. Both the “developmental state model” (e.g, Chalmers Johnson 1982; Alice H. Amsden 1989) and the “neoclassical approach” (e.g, Bela Balassa 1981; World Bank 1993) focused solely on explaining the economic miracle. A new explanatory model is needed which provides clues to both the economic miracle in the past, the meltdowns in 1980 and 1997, and the upsurge of the Korean economy in 1999. This study suggests that a close look at the historical patterns of the Korean “business-state nexus” will shed light on this puzzling phenomenon. This study will uncover the nature of strategic interactions between business and the state across different phases of industrialization and associate that nature with the success or failure of economic reform programs. By engaging in a careful cross-period comparison, this study will grasp a significant part of the development dynamics which were bypassed by previous developmental literature. It is time to develop a new explanatory model for both miracle and meltdown.

Second, the swift ups-and-downs of the Korean economy cannot be explained by

study of state structure alone, due to the fact that institutional settings tend to be persistent and path-dependent over a long period. We must incorporate the structural characteristics of private business to disclose the whole story of the meltdown and quick recuperation. For instance, the characteristics of corporate structure, including ownership, patterns of financing, and internal organization, have a lot to say about the rise and fall of the Korean economy. "Debt-driven growth strategies" by corporations are vulnerable to outside shocks or financial crises during which severe liquidity problems can suffocate debt-ridden firms. But once the liquidity problems are lifted, these debt-ridden firms can roll again. Recently there has been burgeoning literature in this area. For instance, Robert Wade (1998), along with Frank Veneroso (1998) attempted to explain the economic crisis in Asia with an examination of corporate structure. But still more scholarly attention must be paid to the private sector. This study incorporates the structural characteristics of corporations into the study of business-state relations in order to interpret the occasional falls and speedy rises of the Korean economy.

Third, this study is a response to the backlash of criticism against the statist approach in the context of the Asian economic crisis. This study will stem the false tides in which Western media and academic circles have rushed to point to "crony capitalism" as the seed of destruction. Asian NICs, which had been applauded as successful models for other developing countries to emulate, are now once again lumped together with other late-late developers. The close business-state linkage has been heavily criticized as the original, institutional malady which should have been discarded long ago. Many of the conventional state-based explanations have been under unfair attack or thrown out as

discredited. The pendulum may have swung too far: from lavish applause and reverence for stellar economic performance in the 1980s to quick, excessive contempt for the Asian model right after the exposure of the financial meltdown. It seems that the legacy of developmental work in the political economy of development from the last couple of decades is about to be washed away by what Geddes labeled the “sand castle phenomenon.”¹ By sorting out which aspects of the business-state nexus are inimical and which are conducive to economic development, this study attempts to correct the blunder of “throwing the baby out with the bath water.” The structural characteristics of the business-state nexus vary widely across different time periods, sometimes displaying a benevolent and sometimes a malicious facade in the context of economic transformative programs. Which facade of the business-state nexus shows up depends upon the conjunctural combination of variables at a given time. The business-state nexus does not always serve as an institutional conduit for the rent-seeking of private business, but only under circumstances where the state becomes captured by private power holders, as a result of the politicization of economic elites, bureaucratic disorientation, dislocation of the policy coordination system and so forth. Only empirically rigorous work will be able to banish this false view of the business-state linkage in Asian countries. In addition, exploring the business-state nexus involves carrying out the legacy of the statist’s work.

¹ Barbara Geddes pointed out that comparative politics has been dominated by the “sand castle phenomenon,” with one paradigm being replaced by another paradigm time after time. The frequent paradigm displacements prevent comparativists from deepening our understanding of political/economic development, owing to the fact that comparativists could not build up our knowledge on the basis of legacy from previous studies.

Fourth, neither can this study agree with the overly defensive attitude of some literature, which claims that a given Asian model requires only a technical modification or no adjustment at all, much less a paradigm shift. Among these viewpoints, the “liquidity-crunch explanation” asserts that the current economic woes are primarily attributable to a mere “liquidity problem” generated from the harsh assault of “hot money” rather than a crisis of “real economy” (Devesh Kapur 1998; Linda Lim 1998). From another point of view, the overwhelming majority of current studies on the Asian financial crisis have been inclined to attribute the cause of the “financial big bang” to the backwardness of financial institutions in Asian countries. According to this group of scholars, the lagging institutionalization of the central bank’s independence, fragmented and ineffective financial supervisory institutions, rigid exchange rate systems, weak bank disclosure systems and nontransparent, inefficient ties among government, banks and businesses are at the root of the financial crisis (S. Radelet and J. Sachs 1998; Henry Laurence 1998). This seems to be a dominant argument for the explanation of the Asian crisis. Other scholars point to the vulnerability of Asia’s “high debt developmental model” under the high globalization of capital and production markets and to the false neo-liberal approach of Asian states toward foreign borrowing and capital markets as the causes of the financial crisis (Robert Wade and Frank Veneroso 1998; Robert Wade 1998). The fundamental problem with the above-mentioned groups is that they do not look at the core engine of dense industrialization in the private sector, in the Korean case, the Chaebol.² Instead, they tend

² *Chaebols* are large business groups which are characterized by the following: First, ownership of a conglomerate in Korea is confined to a single founding family. Second, management of affiliated firms in a business group is generally concentrated in a

to dig at the surface issues of economic meltdown. By doing so, although they are quite successful in articulating the direct origin of the currency crisis, they are inclined to neglect the “structural forces” behind the phenomenal breakdown. Furthermore, an adequate understanding of the “structural forces” requires a new approach to the single private power holder which is unchecked by other social groups under democratic rule, the Chaebol. Not only the constellation of the power arrangement between Chaebol and state, but also the very character of the conglomerates, must be brought to our attention. In short, only a comprehensive understanding of the business-state nexus will unravel the puzzle of the economic meltdown in Korea.

Finally, this study will undertake the task of overcoming the common fallacy of the institutionalist approach, that is, “path-dependency.” Although neoinstitutionalists are surely right that institutional legacy in the past constrains and channels human interactions into a “path-dependent way” even during political and economic turmoil, institutionalists are, to a large extent, hapless in explaining changes and envisioning the new prospects of economic/political development. Statists, who have dominated in developmental literature, have neglected the potential for change inherent in developmental states, mostly owing to its path dependency nature. The rising economic strength of private business

single individual, that is, the owner-chair, who is positioned at the peak of the hierarchical structure. The owner is able to wield tremendous decision-making power using a complicated web of cross-ownership while holding a comparatively small portion of a business group’s assets. Third, large *Chaebol* groups in Korea pursue diversification strategies to diffuse risk or utilize slack resources. They diversify widely, producing at the bottom end and middle level of many unrelated markets. For example, Samsung group was involved in over 30 different industries in 1997 with over 40 affiliated firms. (Refer to Cho, Dong-Sung 1990, pp. 387-411).

and the ascending scale and maturity of the economy itself placed heavy stress on the old institutional shell of the business-state nexus. In other words, the Korean economy itself had outgrown its institutional settings. Changes and upheaval are always embedded in any political/economic system over the long term. In the Korean case, changes in the developmental model have been faster and greater than in other early Asian dragons (Singapore, Hongkong, and Taiwan). In particular, the Korean state's strategic choice of the Chaebol as its private partner precipitated the quick evolution in the business-state relationship. By broadening the scope of variables, especially including changes in the private sector, my "combined business-state model" can grasp the dynamics of changes across different time periods. Thus, this study is designed to explain both persistence (path dependency) and change by building a dynamic model of interpretation.

"One of the striking yet understudied phenomena of late, late development is the dominance of the private sector by a handful of diversified business groups... Korean Chaebols are the most extreme examples" (Haggard, Maxfield, and Schneider 1997:45). As Haggard and his colleagues have pointed out, the case of Korea is of particular interest, in that private business has grown with unprecedented speed during the last three decades with diversified business lines. Their quick rise shifted the balance of power between the private and public sectors, alongside deepening industrialization. In other Asian countries, the state's dominance over the private sector has, to a large extent, persevered due to the weakness of the private sector (Yun-han Chu 1994). But the rapid growth of big business groups in Korea clearly presented a new kind of quandary to be dealt with by the state. The distinct alteration in the power balance between private

business and the state across different time periods provides an opportunity for political economists not only to conduct historic comparisons and but also to shed light on the path to be followed by other Asian countries. The cross-historic period comparison would unravel the popular fallacies in some developmental theories. This study boldly contends that the divergent patterns of the business-state nexus explain the degree to which each Asian country fell into an economic quandary. For instance, the path of market deepening in Taiwan and Singapore has been smoothly orchestrated by the state, owing to both the relative absence of well-organized big business groups and the sustained institutional flexibility of the state. In other words, the state did not become a captive of big capital during market-oriented reform and was able to avoid an IMF bailout program in 1997.

A second reason for interest in the Korean case concerns a scholarly curiosity into how the extremely interventionist state in Korea resettled its connectedness with the private sector during the market deepening process. Korea had utilized the archetypes of “embeddedness” (Evans 1989), “quasi-internal organization” (Lee and Naya 1988), and “governed interdependence” (Weiss 1994) as conduits to deliver developmental directives and guidance to the private sector during the developmental era (1960-1980). Despite its heavy connectedness with private partners, the Korean state remained autonomous from private powerholders. In other words, the Korean state was able to engineer an equilibrium between the two contradictory conditions “state autonomy” and “embeddedness” in the form of the business-state nexus over time. This delicate equilibrium could have been disturbed for various reasons. Neither pulling itself abruptly out of the market nor sticking to the past pattern of intervention would have been ideal.

Considering that there have been strong partners, that is, a “strong state” and a “well-organized business peak association” on both sides of the business-state nexus, reshaping business-state connectedness would involve a long, adaptive and evolutionary process and its consequential effect on society would be extensive and thorough. Thus, studying the case of Korea would unravel the knot of questions with which political economists have been concerned.

More importantly, Korea went through the most comprehensive democratic transition and consolidation among Asian countries in the 1980s and 1990s. Korea has been rated as the most “liberalized and democratized” nation in Asia except for Japan, according to the *Freedom House* report. Democratization produced extensive implications for the business-state nexus. A fundamental question centers around the compatibility of the “developmental state” with political liberalization and democratic forms of governance. The characteristics of liberal democracy, including the open power contests through the ballot box, the unleashing of pent-up distributional demands, civil society unfettered from state control, decentralization of power, free-wheeling media and so forth, was expected to undermine the very institutional foundations of the developmental state. The unusually extensive and rapid degree of Korean democratization among Asian countries presents ample opportunity for comparativists to explore: 1) whether or not regime type itself has explanatory power over the success or failure of market-oriented economic reform; 2) the extent to which democracy accelerated the deprivation of state autonomy from private power holders, in particular, Chaebols; 3) what sorts of effects democracy had on the internal structure of the state; 4) the extent to which

democratization accounted for the failure or success of market deepening programs; and 5) the extent to which and how democratization diminished the president's economic sovereignty. In short, it would be extremely interesting to examine whether or not and to what extent the institutions of the developmental state survive under conditions of popular participation and democratic rule.

This study is not only my venture to explain the puzzling ups-and-downs of the Korean economy across different time periods, in particular, across different regime types, but also my effort to answer questions which have been overlooked in previous developmental work. This study is basically concerned with the cause-and-effect relationship between different patterns of the business-state nexus and economic transformations. By paying attention to the private sector, which was, by and large, ignored in developmental literature, and extending the scope of the research time period into democratic governance, this study will grasp the genuine picture of economic development in South Korea.

THEORETICAL CONSIDERATIONS

This study relies on several bodies of literature about economic and political development. Most notably, state-centered studies on developmental issues, business-state literature, and institutional/structuralist studies on democratization will be incorporated into this study. The construction of an explanatory model on the cause-effect relationship between the business-state nexus and economic transformation programs requires the creative amalgamation of three different bodies of literature. The

first part of the theoretical construction consists of the critiques of previous studies on developmental issues, mainly because the main objective of this study is to overcome the fallacies of the statist approach on the one hand, while carrying on its legacy on the other hand.

(1) Previous Studies on State Autonomy and Development

In the 1980s, three major approaches emerged to account for the “Asian miracles” during the last three decades. Each of these approaches centered on one context or one factor that was believed to have played a crucial role in East Asia’s splendid economic growth. The first group of scholars (Balassa 1980; 1981; World Bank 1993) pointed to “market conforming policy behavior” as the critical factor in determining economic development. This neoclassical view attributed the miracles to an outward-oriented development strategy, and market-conforming microeconomic policies and their effects on allocation efficiency. The underlying assumption in this view was that well-developed markets existed which would function efficiently with minimalist intervention from the government. However, in contrast to the neoclassical standpoint, the private system has been manipulated with price distortions, discretionary interventions, and sector-specific industrial policies, as has been well-documented and empirically-proven in statist literature. In short, the free-market and free-trade economic explanation has been well refuted by statist both empirically and theoretically (Refer to Wade 1990; Ha-Joon Jang 1993), so that little time need be spent here refuting their theoretical framework.

The second approach took the “global political economy approach” (Cumings

1987; Woo, Jung-en 1991) which considered the world economy to be the critical external context. This approach incorporated East Asia into the international economic system from which East Asia has benefited. This approach revised the world system model in such a way that the “satellite state” was not always doomed to be underdeveloped, but rather that dependency could be manageable and made beneficial to the ascent of a “satellite state,” depending upon the timing of its incorporation into the world system and its strategic relationship with the “core countries.” This approach made an important contribution to the understanding of the economic miracle in East Asia by reminding us that the miracle must be understood in the international context. But the timing of incorporation into the global market and assistance from the outside have limited explanatory power. The timely incorporation and foreign help did not necessarily lead to stellar economic performance in other parts of world. Foreign help works only in association with positive domestic forces for an economic miracle. In a word, international forces have only limited implications in the context of explaining the Asian miracle during the last three decades (Hsin-Huang Michael Hsiao, 1995).

The third approach (Jones and Sakong 1980; Johnson 1982; Amsden 1989; Wade 1990; Chang, H. J. 1994) saw the state as the fundamental locomotive behind the miracle. Asian states manufactured miracles with “sector-specific promotional policies” throughout different phases of industrialization. In contrast with the neoclassicals’ contention, “sector-specific promotion” involved deliberate “price distortions.” Asian states had the bureaucratic and technical capability to seduce business them into target industries. In addition, states made sure that profits garnered by private business were channeled into

reinvestment rather than consumption and speculation. As Onis (1991) pointed out, the “Asian miracle” did not stem from the right kinds of macroeconomic policies adopted by Asian states, but from the right kinds of institutional settings which made the adopted macroeconomic policies workable. Accordingly, the overwhelming majority of developmental literature began with a well explicated description of a particular kind of state, that is, a “developmental state.” Developmental scholars generally suggested four defining characteristics of a developmental state (the source of state autonomy) which have enabled the East Asian states to pursue state-led strategies successfully. First, developmental states were distinguished by their “superb administrative capability.” The high administrative capability came from three important sources: 1) a merit-based recruitment system; 2) an effective reward system; and 3) the existence of competent elite technocrats. In all of East Asia, career civil servants were enlisted via highly competitive civil exams, not via patron-client networks, political favoritism, or kinship. Meritocratic civil exams were highly effective in selecting competent students and thereby promoting the overall administrative skills of the bureaucracy (Johnson 1982; Amsden 1989). Officeholders were also compensated with benefits which were comparable to employees’ benefits in the private sector. The overall combination of financial incentives was good enough to encourage career civil servants to pursue their long-term careers within the bureaucratic system. Additionally, developmental elites who were placed in core policy institutions such as economic planning agencies, development banks, and government research institutions were predominantly from prestigious universities and often trained in prestigious American institutions. They retained real power, authority in economic

planning, and technical competence (Refer to Lee Jang-Kyu 1992, and Jeong Jeong-Gil 1994, for the Korean case). They were protected from the political influence of collective action by a chief-executive who was developmentally-driven and determined to achieve industrialization because his regime survival relied upon high quality economic performance (Kim Byung-Kuk 1994). In addition, a unique institutional structure and growth-oriented political coalition safeguarded economic planners from political and societal pressures (Peter Evans 1995; Robert Wade 1990).

The second defining characteristic of the developmental state was that was it noted for its relative autonomy from civil society. The high autonomy of the developmental state originated from the fact that neither a strong bourgeoisie nor a powerfully organized labor class existed. Weak and subordinated civil society relative to state power was the result of conjunctural historical events over a long period of time. For instance, the Japanese occupation (1910-1945) restrained the emergence of a powerful bourgeoisie in Korea and Taiwan and the landed class lost its power base through the unusually successful land reforms in both countries in the 1950s. Not only did the states secure pre-emptive control before a powerful bourgeoisie appeared but also the bourgeoisie's institutional access to decision-making was limited (Stephan Haggard 1990:51-75; Peter Evans 1995). The overall effect of the weak civil society was to promote the state's "ability to expand social space for effective economic policy maneuvering by insulating the economic domain from political pressures and overcoming the dilemma of collective action" (Moon Chung-in and Rhyu Sang-young 1999). The relative autonomy of the state did not mean isolation from civil society. Despite the

power and relative autonomy of the state apparatus, the state has become embedded in civil society through a dense web of ties with business, peasants and other social groups through which the state has been capable of mobilizing scarce resources for their developmental objectives. Peter Evans (1989:575-81 1995:43-73) coined this as “embedded autonomy.” Formal and informal networks between the bureaucracy and important economic actors in the private sector did not necessarily lead to the captivity of the state by private power holders, rather they gave the state a wider range of policy choices and a chance to carry out effective implementation of the chosen policy.

The third distinct feature of the developmental state was internal cohesiveness that allowed state managers across different sectors to act in unity. This high internal cohesiveness was attained by the meritocratic recruitment system, ideological coherence, close interconnections among career civil servants, and the clear location of decision-making in the bureaucratic system (Johnson 1982:21). The practice of recruiting top economic technocrats at the core economic apparatuses was especially discernable in the way that the chief-executive selected his agents solely on the basis of merit and technical competency. Thus, this group of technocrats was able to be dedicated to the collective goal of improving national wealth. As a result, individual officeholders restrained themselves from engaging in graft, embezzlement and other predatory practices. Identical educational backgrounds, which were fostered by the recruitment of graduates from a limited number of prestigious universities, also set the social foundations for freer and more effective interactions among officeholders, and, thereby, cut down transaction costs within the bureaucratic system. This bureaucratic coherence also gave the chief-executive

not only a wide range of policy choices but also an assurance of policy implementation with bureaucratic mobilization (Leftwich 1995; Kim Byung-Kook 1994).

The fourth characteristic shared by East Asian developmental states was that there has been an executive head of government who was determined to carry out developmental programs and that determination was backed by a broad and enduring political coalition. In South Korea, military generals, state managers and entrepreneurs formed the core of this political coalition with the loose incorporation of peasants and the working class (Moon, C. 1988). In the case of Taiwan, the Kukmindang embodied this coalition with tight political incorporation of broad social classes. These developmental political coalitions stood on two key ideological bases: 1) national security and 2) single-minded developmentalism at the expense of social justice, welfare and democracy. The political/economic rivalry with and imminent threats from communist regimes drove the chief-executives toward swift industrialization, because that was the only way of winning over communism. On the other hand, under authoritarian rule, the ruler also complemented his lack of political legitimacy with quick and quantitative economic development (Lee Yeon-ho 1997:86-90; Kim Byung-Kook 1994:167-210). In addition, the chief-executive possessed enormous power to safeguard his economic agents not only from societal pressures but also from the political pork-barreling of legislature because of the distinctive institutional structures which allowed a high concentration of power in the hands of the chief-executive. This concentrated political power could also be exercised in an efficient manner, owing to the political support mobilized by the broad catch-all party. Party systems in these countries, which were not polarized and were less fragmented,

worked as a conducive force for the efficient exercise of executive power by the chief-executive (Haggard 1990).

Simply speaking, the statist approach associated the four above-mentioned traits of the “developmental state” with the stellar economic performance of East Asian countries. But it is more precise to say that they were perplexed by the phenomenal economic growth in the region first and then traced back looking for explanatory variables, instead of vice versa. Their “causal” linkage between the “developmental state” and superb economic performance is often circumstantial rather than based on rigorous empirical examination. More importantly, the state-centered approach is “static and stationary” in that they are not able to grasp the dynamics of change in strategic interactions between state and private power holders over time. State-centered literature did not pay attention to how the state changed as a result of social and political changes and economic transformation. In other words, statist ignored the notion that states and societies are “mutually transforming” over time (Migdal, J. S. 1994). The lack of attention to the private sector hampered the statist approach from foreseeing the emerging new patterns of the business-state nexus. Basically, the developmental literature treated societal actors lightly and thereby ignored the potential for change in the nature of the relationship between state and civil society. Recent studies (Rhee Jong-Chan 1994; Kim Eun-Mee 1997; Lee Yeon-ho 1997) on the Korean developmental state presented the developmental state as an inherently unstable and transitory form of state structure. Unlike the advanced democracies which have been anchored in stable models, such as the liberal-pluralist, laissez faire, or democratic corporatist states, the state structure in the developing

countries, to a much higher degree, has been in transition, searching for its own model (Lee, Yeon-ho, 1997). The “developmental state” in Asia has inherent contradictions and limits within the system. In short, by incorporating the private sector into our research, political economists might be able to turn the statist approach into a more dynamic and flexible explanatory model.

The state-centered approach is an inadequate theoretical framework for explaining both the miracle in the past and the meltdown at present in the East Asian economy. During the developmental era, the state-centered interpretation was relatively applicable, due to the fact that the state, as senior partner, steered and guided its private junior partner with its ample institutional and material resources. Accordingly, a close look into state structure disclosed the essence of the developmental story. But, in the post-developmental era, the private power holders have grown into equivalent partners with the state, so that the top-down approach was no longer workable in interpreting economic transformation. Without extricating cooperation from private power holders, the state could not proceed with market-oriented reform. The economic meltdown in Asia not only stemmed from the top (state) but also from the bottom (society). Constructing an explanatory model, which accounts for both the miracle in the past and the meltdown at present, must begin with the incorporation of the private sector into our study.

(2) *The “Combined Model of the Business-State Nexus” and Economic Transformation*

Clearly, the study of the developmental issues in Asia must involve both state and business, not from the top-down but from an “interactional perspective.” As a matter of fact, though still in its infancy phase, there has been increasing interest in business-state relations. Recent literature points out that certain structural characteristics of the business-state nexus are positively associated with good economic performance. In other words, the pattern of business and government relations accounts for a large part of the variation in economic performance (MacIntyre (ed.) 1994; Evans 1995; Sylvia Maxfield and Ben Ross Schneider (ed.) 1997). For instance, Evans (1995) pointed out that East Asian countries are noted for “embedded autonomy³” in which, although a strong connectedness exists between public and private partners, the state preserves its relative autonomy from private partners in making strategic choices. This trait of business-state relations is convincingly associated with stellar economic performance in East Asia. But both MacIntyre (1994) and Evans (1995) largely failed to distinguish themselves from statist literature in that they did not pay attention to the structural characteristics of private business. Especially, Evans’ “embedded autonomy” is, by nature, a stationary and static concept, like the statist approach in general. On the other hand, Maxfield and Schneider’s approach (1997), although making a great contribution by incorporating private business

³ Evans (1995) was the first to insist that the combination of connectedness and autonomy make a state “developmental.” But he made little contribution to the understanding of how and what sustains the balance of these two contradictory concepts. He did not explain the complex political dynamics of the “embedded autonomy” between the state and private business.

into developmental issues, remains in the early phases of theoretical speculation.

In the context of business-state relations and economic performance, the first question which arises is: Why is a “tight business-state nexus” conducive for superior economic performance? In Taiwan, Korea and Japan, there have been close formal and informal institutional networks between business and state across developmental and post-developmental eras. The network was a hierarchical organization which handled transactions that might otherwise be carried out in the market place during the developmental era (1960s-1980s), but the entity was transformed into a symbiotic relationship in the mid-1980s. Lee and Naya (1988) called this hierarchical internal organization the “quasi-internal organization.” During dense industrialization in the 1960s and 1970s, the state’s relationship with major enterprises was intimate, direct, and dense, although the state, as the senior partner, directed and disciplined its private counterpart, as a junior partner (Jones and Sakong 1980). But, during the 1980s and 1990s, the hierarchical organization of the business-state nexus has been in steady transition. The old pattern of the nexus came under high distress, owing to both the shifting balance of power between state and business, and the urgent need to accommodate the market-deepening process in Korea. The later business-state nexus was characterized by less dense and intimate linkage, but the role of the business-state nexus as a key institution dealing with pivotal developmental issues hardly diminished even during the post developmental era (1990s).

Initially, however, such arrangements between business and state facilitated communication and cooperation between the two, mostly with information sharing about

prospects of the global market, administrative directives and guidance, private business' investment intentions, and so forth. The "corporate-structure-like" organization created a greater flow of information than would be possible through markets. "The quasi-internal organization" persistently reinforced incentives for both government and business to engage in productive activity and was also effective in reducing transaction costs by slimming down the "problem of information asymmetry" between principal (government) and agent (big business) (Refer to Douglass North for a debate on transaction cost and information asymmetry, 1990:27-35). Credit allocation, distribution of business licensing, and auditing credit recipients' performance all involved the issue of informational asymmetry between government and business. The market was an inappropriate tool to distribute these developmental resources, due to the backwardness of its information distribution system. Rather, the "quasi-internal organization" was able to save some costs by the "internalization of transaction costs" (Lee, Chung H. 1992).

The second benefit accrued from regular, frequent, long-term interactions of business and state is the development of "trust" and "cooperation" between the two. As shown in Robert Putnam's work, "...the greater the communication (both direct and indirect among participants), the greater their mutual trust and the easier they will find it to cooperate" (Putnam 1993:174). From private business's perspective, a "trustworthy government" diminishes uncertainty, lengthens the time horizon and cuts down the risk level business must bear. As a result, there will be a high increase in investment by the private sector. A private system, pursuing profits, is likely to be hesitant to invest if high uncertainty prevails. In most developing countries, property rights are flimsy and market

uncertainty is high, alongside political instability. In particular, with respect to economic transformative programs, private business calls for withholding investment until much of the residual uncertainty regarding the eventual success of the economic transformative program is eliminated (Dani Rodrik 1991). Thus, a public system must be able to guarantee political stability and deliver its commitment to the goal of development to the private system through its networks. When the trust level is really high between the two, the pattern of investments will be transformed from a short-term to a long-term horizon, from smaller-sized to larger-sized, from a slower to a quicker pace. Trust between business and the government system can reduce transaction and monitoring costs (Schneider and Maxfield 1997:12-14).

Tight networking between the two fosters “robust norms of reciprocity,” again according to Putnam (1993). Frequent interactions “are apt to develop strong norms of acceptable behavior and to convey their mutual expectations to one another in any reinforcing encounters” (Putnam 1993:173). The robust norms of reciprocity reduce the chances for both parties to be free riders or for cheating. Private partners must make some contribution to development in return for preferential credit allocation and financial subsidies. Whether or not a state is able to keep its private partners from shirking their contribution is a key determinant for the success or failure of the economic program. Governmental elites attempt to persuade their private partners to remain in the reciprocal agreement on developmental programs. Monitoring, disciplining or punishing free riders in the private sector is simply too costly or almost infeasible without a robust norm of reciprocity between the two. The breakdown of “reciprocity” often leads to a “predatory

state” in the public system and “rent-seeking” by private power holders (Schneider and Maxfield 1997:10).

However, there is danger implicit in an intimate, direct business-state linkage. It can digress from a constructive and goal-oriented collaboration and turn into a rent-seeking collusion. Or, it can run into organizational failure simply because the scale and maturity of the economy outgrows its institutional shell. If the “quasi-internal organization” does not turn itself into an institutional system which can accommodate changes occurring from rapid economic growth and transformation, it will generate a serious “moral hazard” problem. If the state-business relationship remains a principal-agent relationship in terms of credit and equity rationing, in particular, under a full-fledged economy, a “moral hazard problem” will be appear as the predominant pattern in the business-state nexus, because there will be increasing informational asymmetry between private agents and the public principal as the economy gets larger and more complex. Accordingly, the pattern of the business-state nexus must be adaptable alongside economic and political development.

Now, let us turn to the question of how we can keep the business-state nexus from degenerating into a rent-seeking collusion. What sorts of forces continue to hold the business-state nexus on the right track of constructive and efficacious collaboration? How can we protect the responsiveness and adaptability of the business-state nexus from outside shocks or a changing economic environment? Private business would be tempted to use resources wastefully or unproductively in growth-inhibiting ways unless monitoring and discipline measures were properly installed or the costs of credit diversion were bigger

than the payoffs. Government officials also would be exposed to the rent-seeking private business, owing to the fact that discretionary power over budget, credit allocation, and other public resources will generate “rent.” What sorts of forces discipline state and business in the absence of public accountability? Previous business-state literature listed several institutional, contextual factors which are essential in keeping the business-state nexus on the right track of constructive collaboration: 1) coherent cohesiveness in the internal structure of the state (Evans 1995; 1997; Schneider & Maxfield 1997); 2) development-driven political leadership (Onis 1991; Lim and Paek 1987); 3) outward-oriented development strategy (Kang 1996; Lee 1992); and 4) power balance between the private and public sectors (Haggard, Maxfield and Schneider 1997; Kim Eun-Mee 1997). Unlike previous studies which centered on only one or two factors in interpreting the business-state nexus, my “combined business-state model” incorporates all of the above-mentioned factors into this inquiry, except for the outward-oriented developmental strategy, and examines which forces define the strategic interactions of business-state in any given time period.⁴ The reason why my “combined model of business-state” is superior is clear, as compared with previous studies on the business-state nexus. Each one of the approaches mentioned above may be appropriate or inappropriate, depending upon the time period chosen to study. Selection bias has been prevalent in this area. One

⁴ Although different from my combined model in terms of research purpose, there is a model which incorporated a wide scope of institutional components of government and tested whether or not there was a strong correlation between institutions of governance and development performance in Latin America and East Asia. Campos and Lugent (1999) included in their model 1) the executive, 2) the bureaucracy, 3) the rule of law, 4) the character of the policy-making process, and 5) civil society. (Refer to Campos and Lugent, *World Development*, Vol.27, No.3, pp.439-452, 1999).

variable is likely to have more explanatory power than others in any given historic period, because each variable works differently in the context of the whole (Charles C. Ragin 1987).

In the context of institutional and contextual forces which maintain the business-state nexus on the right track of constructive collaboration, first, C. H. Lee (1992) and M. H. Kang (1996) contend that market competition is necessary to ensure the survival of the quasi-internal organization as an efficient credit allocation tool. Under an outward-oriented economic system, there is a mechanism which corrects inefficient credit allocation carried by a tight business-state linkage. “For a small developing country committed to an outward-oriented development strategy, prices are externally determined parameters. The government cannot thus arbitrarily change prices to cover the consequences of an inefficient allocation of credit” (Lee 1992:193). In short, credit allocation via business-state networking would match what the market would do. But the applicability of this explanatory model greatly depends upon the extent to which a nation’s economy is associated with exports and imports. In addition, this structural variable is too deep and too wide to explain variations in the efficiency of the business-state nexus across different time periods. This functionalist approach has very limited usefulness for this study, although the underlying logic of the argument seems to work, to some extent, in small countries.

Second, statist insist that “government-business relations cannot be interpreted without first specifying the internal structure of the state” (Evans 1997:66). Many developmental studies refer to Weberian bureaucracy in their account of why the self-

interested public officeholders in East Asia were able to carry out the collective goal of economic development, instead of falling prey to the rent-seeking private businesses (Chalmers Johnson 1987; Peter Evans 1995, 1997). “Weberian bureaucracy,” which is an indispensable element for a collaborative relationship between business and state, mainly features a corporate cohesion of the organization, an unambiguous location of decision-making and channels of authority and internal traits fostering instrumental rationality and activism (Max Weber 1958). These features of Weberian bureaucracy are positively associated with the state’s capacity to monitor and discipline individual incumbents, so that they are constrained to behave as members of a larger collectivity with a more encompassing set of interests such as economic reform programs (Peter Evans 1997:68).

The first feature of a Weberian bureaucracy is most likely to be constructed on the foundation of a merit system of recruitment (Peter Evans 1997:69). If governmental positions are distributed, not on the basis of merit, but on the basis of patron-client networks and kinship, officeholders are not only expected to be less competent in managing their jobs but also to destroy internal cohesiveness within the bureaucratic organization. Second, in relation to a Weberian bureaucracy, the patterns of reward systems for recruits are as important as the patterns of recruitment. Without a carefully-designed compensation and promotion system, recruits can hardly be expected to pursue their lifelong careers within the government. The overall combination of incentives, whether the incentives are based on material compensation or social prestige, is highly correlated with the aggregate capacity of the officeholders. It is well-known that high performing Asian economies have all made deliberate efforts to compensate government

officials with high job security, salaries comparable to the private sector and generous retirement benefits (World Bank, East Asian Miracles 1993a:176-177; Evans 1998:70-71). Maintaining a high quality labor force within the government is also important in that officeholders could acquire cultural legitimacy to rule over their civilian partners. Third, coherent organizational unity within the bureaucracy was also promoted by the purposefully designed assignment of decision-making power and by clarifying the unambiguous location of decision-making within the bureaucracy (Kim Byung-kook 1994:167-210). With institutional clarity of the channels of authority in the decision-making process, the state could maintain the corporate coherence necessary to pursue collective goals among different cabinet ministries. In other words, whether or not a well-designed policy coordination system exists is critical to holding the bureaucracy together. In short, Weberian bureaucracy is characterized by a meritocratic recruitment system, a rewards system comparable to the private sector, and the institutionalization of a clear decision-making location. These institutions are critical sources in disciplining state and business. But we must explain where these Weberian characteristics came from. What sorts of political forces or incentives drove political leadership to install Weberian bureaucracy?

The so-called “developmentally-driven” and “developmentally-determined” collective political leadership is often referred to as the original source for Weberian bureaucracy. East Asian leaders’ single-minded adherence to growth and industrialization at the expense of other objectives has been conducive to elite unity around developmental-oriented ideology and thereby keeps the bureaucratic system from becoming involved in

predatory practices (Ziya Onis 1991). There has been a long litany of developmental elites in East Asia, such as Prime Minister Lee Kuan Yew in Singapore, Presidents Khama and Masire in Botswana; President Park Chung Hee in Korea (Lim and Paek 1987), Prime Ministers Tunku Abdul Rahman, Tun Razak and Dr. Mahathir bin Mohamad in Malaysia (Ahmad 1989). The core of developmental elites consists of economic technocrats and career bureaucrats rather than political and legislative elites (Leftwich 1995:405-406). However, studies on developmental elites must be reorganized in such a way that they show that there is a clear correlation between leadership and its disciplining effects on the business-state linkage. First, we must demonstrate whether or not a strong correlation exists between the unusual degree of external threats confronted by the East Asian states and the leaders' policy priorities in the region. The security threats have been commonly referred to as one reason why leadership in East Asian was solemnly committed to rapid industrialization (Amsden 1989; Deyo 1987; Johnson 1982; Wade 1990). Second, we must examine whether or not the high commitment to growth by the leadership led to the protection of developmental elites from the political pressure of distributional coalitions. Without firm backing from the chief-executive, developmental elites are often exposed to the political pressure of societal groups or political pork-barreling. Accordingly, the institutional autonomy of the core economic apparatus is a critical factor in securing the business-state nexus on the right track of constructive collaboration.

But under which political environment is the chief-executive willing to protect economic technocrats? Only the dynamics of "regime survival politics" determine the utility calculation of a ruler. Rulers are always greatly concerned about retaining and

expanding their power. To accomplish this political objective, rulers are likely to utilize the resources available to them including public spending and personnel recruitment. In the turbulent politics of developing countries where the degree of institutionalization is low, executives can rarely take political survival for granted. It seems that the executives mobilized two main resources in their hands, public spending and the recruitment of bureaucrats, to construct political coalitions, which are the cornerstones for survival. Public expenditures rise as a way of ensuring that a leader's followers remain loyal to him. Bureaucratic appointments are often used as a key instrument to deliver biased allocations to his favored constituency (Barry Ames 1987). In short, it is believed that "regime survival politics" is correlated with bureaucratic appointment in the Korean case in particular.

Previous studies on leadership were often executed in a non-systematic way, so that they failed to demonstrate the correlation between significant factors. In addition, there have been few studies done on whether or to what extent democratization changes regime survival strategies and thereby the leadership's commitment to economic progress. Unlike previous studies in which discussion of leadership was often based on anecdotes, we will empirically measure the degree to which the leaders were determined to guarantee the institutional autonomy of the core economic apparatus, by inquiring, first, into the chief-executive's policy priorities and, second, into the recruitment of developmental elites by the chief-executive across different regime types. In short, political leadership will be incorporated into this study, primarily questioning whether or not political leadership inflicted damage on the institutional autonomy of core economic agencies.

The last group of variables which are incorporated into the “combined model of business-state,” concerns capital resources in the hands of both business and state. Who dominates between business and state is inevitably associated not only with institutional but also material resources. The discussion on material resources must touch on the private sector, in the South Korean case, the Chaebol, by a close look at: 1) its overall capital power; 2) the political consequences of corporate organization; and 3) the different types of business associations. One group of business-state approaches emphasized that the state’s policy options are constrained by the capitalists’ control over physical and financial assets and capital mobility. “Capitalists do not even have to organize and act collectively: it suffices that they blindly pursue narrow, private self-interest to sharply restrict the options of all governments. This is the theory of ‘structural dependence of the state on capital’” (Przeworski and Wallerstein 1988:12). Albert Hirschman (1978) also drew a clear picture of structural dependency in his article. “Movable property and its exit” work as a force to constrain the government’s leverage to maneuver the private sector. Hirschman’s viewpoint was carried over to the recent scholarly works on “capital mobility” under globalization of the financial market. The emerging consensus among recent works is that rising capital mobility has put pressure on governments to abandon regulatory controls (Goodman and Pauly 1993; Haggard and Maxfield, and Schneider 1997:38-39).

To apply these “structural dependency” works to the business-state nexus, in particular in the case of Korea, a large amount of capital in the hands of big business means that political survival of the regime becomes reliant upon the economic

performance of big business, improving big business' leverage against the state. High economic concentration in a handful of diversified, giant conglomerates did entrap the state as a captive, leading to the utilization of the business-state nexus for the promotion of their narrow, particular interests. Deepening the state's "structural dependency" upon "big capital" was inevitable as capital has grown bigger (Peter Evans 1997). The state's dependency on big business also means that the state is no longer autonomous from business in setting the long-term economic agenda. Losing autonomous power often results in that the strategic policy goals of the state reflect primarily the interests of big business rather than the genuine interests of the overall national economy. Especially political regimes which are sensitive to economic fluctuations for some political reason will be more vulnerable to the movements of capital, because the level of investment determines economic growth and private-sector actors control investment decisions. The consequential effects of "structural dependency" on the business-state nexus will be explored by a close examination of changes in the ratio of economic concentration in the hands of the Chaebol, because the big business groups' decision-making power on investments will be reflected by their sheer weight in aggregated economic activities. However, we must bear in mind that capital size alone cannot dominate the business-state relations. The effects of material resources both in the public and private sectors would be channeled through their institutional settings. Thus, this structural variable will be examined in the context of institutional settings in my "combined model of business-state."

However, the political effects of the Chaebol's capital control must be examined in

the context of the traits of corporate structure. For instance, private business, especially in developing countries, is not capable of internal financing, but a large part of business funds come from external sources, such as banks, money markets, non-banking financial institutions, foreign borrowing, and even curb markets. And these external financial sources are often under governmental control or regulation. Threatening a corporation with the cutoff of capital is credible when the government controls the flow of major corporate capital (Pempel, T. J. 1999). Haggard, Maxfield and Schneider (1997:37) contend that “characteristics of corporate structure, including size, internal organization, ownership, and patterns of financing, seem to affect both business preferences and the leverage that firms have vis-a-vis government actors.” The debate on this issue is basically concerned with how the structure of the Chaebol is associated with the structural characteristics of the business-state nexus and, as a consequence, with economic development. As Haggard, et. al., (1997:48) noted, “the size, financing and diversification of big business in developing countries can have important implications for relations between government and business.”

Large conglomerates with highly diversified business lines and high capital concentration have been recommended as a positive force for rapid economic growth for different reasons. Amsden (1989) and Amsden and Hikino (1994) emphasized the economics of scope occurring from the diversified business organization of Korean Chaebols. Korean conglomerates have been at an advantage in negotiating and borrowing technology from foreign firms because the diversified business lines make it possible for the conglomerates to utilize the same technology in other plants and to jointly handle its

negotiations over technology rent and licensing. Some Korean scholars (KERI 1995) referred to the extensive diversification of business lines by Chaebols as a positive force in business-state relations. Based on Olson's work (1982), they emphasized that the encompassing organizations of the Chaebol have become more concerned about the prosperity of the overall national economy than the particular distributional interests. "Most distributional coalitions slow down a society's capacity to adopt new technologies and to reallocate resources in response to changing conditions, and thereby reduce the rate of economic growth" (Olson 1982:74). But the size and scope of the Chaebol make them shy away from collective actions which are inimical to economic growth, rather they become more interested in promoting the national wealth.

But the diversification of business does not always work positively for the national economy. Korea has slowly graduated from catch-up economy status and therefore "technology rent" no longer weighs as heavily as in the past. More importantly, at the moment when the Korean Chaebol must lead technologically in some industrial sectors, like semiconductors, steel, and shipbuilding, deep specialization in a particular business line turns out to be necessary and indispensable by concentrating capital and managerial resources in a limited number of business lines. Furthermore, early studies did not see the potential negative implications of conglomerations, that the extensive diversification, complex financial transactions, high capital concentration, and ownership concentration of the Chaebol would create a number of monitoring and regulatory problems for the government. And the "Olson-based argument" also lost its persuasive power as the Chaebol clashed with the government in the context of market-oriented reform. The

organizational structure of the Chaebol, which went along with the state-led economy, turned out to be in conflict with the market-deepening process. In Chapter IV we will debate extensively the issue of why and how the Chaebol system began to work against the market-oriented economy and have an inimical effect on business-state relations. In short, this study attempts to correct the fallacy of previous studies that the political consequences of a corporate organization are always positive. I contend that the consequential effects of a certain type of corporate organization on the business-state nexus changes, depending upon the phase of economic development.

Which side, state or business, reserves the “power of financing” for investment projects and managerial expenditures would also be a critical factor in determining who will dominate the business-state tie (Shin Hee-keun 1993; Choi Pil-sun 1990; Kang Seok-ryul 1994). If corporations are capable of financing their investment projects and daily business funds without help from the government, the state would be extremely handicapped in its venture to get business to comply with its transformative programs, unless business cooperates voluntarily with governmental programs (Haggard, Maxfield, and Schneider 1997:46–48). Discerning the extent to which business or government holds financing power involves a wide range of financial variables: First, a high ratio of policy loans relative to total bank loans, which have accounted for the lion’s share of business funds during dense industrialization, is assumed to be positively associated with the government’s power to induce business into its transformative programs, and vice versa in

the case of a low ratio (Choi Pil-sun 1990). Second, corporations' structure of financing⁵ is also a critical factor in understanding which side will prevail in the economic arena. If a large share of business funding comes from "internal reserves" rather than borrowing from domestic financial institutions or foreign borrowing, both of which have been controlled by the government, business would not sway under governmental pressure to comply with its transformative programs. Third, who controls foreign borrowing also has strong implications in the context of the economic power balance between state and business, because foreign capital has accounted for a large part of financing in Korea.

Although slightly different from business' financing ability, the "financial vulnerability" of business (the average debt-to-equity ratio of corporations) is also likely to play a critical role. Debt-ridden businesses in Korea are, in general, very vulnerable, especially during an economic downturn (Wade and Veneroso 1998). We might expect Korean firms with a high debt-to-equity ratio to be more attentive to government directives if they think the government is their last resort for help (Haggard, Maxfield, and Schneider 1997:46). The quick recovery of state autonomy from big business under President Kim Dae-jung (1998-present) is largely attributable to the high financial vulnerability of the Chaebol. A policy measure halting the injection of new capital to the financially distressed enterprises would be sufficient for the government to bring business

⁵ The sources of financing can be divided into two broad categories: internal funds and external funds. Internal funds include "savings for depreciation," "appropriation," and "internal savings," whereas external funds consist of borrowing from monetary institutions (banks and non-banking financial institutions), security markets and money markets (issuance of stock and corporate bills), government and curb markets, and foreign financial institutions and other foreign sources. Firms in developing countries tend to rely upon external sources, while firms in advanced industries upon internal sources.

back into the government-drawn reform programs, because the most debt-ridden enterprises would be pushed to the brink of collapse during economic recession. In short, the debt/equity ratio across different time periods is incorporated into my combined model of business-state nexus.

Thus, my research effort to explore changes in the structural characteristics of the business-state nexus includes a wide number of variables, including, first, the internal structure of the state; second, political leadership; third, overall capital power; and fourth, the characteristics of corporate organization. The structural characteristics of the business-state nexus basically concern: who governs or dominates the business-state linkage; the extent to which each side is autonomous from its partner; whether it remains in goal-oriented, constructive collaboration or turns to rent-seeking collusion; the degree to which the business-state is free from rent-seeking or corruption; and the extent to which the business-state nexus is responsive to outside shocks and adaptive to newly emerging economic environments. The above-mentioned critical factors in determining the nature of the business-state nexus can be summarized by the following formula:

$$Y_i = S_{i-k} + E_{i-k} + e$$

where,

S_{i-k} is a vector of state structure variables that include:

S_a : Bureaucratic system (Recruitment system, Reward system)

S_b : Policy-making regime (policy coordination system)

S_c : Political leadership (Institutional autonomy of core developmental agencies)

E_{i-k} is a vector of corporate organizational characteristics variables that include:

E_a : Degree of economic concentration in the hands of big business

E_b : Diversification of big business groups
 E_c : Financing ability of corporations
 E_d : Financial vulnerability of corporations
 E_e : Government's power to control credit allocation

Y_i : Structural characteristics of the business-state nexus

Y_i : Our dependent variable will be measured by the success or failure of economic transformative programs across different time periods. Simple economic growth rate does not reflect the traits of the business-state nexus. Transformative programs, which aim at the reconstruction of Korean industry or the whole economy into more competitive forms in the near future, are an area in which researchers are able to measure the "responsiveness," "flexibility" and "adaptability" of the business-state nexus during a given time period. This variable will be operationalized with empirical measurement of whether or not each transformative program attained its policy target at the end of the program. There have been five major transformative programs: 1) Restructuring Economy: outward-oriented economic system (1963-1970); 2) Deepening Industrialization: Heavy-Chemical Industrialization (HCI)-drive (1973-1979); 3) "Slouching toward Market": HCI Restructuring and Industrial Rationalization (1980-1986); 4) Market Deepening (I): Chaebol reform (1987-1997); 5) Currency Crisis and Market Deepening (II): Financial and Chaebol reform (1998-present). Each one of these programs was selected after extensively examining the government documents published by pilot economic agencies.

My "combined model of the business-state nexus" is distinguished from previous studies on economic development in several ways. First, it is a "dynamic model" which can grasp the changes in the business-state nexus and associate those changes with the failure or success of economic transformative programs. In this dynamic model, the internal structure of the state and corporate organization have been in a changing rather than a stationary mode. In addition, a certain characteristic of organizational and institutional settings in both public and private sectors can be conducive or inimical to economic transformation, greatly depending upon the conjunctural combination of variables in a given time period. Rather than saying that one institutional character is

always benevolent to economic progress, this model insists that “it depends on the context.” Second, it is a “combined model” which incorporates a wide scope of variables and tests against the empirical world whether or not a variable has explanatory power. It diverges from statist and Marxist literature, which centers on state structure and economic base, respectively. Neither is the top-down nor the bottom-up explanation applicable to the case of Korea. By taking a close look at both institutional and material resources in the public and private sectors, the “interactive interpretation” of business-state relations expands our understanding of economic development. By doing so, not only will the root cause of the “miracle” but also of the “meltdown” be disclosed. Third, it is a “systematic model” which intends to uncover changes in the business-state nexus in a methodical manner. Even recent business-state approaches (Yun-han Chu 1994; Chung-in Moon 1994; Andrew MacIntyre 1994; Hsin-huang Michael Hsiao 1995) cannot escape from criticism on a few points. First of all, most recent works are still too descriptive and empirically weak, mostly underpinning their findings with anecdotes rather than with consistent empirical data. Second, their works cover a relatively short period of time, so that they are not able to sort out which variable is explanatory based on comparison and contrast across different time periods. It is believed that comparison and contrast is the basic tenet of the scientific approach, but previous works failed to engage in this basic operation.

MEASURING MAIN VARIABLES

S_{a.1}: Bureaucratic Foundation: Recruitment System (Tables 2.17 & 2.19)⁶

In order to measure the extent to which the recruitment system has been open, transparent, and competitive, first, the rates of competition in civil service examinations at different levels between 1949 and 1997 were examined (Table 2.17). Second, the openness and transparency of the recruitment system was measured by the ratio of recruitment through open civil exams (Table 2.19)

S_{a.2}: Bureaucratic Foundation: Reward System (Graph 2.3 & Tables 2.15 & 2.20)

Regarding the reward system, the main research concern is whether or not the overall combination of rewards for career officeholders was commensurate with those available to people of comparable qualifications in the private business sector. However, data which indicates the overall combination of rewards is not available. Thus, relative salary was substituted for the overall combination of rewards (Table 2.20 & Graph 2.3). This study also measures the labor quality of career civil servants relative to employees in the private sector by examining the proportion of college graduates across the two different sectors (Table 2.15).

S_{b.1}: Policy Making Regime: Policy Coordination System (Table 2.8)

The “policy coordination system” concerns the degree of coherent cooperation

⁶All tables follow the chapter for which they are numbered, e.g.: Table 2.1, 2.2, 2.3, etc., follow Chapter II. All graphs and tables numbered “A.#” are located in the Appendix.

among major and minor economic cabinet ministries. Various institutions were researched, including the Ministerial Cabinet Meeting (MCM), the Conference of Economic Ministers (CEM), and the Conference of Vice-Economic Ministers (CVEM). The Korean government's intention was to coordinate and intermediate economic policies among economic agencies using the three aforementioned institutions. It became clear that the "ratio of original bills passed without revision" in the CVEM was most likely to indicate the degree of unity among the involved agencies, because the members of CVEM (who were bureaucratic technocrats with long careers within the ministry) were, in fact, in charge of the practical issues involved in economic programs, representing their ministerial interests. A high ratio of bills passed without revision implies a high degree of unity, under then-bureaucratic practices in which most economic bills initiated by a competent ministerial section were pre-determined among the involved parties via informal connections before they reached the CVEM table.

S_{b-2}: Economic Policy-Making Regime: Degree of Power Concentration (Table 2.14)

In order to measure the concentration of economic policy-making power in the hands of the Executive (economic agencies), this study probed into the legislative power of the Executive and Legislative branches regarding economic bills. Knowing who initiated the economic bills and whose bills passed without revision on the floor of the National Assembly is critical to understanding who was in charge of policy-making. When the Legislative was in charge, it is assumed that there would be more input from interest

groups in the policy-making process, because the National Assembly provided interest groups with ample, malleable political room in which they could pursue their interests. Thus, a higher ratio of legislation initiated by the Executive, relative to total legislation, and a higher percentage of executive bills passed without revision imply that economic policy-making was concentrated in the hands of the Executive.

S_{c.1}: Collective Political Leadership: Development-driven Leadership (Graph 2.1 & 2.2)

This study examined whether the political leadership was development-driven by looking at the chief-executive's policy orientations. This study quantified the presidents' inaugural addresses and annual "State of the New Year Messages" into different ideological categories over time. Then, this study attempted to determine which ideological orientation motivated political leadership to be committed to economic progress.

S_{c.2}: Collective Political Leadership: Institutional Autonomy of Economic Agencies (Tables 2.5 & 2.6)

Measuring "Institutional Autonomy of Economic Agencies" concerns the assessment of the chief-executive's determination to prevent political pork-barreling from influencing his appointment of elite technocrats in core economic agencies. First, the career backgrounds of the core economic ministers before their appointments to their positions were examined. A large percentage of career politicians assigned to the core

economic agencies has negative implications for “institutional autonomy,” owing to the strong tendency of politicians to reflect the imminent political interests of the ruling party rather than economic rationale in policy programming (Table 2.5). Second, this study examined the extent to which each chief-executive attempted to inject his political proteges into the core economic machinery (economic planning agencies, banks, financial supervisory commissions). It can be assumed that the chief-executive’s biased appointments of his political proteges to economic positions inflicts damage on “**I**nstitutional autonomy”. This study tried to measure the degree to which the chief-executive attempted to transform the economic agencies into regime supportive machinery through biased assignment of his loyal constituents (elites from his hometown) at the cost of institutional integrity and autonomy of the nucleus economic apparatuses (Table 2.6).

E₂ = Economic Power of Big Business: Degree of Economic Concentration in the Hands of Big Business (Table 3.25 & Graph 3.6)

This variable concerns the rise and fall of the “state’s structural dependency on big capital.” This variable measures the share of the national economy controlled by big business. The relative significance of big business in the Korean economy can be measured using four different indicators (total assets, sales, employment, and value-added) which are commonly employed to gauge the degree of “general economic concentration” (Hwang, In-hak, 1997:89-91). Each index (e.g., the percentage of total assets held by the top 10 or top 30 big business groups relative to total national assets) implies the relative weight of the largest 10 or 30 Chaebols in each category of the manufacturing sector.

E_b: Degree of Business Diversification (Table 3.28 & Graph 3.5)

This variable is complementary to the above in measuring the economic power of big business. It is assumed that the larger the number of industries in which big business groups are involved, the more influential power on the society they have (Table 3.28).

Thus, the number of affiliated firms under big business groups and the number of business lines under big business groups were considered here.

E_c: Financing Power of Corporations (Tables 3.10 & 3.11, Graph 3.3 & 3.4)

The financing power of corporations concerns what ratio of business funds can be internally mobilized, without depending on external sources such as bank loans, issuance of stocks and corporate bonds, foreign borrowing and other loans from non-banking institutions. A higher ratio of “internal reserves” within firms means higher financing power and financing independence from external powers. Corporations with a higher ratio of internal reserves are more likely to be resistant to governmental pressure, because they do not have to plead for more loans from the government-controlled banks. However, in order to grasp the overall picture of the financing power of corporations, a close examination is necessary of not only the proportion of “internal reserves” relative to total business funds (Table 3.10), but also of the structure of external sources, due to the fact that, among external sources, issuance of valuable securities and borrowing from non-banking financial institutions (insurance, merchant banks, and others) could be carried out without governmental help. Accordingly, we examined the structure of financing (Table 3.10) and the structure of external sources (3.11) at the same time.

E_d : Financial Vulnerability of Business (Table 3.29, Graph 3.8)

To grasp the overall picture of the financial vulnerability Korean firms have faced, this study examined the average debt-to-equity ratio of Korean corporations. It was assumed that highly leveraged business groups would be more attentive to the reform directives of the government. When the ratio of indebtedness was high among corporations, the government was expected to enjoy an edge over private business.

E_e : Government Power to Control Credit Allocation (Tables 3.22 & A.2, Graphs 3.1 & 3.2)

The government's power to control bank credit was measured by the weight of the governmental policy loans relative to total money lent, notwithstanding that the government was involved in a wide range of control over financial institutions (controlling interest rates of general bank loans and interest rates for deposits, determining to whom bank loans were available and who ran financial institutions). The size of policy loans really reflected the extent to which the government was involved in the credit allocation process (Table 3.22). In order to measure the power of policy loans accurately, the gap between the interest rate of policy loans and of general bank loans must be considered, because policy loans have substantial power to induce business into the government's transformative programs only when the interest rate gap is considerable. Thus, in Table 3.22, the "ratio of policy loans" and "interest gap" are displayed together. The "interest gap between policy loans and general bank loans" was calculated using only the interest rates of export funds (which have been the most significant policy loans since 1961),

although other diverse policy loans have existed. More information on various interest rates is available from Table A.2 and Graph 3.2.

JUSTIFICATION OF THE RESEARCH METHOD AND DATA SOURCES

The fundamental approach to the question raised is the case study. South Korea was selected for this case study based on the unique existence of the Chaebol whose political/economic power was overwhelming society, owing to their sheer size and diversified power. The presence of the Chaebol presents a political quandary which diverges from other Asian NICs during market-oriented reform. For instance, market deepening programs such as deregulation, liberalization, or economic openness are deeply entangled with restructuring the Chaebol system. In addition, the power of private business more quickly overrode the power of the state in Korea than in any other country in East Asia. For instance, without an adequate understanding of how the existence of an overgrown power holder in the private sector restricts the range of policy choices by the state during democratic rule and how and why political and economic reform programs were boycotted by the Chaebol, the root cause of the financial crisis in 1997 could not be unraveled in an appropriate manner, unlike other Asian countries. This case study may also shed light on the cases of other Asian countries which will follow the suit of Korea in the near future, as the private sector eventually grows bigger and overrides state power.

Within a case study framework, this study employs a “comparative-historical analysis,” basically comparing and contrasting the different patterns of the business-state nexus and their economic performance across different time periods. I did not approach

the issue of the business-state nexus with one single pre-determined answer. Unlike the theory of the state's structural-dependency, the statist approach, or the theory of corporate organization, this study attempts to sort out which variable had more explanatory power alongside historic comparative analysis. Except for the main underlying assumption that the strategic interactions of business-state are defined by institutional and capital resources held by both state and business, there was no *a priori* **theoretical** paradigm providing initial answers to the research questions. This study first **defined** patterns in the structural characteristics of the business-state nexus across different **time** periods and tried to correlate these patterns with the well-defined outcomes of **economic** transformative programs. This study primarily utilized Theda Skocpol's **controlled** comparison of macro phenomena by using the methods of agreement, similarity **and** difference. But, this "similarity and difference method" was complemented by **rigorous** data collection and graphic presentation. Thus, it shall be easy for readers to **determine** what happened.

The time periods covered in this study were divided into five segments along with five **distinctive** "economic transformative programs" which the Korean state pursued **alongside** dense industrialization (Refer to Figure 1.1): 1) Restructuring Economy: **outward**-oriented economic system (1963-1970); 2) Deepening Industrialization: Heavy-**Chemical** Industrialization (HCI)-drive (1973-1979); 3) "Slouching toward Market": HCI **Restructuring** and Industrial Rationalization (1980-1986); 4) Market Deepening (I): **Chaebol** Reform (1987-1997); 5) Currency Crisis and Market Deepening (II): Financial **and Chaebol** Reform (1998-present). These five transformative programs were selected

on the basis of an extensive review of government documents issued by the core economic agency, the Economic Planning Board (EPB, later to become the Ministry of Economy and Finance, MOEF). Transformative programs were the government's central policy targets to shift or reconstruct industrial structure in order to cope with the changing global economic environment. In particular, market deepening programs during the late 1980s and 1990s were the Korean state's endeavor to carry out a "paradigm shift" from state-led to market-led economy. Whether or not these economic transformation programs (policy preferences) have been carried out successfully is a dependent variable in this study. Previous developmental literature often neglected to rigorously and empirically test the correlation or causal-effect relationship by picking broad macroeconomic indicators as their dependent variables. Macroeconomic performance reflects not only a government's ability to manage the economy but also the combined effects of a large number of variables. By narrowing down the dependent variable to transformative programs, it is believed that this study is able to establish the correlation between the different patterns of the business-state nexus and transformative program results in an improved way. These economic transformative programs can be arranged according to the nature of the state as follows: 1) comprehensive developmental state (1961-1970, 1973-1979); 2) limited developmental state (1980-1987); and 3) post-developmental state (1988-1997, 1997-1999), as shown in Figure 1.1.

This "historic comparative analysis" will go through four different steps to explore the economic outcomes of business-state interactions over five different time periods. For each time period, this study will investigate: first, which type of connectedness between

business and state was constructed by the state; second, which transformative program was set by the government; third, the government's endeavor to induce business into strategic industries with the use of material resources; and, fourth, whether the nature of the business-state nexus was negatively or positively associated with the failure or success of transformative programs. As illustrated in Figure 1.2, the strategic interactions of business and state are basically defined by two broad categories of variables, that is, institutions and resources, in the private and public sectors. However, among the listed variables which are believed to influence business-state interactions, some variables which are less critical, for instance, taxation policy and the tariff system, were discarded from this model due to limited space. Some variables which do not vary across different time periods, for instance, structure of business associations, will be explored only during one period.

For the first step, I will inquire into the pattern of specific internal organizations of the business-state nexus over time. The pattern varies, largely depending upon the substance of the transformative programs. For instance, the heavy-chemical industrialization program under Park Jung-hee (1972-1979) required a very dense, direct, intimate linkage between big business and the state behind closed doors, while "industrial restructuring" programs were carried out by an intimate but loose linkage of business-state during the Chun Doo-hwan regime (1980-1987). Thus, the objective of reform programs was strongly associated with the pattern of connectedness.

The second step is laying out policy preferences by state and business. It is quite easy for researchers to detect which economic program was considered to be most critical

by state and business. The Korean government carefully blueprinted transformative programs for each period to move industrial structures on to the next phase of industrialization. For instance, the essence of transformative programs had been embodied in setting “target industries” on the basis of strategic market analysis and pushing these through with preferential credit allocations up until 1980. But from 1980 on, the Korean state turned its attention to “market-oriented reform” with transformative programs, which was quite distinct from the preceding periods. Especially in the context of “regulatory policies over big business,” divergent policy preferences between business and state would never disappear throughout different phases of policy implementation. Thus, the transformative program itself (whether policy preferences were convergent or divergent) required different types of institutional linkages of business-state.

The third step is to examine how the government manufactured an “incentive structure” to induce business to follow its policy goals. Concerning the “incentive structure,” the material resources held by state and business will be closely examined, specially focusing on credit allocations and political/economic threats from both sides. As for the first three periods (1960-1970, 1971-1979, 1980-1987), this part of the study involves examining how the government coaxed business to follow its policy targets, but during the last two periods (1988-1997, 1997-1999) it is concerned with how government-business interacted around critical transformative programs with the use of their institutional and material resources. This study measures how powerful the incentive structure has been across different time periods through an examination of the size of policy loans, foreign borrowing, and interest rates. The financial vulnerability of

businesses will also be examined to deepen our understanding of the “incentive structure.”

To measure industry-specific incentive structures, I will look closely at what portion of policy loans were poured into target industries to attract business.

In the last step, this study will judge the success or failure of transformative programs. The basic measuring method will be to see whether or not the policy goals were accomplished under the selected policy measures. After exploring the strategic interactions of business-state in each period, I will describe the growth of big business as the result of policy measures. These four different research steps will be stretched over five different time periods. By setting these variables in different historic periods, this study tries to demonstrate changes in the structural characteristics of the business-state nexus and associate these changes with the success or failure of transformative programs. Unlike previous studies on the nexus, the study covers a wider horizon of time and scope of variables, underpinning our argument on historical comparative analysis. This “comparative-historical analysis” will be backed by a mixture of qualitative and quantitative data, while maintaining a narrow and sustained focus on the changes in political institutions and policy locus.

PLAN OF THE STUDY

This study consists of four major parts: 1) laying-out the theoretical framework (Chapter I); 2) identifying the most critical variables (Chapter II); 3) historic comparative analysis (Chapters III, IV, V); and 4) explaining the findings (Chapter VI). The first part will be devoted to identifying the major issues involved in this study, a theoretical

discussion, developing hypotheses, the significance of this study, and the methodology to be used to test the hypotheses against the empirical world. In order to make the major issues of this study clear, the introduction will also conduct a theoretical discussion on the context of the historical background and the macro-economy of Korea. This chapter has already begun to address its purpose.

The second part is designed to identify changes in the internal structure of the state and political leadership, which are the most significant political variables. This study will summarize changes in political variables, so that readers can grasp a clear picture of the overall political change. The central concern of Chapter II is to demonstrate how democratization undermined the sources of state autonomy or changed the structural characteristics of the developmental state, while paying close attention to the role of the rising scale and complexity of the Korean economy as a driving force toward a post-developmental state. To prove the point, I will examine the bureaucratic recruitment and reward system, policy coordination system, and how the organizational and ideological cohesiveness of economic technocrats disintegrated with the rise of organizational interests within the bureaucratic system during democratization. As for political leadership, this chapter will inquire into how electoral politics changed the presidents' policy priorities and, as a consequence, changed the structural characteristics of bureaucratic elites at the locus of economic agencies and the financial sector under different political regimes. Along with that, I will also examine changes in the degree of political power concentration in the hands of the chief-executive as a result of democratization. The objective of this chapter is to show the different natures of the

“developmental state” (1960-1979), “limited developmental state” (1980-1987), and “post-developmental state” (1988-1999) with solid quantitative data.

The third part, Chapters III, IV, and V, is the main body of the “historic comparative analysis.” By narrowly focusing on the most critical transformative program for each period, each chapter is designed to examine which variable in the “combined business-state model” has the most explanatory power for the failure or success of economic transformation. “Comparison and contrast” will be used as the main method to discover what really happened. Chapter III concerns three economic transformations: 1) adoption of export-led economy (1963-1970); 2) Heavy-Chemical Industrialization (HCI) (1973-1979); and 3) restructuring the HCI-drive and rationalization of industry (1980-1987). The primary focus of the first period (1963-1970) is on how the Park regime restructured its institutional settings and firmly anchored the state’s leadership over the private sector, regarding industrial policy. Comparison with the early Rhee regime (1948-1960) in the context of the internal structure of the state will disclose why Park was able to restructure the Korean economy into an “export-led structure.” As for the second period (1973-1979), this study will center on Park’s political efforts to build the special agent to drive Heavy-Chemical Industrialization. The relatively quick fallout of the HCI-drive in the late 1970s will be explained by a close look at the political consequences of the special agent which had become subject to the ruler’s political interests. The third period (1980-1987) concerns the Chun Doo-hwan regime’s endeavor to repair the fallout of the HCI-drive and upgrade industrial structure, while handling the Chaebol, which became increasingly powerful in the early 1980s. The study’s main focus during this

period is on how Chun maneuvered private power holders to attain his policy goals, that is, “restructuring the HCI-drive and rationalization of industry,” whereas he attempted to embrace more market force. With this period, we will try to demonstrate that, even under mounting “structural dependency” of the state on the Chaebol, the Korean state was relatively successful in manipulating the Chaebol, mainly owing to the persistence of developmental leadership by the state, at least, during Chun’s early reign (1980-1984).

Chapter V concerns the “dual transformation”: market deepening programs and democratization during Roh Tae-woo (1988-1992) and Kim Young-sam (1993-1997). Special attention will be given to the consequential effects of democratization on the internal structure of the state and political leadership. Because the essence of the democratic effect on state structure is presented in Chapter II, our debate on institutional linkage between state and business will be spent on rising corruption and collusive elite structure in economic agencies. More importantly, we will explore why the Chaebol increasingly turned into a stumbling block to market-deepening. No longer were the Chaebol in accordance with market forces or governmental market-oriented reform. The detailed descriptions of the strategic interactions of business-state, in the context of market deepening programs, will disclose that the Korean state had been captured by the Chaebol, not only because of the Chaebol’s overall capital power but also the disarray, dislocation and politicization of the bureaucratic system, the institutional distraction of the chief-executive, and the breakdown of institutional autonomy in economic agencies. In the last part, this chapter singles out the failure of Chaebol reform as the root cause of the financial crisis in 1997.

Chapter V concerns the Korean state's impressive handling of the currency crisis and subsequent financial market and corporate reform during the Kim Dae-jung presidency (1998-1999). We try to unravel why the Korean state, once low in responsiveness and adaptability to external shocks, has become effective in dealing with economic crisis. The dynamics of crisis politics will be explored to explain the quick reclamation of dominance by the state, although in relative terms, over private power holders. The persistence and changes in the patterns of strategic interactions between business and state will be discussed to define the limits and potential fallout of the ongoing Chaebol reform program, though relatively successful up to the present. The last chapter will be spent on the explanation of the findings. Findings will be organized first in the context of the overall theoretical framework and, second, according to each variable. The review of the "combined business-state model" will engage in discussion on the prospects of the business-state nexus in Korea in the future and the transferability of the Korean model to other developing countries.

CHAPTER II

THE CHANGING BUSINESS-STATE NEXUS (I): THE INTERNAL STRUCTURE OF THE KOREAN STATE

This chapter concerns the rise and fall of the developmental state in Korea.

Changes in the structural characteristics of business-state relations cannot be adequately understood without first specifying the changes in the internal structure of the state. The health of external linkage with the private sector, to a large extent, depends upon the internal coherence of state structure. Without internal coherence external linkage is predicted to result in corruption and the capture of the state by private power holders. My discussion of the internal structure of the state involves three key institutional components which constitute the Korean developmental regime: *1) the collective political leadership; 2) the policy-making regime; and 3) the bureaucratic system.*

First of all, this study explores what sorts of dynamics of coalition politics foment developmentally-driven or corruption-prevalent collective leadership. Coalition politics reflect the regime's survival strategy. Political regimes in Korea have striven to manufacture different patterns of political coalitions among social groups over time, given the political climate. My study on coalition politics over time is designed to grasp the *political aspects of the state*. Politicians, more precisely, the president, not the bureaucracy, ultimately controlled the policy-making process. In addition, the policy-making regime and the bureaucratic system were often restructured according to the political regime's political task. In particular, in the case of Korea, the chief-executive directly and extensively intervened in the economic policy-making process with well-

defined and concentrated power, as compared with other Asian countries (Cheng, Haggard, and Kang, 1998). Thus, exploring the presidency will unravel some significant aspects of the business-state nexus in Korea. This study seeks to focus on the following questions: *1) How did the “developmentalist coalition” emerge in the early 1960s and fade away from the early 1980s? How did regionalism arise as the predominant political dimension which defines coalition politics, following democratization? 2) Why did the Korean chief-executives single-mindedly adhere to economic progress during the developmental era? 3) Were there significant changes in the chief-executives’ adherence to growth and economic development across different time periods? 4) Did electoral politics or democratization lead to changes in the regime survival tactics and thereby policy priorities of the chief-executives? And 5) Was the chief-executives’ strong commitment to growth correlated with the merit-based economic elite assignment, which was critical to the institutional autonomy of economic agencies?* By addressing these questions, this study attempts to demonstrate the dynamics of the changes in political aspects of the Korean state. In particular, a close look at political leadership, centering on the presidential office, will hopefully unravel the political aspects of the state.

Second, scrutiny into the economic policy-making process must be undertaken to understand the interactions of business-state. The policy-making regime is an institutional procedure from the initial drafting of an economic policy to the implementation. A wide range of the executive and legislative bodies are involved in this procedure (Refer to Figure 2.1). In particular, “pilot economic agencies,” which play a key role in the policy-making process, steered and disciplined the hierarchical internal organization of the business-state relationship during the developmental era, and the inner dynamics of the

symbiotic business-state relationship during the post-developmental era. The policy-making regime is a direct bridge transporting the policy intent of the executive to the private sector. Thus, the contour or makeup of the policy-making regime is assumed to play a decisive role in explaining the structural characteristics of the business-state nexus. This research centers on the questions of: *1) where the genuine location of decision-making has been; 2) to what extent decision-making has been centralized; 3) how the policy-making process has been coordinated; 4) to what extent the bureaucracy and executive were free from the legislature (politics); 5) to what extent the “pilot agency” (Economic Planning Board, later on, Ministry of Economy and Finance) has enjoyed autonomy from normal bureaucratic routines; and 6) whether or not democratization has made an impact on these issues.* It is assumed that clarity in the decision-making location, a well-established coordination system, executive dominance over legislative, and high autonomy of pilot economic agencies are positively associated with the state’s leadership over private economic actors. Strong state leadership over the private sector is, in turn, hypothesized to be a critical source in keeping the business-state nexus from disintegrating into a corruption cartel. However, this hypothesis will not be tested empirically until the following chapters. Rather, this chapter is designed to provide a solid description of the “economic policy-making” regimes over time.

Third, concerning the bureaucratic system, this study will examine the recruitment and reward system. A pattern of business-state nexus (which is prerequisite for economic progress) would not be constructed without a certain type of bureaucracy (Evans 1998:69). More open, transparent, and merit-based recruitment of officeholders is an institutional foundation for the construction of a coherent bureaucratic system. It is

assumed that a goal-oriented and cohesive corporation within a bureaucratic system is likely to restrain individual officeholders from being interested in bribery and rent-seeking. Thus, this study attempts to measure the *competitiveness* and *openness* of the recruitment system. On the other hand, in order to keep officeholders on the track of the collective goal of improving national wealth and economic progress, the state must be able to compensate competent recruits with financial and other rewards. Thus, this study will probe into the *comparability* of the overall reward package for civil servants. Although the recruitment and reward system does not directly define business-state relations, it is a common belief in developmental literatures that transparent and open distribution of governmental positions is the first step toward a business-state nexus which is characterized by “state’s dominance,” “goal-oriented, constructive collaboration,” and “high responsiveness and adoptability.”

There have been five critical forces which drove changes in the Korean developmental state: 1) globalization; 2) the rise of capital power; 3) democratization; 4) the rising scale and complexity of the national economy; and 5) the needs of the private sector which have become increasingly complex and information intensive. Among these forces, the first two set the circumstantial conditions for the decline of the developmental state, but did not dictate the detailed changes in the internal structure of the state. The latter three had a more direct effect on the internal structure, as will be demonstrated later in this chapter. Accordingly, this chapter focuses on the following questions: First, how did democratization reshape the dynamics of coalition politics and thereby affect the features of collective political leadership? Can the distinct characteristics of leadership across different time periods be assumed to be associated with different dynamics of

bureaucratic decision-making, the presidential office and its relationship with bureaucratic elites, and the executive-legislative nexus? Second, to what extent has deepening industrialization been internalized into the decision-making machinery of the developmental state? A power shift among pilot economic agencies and agents or among parties involved in policy-making has become inevitable because different phases of industrialization demand the strengthening or weakening of different functions in bureaucratic system. Third, this study also inquires into how the changes in the private sector drove the changes in the public sector. The state and the private sector are assumed to be “mutually transforming” (Migdal, J. S. (ed.), 1994). The public sector is often forced to be rearranged at the request of private business or to accommodate changes in the private sector.

COLLECTIVE POLITICAL LEADERSHIP

(1) Changes in “Coalition Politics”: From “Developmentalist” (1962-79) to “Region-based” Coalition (1987-1999).

The theories of “survival coalitions” say that in the turbulent politics of underdeveloped countries, executives can never take political survival for granted (Barry Ames, 1987). Thus, political leaders are likely to actively pursue political survival by the construction of “political coalitions.” This study begins studying the saga of “political coalitions” with Park Jung-hee who came to power through a successful military coup in 1961. Despite Park’s sweeping political measures against his political opponents and private powerholders, his regime survival was in doubt in the early 1960s. Park perceived that attaining “skin-felt growth” and “solid national security” were indispensable

conditions for his regime survival over the long-run. On the basis of these two ideologies, that is, industrialization and anti-communism, Park constructed a broad developmentalist coalition which incorporated “industrialists,” “generals,” and “state managers,” at the core, along with a broad range of the populace, including the working-class and peasants. In fact, Park succeeded in maintaining a loose corporatist state until the end of his reign (Moon, Chung-in 1988; Choi, Jang-jip 1983).

Now, let us take a close look at his ideological orientation over time through an examination of his speeches¹. The first main focus in this analysis is whether or not there was a strong correlation between the commitment to “economic growth” and the level of the “security threat” sensed by Park and the other chief-executives². Developmental

¹ First, in order to measure the degree of a regime’s policy priority and presidential interests over a wide range of social, political, and economic issues, this study analyzed inaugural addresses and the Annual Speeches conducted by the presidents while submitting their annual budgets (which are comparable to “State of the Union” addresses in the United States) between 1964 and 1998, because inaugural addresses and the state of the union addresses usually outlined what each president or political regime was most concerned about and what each of them intended to accomplish during his reign. I examined the inaugural address plus all the available annual addresses for each president. Each sentence from each speech was categorized according to its policy implications for ten different terms or issues [economic growth, economic stability, economic justice (redistribution & welfare), infrastructure building, structural reform, political stability (order & law enforcement), national security (anti-communism, defense emphasis), reunification (mutual exchange & reunification emphasis), democracy (freedom and fair & free elections), and miscellaneous (education, culture, bureaucracy, etc.)], as shown in Graphs 2.1 and 2.2. Besides the ten-term analysis, I also counted the frequency of economic terms in their inaugural statements to figure out their general interest in economic progress.

² There are plenty of reasons why this study inquires into presidential speeches. Among the four principal factions involved in the policy decision-making procedure, i.e. the Presidency, Bureaucracy, the ruling party and the legislature, and interest groups (especially business), the Presidential office has been the predominant factor in South Korea. Especially after Bureaucratic-Authoritarianism (1972-1979) was installed by Park Jung-hee in 1972, the presidency became an institution with unrivaled power. Almost every single significant power was concentrated in the President, who was virtually

literature on the East Asian miracle often referred to the communist threat as the main reason for the chief-executive's adherence to economic progress. But previous literature has backed their contention with anecdotes rather than methodical empirical tests. My correlation test between "national security" and "economic growth" strongly supports their contention with a high coefficient level, 0.618.³ A glance at the entries for "Economic Growth" and "National Security" in Graphs 2.1 and 2.2, tells us that Park's sense of the communist threat led to his stronger commitment to economic growth, as it did for Chun Doo-hwan. In contrast, the subsequent leaders (Roh and Kim) clearly became less concerned about national security and slackened their pledge to economic progress. The authoritarian rulers, Park Jung-hee (1962-1977) and Chun Doo-hwan (1982-1986), focused almost exclusively on "economic growth" and "national security,"

unchecked by any other institution. The ruling party and legislative branch were under the president's firm control and worked as a rubber stamp for Executive-initiated economic bills during authoritarian rule. The opposition parties and civil society remained fragmented and fragile, so that they had no political power to challenge the policy course set by the President. On the other hand, the President was able to mobilize power apparatus, such as the Agency for National Security Planning (ANSP, previously the KCIA: Korean Central Intelligence Agency), the Defense Security Command (DSC), the Attorney General (AG), the Chief of Police Bureau (CPB) and the Office of National Tax Administration (ONTA), at his discretion, to deal with his political opponents and to force through his economic agenda. In addition, the presidency's patriarchal authority, which has been ingrained in Korean culture, contributed to the shaping of strong presidential power (Lee Yeon-ho 1997:86-97).

Although the economic transformation and democratic transition in the 1980s and 1990s largely undermined presidential power by setting institutional constraints on the president and bringing the presidential office under democratic procedural rules, the president has remained the single most important institution that researchers must look at in order to analyze the success or failure of economic programs. As many studies demonstrate, the President is the key actor in the policy-making process (Lee Yeon-ho 1997:86-90, Hahm Sung Deuk and L. Christopher Plein 1997:30-57).

³ A correlation test conducted between "economic stability" and "national security" produces the coefficient level of 0.547.

although to a lesser extent under Chun (Refer to Graphs 2.1 and 2.2).

Other studies (Song, Keun-won, 1995) also support the finding that Park was exclusively focused on economic and security issues. Park's presidential campaign centered around an economic agenda in 1967 ("economic growth" issues constituted 45.9% of his total campaign issues in the 1967 presidential election). During the 1963 presidential campaign, Park promised to feed people with rapid and quantitative growth. This was a strategic move to compensate for his "lack of political legitimacy"⁴ (Lee Yeon-ho 1997; Jeong Jeong-gil 1994; Kim Jin 1993). But even though his "coalition politics" remained firmly on the track of "growth ideology," as illustrated in the analysis of the presidential election campaign in 1971 (the weight of the economic agenda decreased by 13.9% in 1971, compared with 1967), the "economic growth" agenda became less significant for the survival of Park's regime. National security turned into the regime's primary concern as the United States began to reconsider its military presence in the Korean peninsula. The Carter administration announced its plan to pull-out the American military over the long run as part of its effort to reshape the Far-East security strategy in the early 1970s. Reading Washington's move as a significant hazard to national security, Park began to put more emphasis on national defense. He also decided to go ahead with heavy-chemical industrialization although the Korean infrastructure and market were not ready to move into the heavy-chemical industry. His rush into heavy-chemical industrialization was largely understood as his determination to build up the defense

⁴ He took over power by overthrowing the Jang Myun cabinet in 1960 by a military coup. The populace's attitude was harsh and suspicious of his political intentions, although Park tried to convince the populace by taking revolutionary actions against corruption.

industry in Korea.

On the other hand, concerning the key constituents of the political regime, there were no meaningful changes during Park's reign⁵. The triangular core alliance among industrialists, bureaucratic elites, and the military remained a firm political base even during the Yushin period. But on the periphery of Park's developmentalist coalition, the defection had begun, in particular, by the working class, in the late 1970s. Corporatist control over the working class became increasingly difficult, mainly owing to the rising discontent among urban blue collar workers with deteriorating living standards as the result of the failed heavy-chemical industrialization in the late 1970s (Refer to Frederic Deyo 1989; George Ogle 1990).

Let us take a look at another dimension of Park's coalition politics. Park had become slightly more reliant upon his loyal constituents (Youngnam voters) for regime survival. As shown in Table 2.1, Park became more dependent upon Youngnam voters⁶ throughout his reign (1961-1979). For instance, 61% in 1963, 71% in 1967, and 76% in 1971, of Kyoungbuk people, who were his most loyal constituents, voted for him, albeit Park only garnered 51% of national voters in 1963, 55% in 1967, and 54% in 1971. In

⁵ Park's reign can be divided into two distinct periods: 1) procedural democracy (1963-1971) and 2) the Yushin period (Bureaucratic-authoritarian regime: 1972-1979). During his early reign (1963-71), he was elected as president via popular vote and ruled through his Democratic Republican Party. But shortly after he was elected in 1971, he began to rule through emergency decrees, eventually leading to the establishment of the Yushin regime in 1973. Under the Yushin regime, he did not have to go through a popular election to stay in power. Instead, his presidency was endorsed by his handpicked national delegations. During this bureaucratic-authoritarianism, no meaningful political opposition survived.

⁶ Youngnam (in Table 2.1) consisted of Kyoungbuk, Taegu, Kyoungnam, and Busan.

addition, Park's arbitrary revision of the constitution and subsequent installation of "Bureaucratic-Authoritarian rule" in 1974 sharply diminished the popularity of his regime. This dwindling popularity in turn led to changes in his coalition politics in that his loyal Youngnam constituents became even more prominent in his coalition politics. However, the regional dimension of Park's political coalition did not rise to prominent status even during his late reign. In summary, 'developmentalism' remained the dominant dimension which defined Park's "political coalition" even during his late reign. At any rate, the developmentalist coalition abruptly ended as the main architect, Park, was assassinated by his own prot (the head of the Korea Central Intelligence Agency) in 1979.

For Park's successor, Chun Doo-hwan, "economic growth" and "national security" were also the must-win issues for his political survival. Chun, who served as the head of the military intelligence agency during Park's last year, took power through a military coup overthrowing upper-ranking army officials in December 1979, and then cracking down on the people's uprising in May 1980, killing more than 200 civilians. This left a grave stain on his political regime. His legitimacy in ruling over the Korean population was challenged from the very beginning of his regime. Many scholars see his determination to act decisively on economic transformation programs as his strategic choice for long-term political survival (Jeong Jeong-gil 1994; Lee Jang-kyu 1992). Though this study cannot analyze Chun's coalition politics on the basis of a presidential campaign and election, the lack of political legitimacy of the Chun regime led Chun to be absorbed with "economic growth." Chun was able to successfully rally his core coalition partners: industrialists, generals, and bureaucratic elites, around his regime amid economic crisis. These three groups, who inherently detested disorder and saw their

political/economic interests at stake during the political turmoil in 1980, united around Chun's regime with "growth ideology" (with an emphasis on "economic stability"), at least during the first half of his reign (1980-1985) (Kim Suk-jun 1992). On the other hand, Chun's neo-conservative reform during structural adjustment took away the incentive for the working class to remain part of the developmentalist coalition (Moon, C. H. 1988:76-77). The orthodox reform, including harsh austerity measures, cutting subsidies and disciplining labor, made it impossible for the regime to control labor by the corporatist manner.

Under harsh authoritarian rule, the weight of popular support for the survival of the regime might not have been very significant. But, Chun, suffering from a severe lack of political legitimacy, went a step further toward "regional politics" by appealing to Youngnam constituents for political survival. Both the end of the economic crisis and the mounting popular demand for democratization from 1985 on accelerated the tendency of Chun's survival strategy toward becoming more reliant upon a "region-based political coalition." In short, Chun's political coalition was characterized by more regionalism than Park's, although the "growth coalition" remained an essential part of his political regime. My analysis of presidential speeches confirms that "economic growth" and "national security" remained the pillar ideology of Chun's coalition throughout Chun's reign. As shown in Graphs 2.1 and 2.2, "economic growth and stability" were given policy priority on the economic side while national security was the prime concern on the political side. But economic distributional issues did receive more attention from President Chun than from his predecessor.

Democratization brought a whole new dimension to "coalition politics." Open

contests for power through the ballot box improved the political muscle of the populace, so that the chief-executive was forced to be more responsive to popular interests and demands. Consequently, the survival strategy of the regime had to be based on a winning strategy of “electoral politics.” As shown in Table 2.1, Roh got elected president basically by garnering his hometown voters: Kyoungbuk, Taegu, and Kyoungnam, along with conservative voters in Kang-won, Chungbuk, and Cheju. Kim Young-sam was also sworn in to the presidency with the help of his loyal hometown voters: Kyoungnam, Busan, Kyoungbuk and Taegu. Region has become the single most significant factor in the Korean voters’ choice of presidential candidates (Kim Chae-han 1999). My “regionalism index”⁷ also clearly demonstrates that there has been a rise in the likelihood of voters to cast their ballots on the basis of the candidate’s hometown. The index rose from 11.7 in 1963, to 13.5 in 1971, to 23.4 in 1987, dropped to 19.4 in 1992 and rose to 19.8 in 1997. This simple standard deviation test shows that the region-based voting likelihood doubled between Park’s era (1963-1971) and the new democratic era (1987-1997).

As a consequence of rising regional politics, coalition politics became organized along regions, largely replacing the growth-oriented coalition. More specifically, regional politics became the predominant dimension defining the dynamics of coalition politics, although the developmentalist alliance (military general, state managers, and big business)

⁷ My “regionalism index” is designed to measure the extent to which voters are likely to vote on the basis of the candidates’ hometown. The calculation of the regionalism index is as follows: 1) I calculated the “standard deviation” for each candidate; 2) Then, I summed up these standard deviations; and 3) divided by the number of candidates. The regionalism index numbers are on the bottom row of Table 2.1.

still remained as an important coalition partner. Roh (1988-1992),⁸ who got elected president in 1987 with 37% of the popular vote, stumbled along without a majority in the National Assembly and almost became impotent in managing economic/political affairs. In 1989, Roh managed to merge with two conservative opposition parties whose core power bases were Chungnam and Kyoungnam (Busan), so that the Roh regime broadened his regional power base by incorporating other regions into his political coalition. This construction of a “grand regional coalition” (only excluding Kim Dae-jung’s Honam Province) consolidated his power for a while, but politics had become more sensitive to region-based interests and the chief-executive was compelled to compensate his loyal constituents with governmental jobs and budget allocations.

Let us look at the new-born democratic regime’s policy priorities. The presidents’ economic policy concerns under democratic rule were equally divided into economic growth and distributional issues. Roh was especially forced to deal with distributional issues more intensively, owing to the explosion of pent-up economic demands by the populace during early democratic transition. As shown in Graphs 2.1 and 2.2, the largest portions of his speeches were spent discussing distributional issues, responding to societal pressure for better housing and higher wages during the democratic transition. On the

⁸ Roh Tae-woo followed almost every single footstep of Chun’s during his military career and was a major collaborator with Chun during the military coup in 1980. After serving as the chairperson for the Democratic Justice Party, Roh was handpicked by his predecessor to follow Chun in the midst of the growing democratic movement. With Roh’s announcement of the so-called 6.29 declaration for democracy, Korea began its political openness in June 1987. His decision to go ahead with political openness and direct popular elections for the nation’s highest office was based on two factors: 1) the split of the ruling circle into the soft and hard lines; and 2) mounting popular pressure for democracy (Im, Hyug-Baeg, 1995).

other hand, the issue of national security was largely replaced by the issue of reunification (mutual exchange between North and South, emphasis on reunification). No longer was “national security” able to remain the paramount objective of a political regime.

Unification and national reconciliation were terms more frequently mentioned by the rulers under democratic rule. This trend reflects the growing confidence of subsequent political regimes in the survival of the South Korean capitalist system, as the GNP size of South Korea surpassed that of North Korea in the late 1970s.⁹ The national security threat has become less crucial to political regime survival, following the stellar economic growth.

In addition, concerning the frequency of “economic issues” mentioned in the inaugural addresses, the presidents exhibited quite divergent degrees of interest in economic issues. For instance, Roh mentioned economic growth issues only twice (constituting only 1.6%) in his entire inaugural address, while Kim Dae-jung, Park Jung-hee, and Chun Doo-hwan spent approximately 15% (or more) of their inaugural statements on economic issues. This empirical picture of presidential interests confirms the previous descriptive studies contending that Park and Chun were almost obsessed with the “construction of an advanced industrial society” in Korea, while their successors were less devoted to economic issues. The variation in the chief-executives’ commitment to economic growth mirrors the changes in the political environment under which their regime survival was structured.

Roh’s successor, Kim Young-sam, also got elected largely on the basis of Roh’s

⁹As a matter of fact, up until the mid-1960s, the communist regime in North Korea accomplished superior economic growth than its capitalist counterpart in South Korea. Thus, the political regime in South felt tremendous pressure from regime confrontation for better and quicker economic performance.

“grand regional coalition” (Refer to Kyoungbuk, Taegu, Kyoungnam, Busan, Chungbuk and Chungnam in the 1992 presidential election in Table 2.1). Under Kim Young-sam (1988-1997), “region-based political coalitions” fundamentally characterized Korean politics, leading to changes in the regime survival strategy. Regime survival relied primarily upon maintaining popular support in the regions which constituted the “region-based coalition.” The chief-executives showed their enormous concern for the interests of their loyal constituents with compensation packages, in order to insure the survival of their regimes. In the context of policy priority, Kim Young-sam faced the issues of the post-developmental era, just like his predecessor Roh, such as environment, economic fairness, and redistributive issues. He spent a large part of his speeches on distributive issues, but his speeches clearly reflected the diminished societal pressures during democratic consolidation. In the early 1990s, the Korean government had begun to crackdown on union strikes and popular protests. Thus, by the time Kim came to power, social disputes were under firm control. During the post-developmental era and democratic rule, the chief-executives’ economic concerns have wavered along with macroeconomic indicators. For instance, the economic downturns, between 1990 and 1992, and 1997 and 1998, obviously enticed the chief-executives (Roh, Kim Young-sam and Kim Dae-jung) to consider economic issues during democratic rule time and again.¹⁰

¹⁰Song Keun-won (1995)’s study also supports the statement that Korean presidents showed dissimilar interests in national economic management. His empirical analysis shows that the campaign issues in the presidential elections strongly reflected each president’s view of the agenda most critical to their administration, although the campaign issues were more likely to be swayed by the process of strategic interactions between candidates than were issues in the “state of the new year” addresses. As shown in Table 2.2, among the three elected presidents, Roh again showed the least interest in economic issues, mostly centering his campaign on political issues. Park spent a large part of his

(2) Coalition Politics and Representative Bureaucracy

This section is concerned with how changes in “coalition politics” were reflected in the chief-executive’s governmental resource assignment. Political leaders are likely to actively pursue political survival by manipulating public policy to construct support coalitions. Public expenditures and the recruitment of bureaucratic civil servants are key policy instruments for political survival (Barry Ames 1987; Stockton 1998). However, my primary concern will be limited to how the rulers changed their recruitment of public officeholders, due to the fact that public expenditures were beyond the boundaries of this research. Thus, I will examine the extent to which bureaucratic assignments by the chief-executives fluctuated along with their different survival strategies.

A glance at the bureaucratic elite structure discloses a few distinct features over time: First of all, regardless of regime type and presidency, the largest proportion of high ranking governmental offices, including Secretaries and Assistant Secretaries of Ministries, and comparable executive offices to assistant secretaries, have been filled by elites whose birthplaces (by province) were identical with the incumbent president, except for the Rhee Syngman regime (1948-1960). As shown in Table 2.3, the percentage of office-holders sharing their birthplace with the incumbent president relative to the total number of office-holders during each regime was 16.0% (Kyoung-buk) under Park’s regime (1963-1973), 20.2% (Kyoung-buk) under Park’s Yushin regime (1974-1979), 25.7% (Kyoung-buk)

campaign on economic issues regardless of his opponent’s campaign focus. For instance, the economic agenda raised by Park constituted 45.9% of his total campaign issues in the 1967 presidential election, while his opponent’s, Yun Bo-sun, constituted only 19.6% of his total campaign issues. Again Park campaigned on an economic agenda twice as much as his opponent in the 1971 presidential election (Refer to Song Keun-won 1995).

under Chun's (1981-1987), 21.5% (Kyoung-buk) under Roh's (1988-1992), 23.4% (Kyoung-nam) under Kim Young-sam (1993-1997), and 15.8% (Jeon-nam (Kwang-ju)) under Kim Dae-jung (1998-present). In each case, none of the other provinces showed as high a proportion of officeholders as did the president's province of birth, except under Kim Dae-jung.¹¹ In order to examine whether there was a bias in bureaucratic appointments after controlling for relative population size across different regions (in other words, whether the ratio of office-holders from each region is comparable to the population size in that region: *Representative Bureaucracy*), we subtracted the proportion of regional population relative to the total population from the ratio of office-holders from each region. According to this *Representative Bureaucracy Indicator*,¹² although bureaucratic appointments were less-biased, as compared with mere numbers, office-holders sharing birthplaces with the incumbent president were still over-represented, as illustrated in the larger positive numbers in the "com" (combined) rows of Table 2.3. The over-representation indicator for Kyoung-buk (Taegu) consistently increased, from 2.2% to 9.8%, throughout the four Republics (1963-1992) during which presidents were from Kyoung-buk. The indicator for Kyoung-nam (Busan), which when combined with the Kyoung-buk figure represents the broader regional coalition, also tells us that the high ranking offices of the Korean government were saturated with Youngnam elites (a name

¹¹ According to other studies (Hong Hun-gi 1996; Hwang Jong-sung 1996) which utilize data on the duration of office terms held by elites from each region, instead of data on simple frequency of office-holders from particular regions in this study, bureaucratic representation has been even more grossly biased in favor of the president's home region.

¹² Especially during the 1st-4th Republics, most regions were under-represented, as shown in many negative numbers in the "com" (combined) rows in Table 2.3, because a large number of refugees from North Korea were appointed to high ranking offices during this period, although the population of North Korea was counted as zero in this study.

for the region which combines Kyoung-buk and Kyoung-nam Provinces). For instance, 31.7% of ministerial and vice-ministerial positions were held by Youngnam elites during the 3rd Republic, 38.2% during the 4th, 42.5% during the 5th, 40.4% during the 6th and 41.2% during the Kim Young-sam government.¹³

Second, the presidents' preference for their home region elites has been more strongly exhibited in the nucleus of the power apparatus which constitutes the inner circle of power elites. Those power apparatus can be listed as follows: Agency for National Security Planning (ANSP), AG (Attorney General), Chief of National Police Bureau (CNPB), Director of the Office of National Tax Administration (DONTA), Army Chief of Staff (ACS) and Head of Presidential Secretariats (HPS). Korean presidents across regimes often exercised the power of these apparatus at their discretion to manipulate their political opponents into obedience, so these agencies have been regarded as critical to regime survival. Except for the period of moderate authoritarianism (1963-1972) under Park, a large ratio of office-holders in these apparatus have been from the incumbent president's hometown. More significantly, if we consider the region-based political

¹³ In order to measure the extent to which elite assignment has become regionally-based by the chief-executive over time, I calculated the means of "com" in Table 2.3 across different regimes ("com" stands for the differential (in percentage) between the ratio of actual elite assignments in the region and the ideal ratio (which would be realized under perfect representative bureaucracy). According to my "mean test," the region-based elite assignment index ("mean") increased from 2.44 during Park's rule (1963-1973) to 4.67 during Park's Yushin rule (1974-1979), dropped to 4.23 during Chun's rule (1980-1987), rose to 4.56 during Roh's rule (1988-1992), to 5.46 during Kim Young-sam's rule (1993-1997), and to 6.66 during Kim Dae-jung's rule (1998-present). Roughly speaking, there has been a steady rise in the likelihood of the region-based assignment of high ranking officials by the chief-executives over time.

coalitions constructed by each incumbent president,¹⁴ heads of these agencies who came from each regime's regional power base constituted 46.4% of the total under Park (1963-1972), 52.3 % under Park's Yushin regime (1973-1979), 51.1% under Chun (1980-1988), 79.9% under Roh (1988-1992), 87.4% under Kim Young-sam (1993-1997) and 80% under Kim Dae-jung (1998-present) (Refer to the column called "Total" in Table 2.4). In addition, another power office, the presidential secretariat, showed the same propensity regarding elite distribution across birthplaces. For instance, the proportion of head secretaries in policy divisions from the power-base region was 35.7% during the 3rd and 4th Republics (1963-1979), 58.8% during the 5th Republic (1980-1987), 50% during the 6th Republic (1988-1992), 42.1% during the Kim Young-sam administration (1993-1997), and 50% during the Kim Dae-jung administration (1998-present). The number in terms of presidential secretaries in general shows the same trend with slightly lower percentages across different regimes (Refer to Park Jung-hun 1995:68-69). In short, these overwhelming numbers indicate that the rulers were primarily concerned with regime survival and showed a strong inclination to implant trustworthy proteges in the power apparatus in order to attain that political objective.

Third, a closer examination of the bureaucratic elite structure across different

¹⁴ Presidents Park, Chun, and Roh built upon "region-based political coalitions" which were made up of Kyoungsang-bukdo (their hometown region) as the core power base and Kyoungsang-namdo as the secondary supporting region. There is a long-standing political rivalry between Young-nam (which consists of Kyoungsang-bukdo and namdo, Taegu, and Busan) and Honam (which consists of Jeonla-namdo, Jeonla-bukdo, and Kwangju). President Kim Young-sam, whose hometown is Busan, constructed his political coalition with Kyoungsang-namdo as the core region and Kyoungsang-bukdo as the supporting region. Kim Dae-jung's government is essentially buttressed by a coalition between Honam and Chungchung (which consists of Chung-nam, Chung-buk, and Daejeon).

periods also reveals that bureaucratic representation has become more grossly slanted in favor of the incumbent president's hometown over time, although it is difficult to grasp the worsening regional distribution of bureaucratic elites from Table 2.3. But if one looks in more detail at the bureaucratic elite structure in the Korean government accounting for the relative power weight of each agency within the government, it can be concluded that region-based elite assignment has increased over time. For instance, as demonstrated in Table 2.4, the key power positions have increasingly been assigned to the president's hometown proteges. For instance, the relative weight of elites in the power apparatus from Young-nam Province (which was the hometown of the rulers from 1961 to 1997) increased from 46.4% between 1963-1972 to 87.4% between 1993-1997. Other power apparatus, including the ministries of defense, justice and domestic affairs, and the head of presidential secretariats were rarely allocated to elites whose birthplaces were not in common with the incumbent president. More importantly, the key director offices of pivotal bureaus within each ministry became occupied by the presidents' hometown elites with increasing frequency (Han Myoung-kyu 1990; Chun Yul-woo 1991; Kwon Young-kee 1993; *Hankyeore* 9/21/1995; *Shindongah* May, 1998).

(3) Presidential Elite Assignment in Economic Machinery and Institutional Autonomy of Economic Agencies

Despite the fact that all the presidents demonstrated grossly-biased elite assignments, there were clear distinctions among different presidencies in the context of the assignment of economic technocrats. According to an empirical analysis of the elite structure in the Korean government, the more determined a president was to attain

industrial progress, the more likely he was to protect the institutional autonomy of economic agencies. In other words, whenever “growth coalition” played a more prominent role in the regime’s survival, the chief-executive was more likely to guarantee the institutional autonomy of economic agencies. But when regional politics was rampant, elite assignment looked different. To summarize, the following principles of elite assignment was observed: First, the protection of economic technocrats from politics was institutionally insured by not assigning career politicians to the nuclei of economic agencies. Second, the carefully-recruited economic technocrats were guaranteed long-term tenure in the core decision-making positions, securing high policy consistency and thereby high credibility of governmental programs from business. Third, economic technocrats positioned in the core economic apparatus were selected singularly on the basis of merit, not of regional background.

The preeminent feature of elite assignment by presidents who were determined to isolate the economic agencies from politics was that they rarely let professional politicians run the economic planning machinery. By keeping professional politicians away from the core positions of economic agencies, Park and Chun endeavored to seclude economic management from political pork-barreling. Throughout the entire period of the developmental era, no politicians were appointed to the head of the EPB by Park or Chun, whereas six career politicians were named as the head of the EPB by Roh (1988-1992) and Kim (1993-1997). In other words, 75% of the heads of the EPB under Roh and 42.9% of the MOEF (MOF and EPB merged into MOEF in December 1994) under Kim Young-sam were career politicians. In the minor ministerial positions, the popularly-elected presidents again showed a much higher tendency to name professional politicians

than their authoritarian predecessors. For instance, Park and Chun each appointed only one professional politician to each minor ministerial position during their respective Republics, whereas Roh and Kim Young-sam filled over 30.3% and 23.5% of those positions with career politicians respectively (Refer to Table 2.5).

As shown in Table 2.5, Park (1963-1978), as a former military general, appointed his junior military officers to administer a large number of minor economic ministries (including minister and vice-minister positions). For instance, for the MOC, MOCO, and MOT, 42.9% of ministers between 1963-1972 and 72.7% of ministers between 1973-1979 came from military careers respectively, whereas a smaller ratio of vice ministerial positions was allotted to military career personnel. Park usually assigned the macro economic management, including the drawing of blueprints for the long-term economic plans and regulating prices and finance markets, to the elite technocrat corps in the EPB and MOF. But micro economic projects, such as building dams, highways, seaports and other infrastructure construction projects, were carried out by his junior military officers who were in charge of the MOC, MOCO and MOT (Jeong Jeong-gil 1994). Park's successor, Chun, continued this practice of elite assignment although the rising technical difficulty in running those ministries cut down the proportion of military officers, reducing it to 27% in ministerial positions and 13% in vice-ministerial positions.

Roh and Kim Young-sam diverged from their authoritarian predecessors in terms of elite assignment to economic agencies. The number of career politicians in every single category of the economic ministries increased sharply except for the vice-minister positions of the EPB and MOF (Refer to Table 2.5). The rising number of career politicians as the heads of economic agencies implies that no longer were economic

agencies guaranteed independence from political influence. Elite inter-rotation between economic agencies and political parties also provided interest groups, especially big business, with ample room to manipulate the policy-making process for their own interests because of the politicians' exclusive reliance upon businesses for political funds (Kim Young Rae 1997: Yun Hyung-sub and Kim Young Rae 1989).

According to Hwang Jong-yul's study (1996:148-149), under Park and Chun, there were few elite rotated between the ruling party and economic agencies, but this distinct separation disintegrated during Roh's and Kim Young-sam's reigns (1988-1997). The overlapping elite networks between economic agencies and political parties were also noticeable in the presidential economic secretariats during Roh's and Kim Young-sam's regimes. Larger numbers of principal economic secretaries during Roh and Kim became involved in politics after completion of their appointments, as compared with principal economic secretaries who served for Park and Chun, who rarely engaged in politics (Refer to Park Joong-hun 1995:99). The changing trend in elite assignment under Roh and Kim demonstrated that, as a result of democratization, economic policy-making could no longer be isolated from politics. The politicization of economic policy-making was inevitable as civil society more openly attempted to input their interests into the policy-making process. On the other hand, Kim Dae-jung (1998-present), who came to power during an economic crisis and who is, in general, regarded as dedicated to economic reform programs, partially restored the old principles of elite separation between party and politics and economic agencies, mostly due to the compelling pressure on him to deal with the crisis based on economic rather than political rationale.

The second distinct feature of presidencies whose growth coalition was based on

“growth ideology” was that the length of the terms served by individual economic technocrats under these presidents was much longer than those under the regional-based political coalitions. As shown in Table 2.6, the average length of service of individual ministers in the core economic agencies under Park was substantially longer than under other presidencies. However, during Chun’s reign, potential problems, such as policy inconsistency, which could have been caused by too short a tenure of bureaucratic technocrats in the core economic agencies (although the average duration of individual service in the major economic ministries during Chun’s regime was relatively longer than during Roh’s and Kim’s regimes) were offset by the long tenure of the Principal Economic Secretaries (PES) in the presidential office.¹⁵ But it is easy to see that during the Roh and Kim Young-sam administrations none of the major ministers and PES stayed in their offices long enough to even figure out their jobs in a comprehensive manner. If we only count the average term of office served by the heads of the EPB and the PES in the presidential office, the difference in terms of average duration of service across different presidencies is even more striking. (Refer to Table 2.6). In the minor economic ministries, the same thing was happening in terms of the average service span of individual ministers, although the differential in the average service span of each minister is not as conspicuous as in the major ministries.

¹⁵ During Chun’s reign (1980-1987), basically only two competent economic technocrats, Kim Jae-ik and Sah Kong-il, served as the principal economic secretariat to the presidential office, if we disregard Park Young-chul who worked briefly at the end of the Chun regime. Both Kim and Sah were delegated extensive power in handling national economic affairs from Chun who was quite ignorant of economics at the beginning of his term. Their close linkage with the EPB helped them work with the EPB in a decisive manner (Lee Jang-kyu 1992).

Individual technocrats' long tenure, which indicated a high degree of trust and power delegated by the chief-executive to the technocrats, also presented many important implications for policy-making. First, long tenure for individual technocrats secured policy consistency at least during their terms of office. For instance, Park let one individual technocrat (the head of the EPB) steer macro economic policies for an average of 27.6 months in office, and Chun (in his case, the Principal Economic Secretary) allowed an average of 45 months, while the average duration of the EPB head under Roh was 11.5 months and under Kim Young-sam, 8.6 months. Especially under the Roh regime, whenever there was a shuffling of the economic management team including the head of the EPB and PES, economic policy vacillated wildly between "stability-first" and "growth-first" policies (Lee Hong 1992; Jang Jae-sik 1992). The Kim Young-sam government also failed to maintain policy consistency owing to frequent shuffling of economic teams. As demonstrated in Table 2.6, the economic leadership under Kim Young-sam changed every 10 months, and so did his economic policy.

Second, a long tenure enabled the economic technocrats to retain autonomy and strong controlling power over the civilian sector. Under a frequently changing economic policy, business was less likely to trust the governmental leadership, because the credibility of policy measures was under serious doubt. Business tended to take a "wait-and-see" or "foot-dragging" attitude toward economic programs rather than committing to them when government incentive packages or threats were seen as unreliable and inconsistent over time (Concerning government credibility and business commitment, refer to Schneider and Maxfield 1997:11-12). As a matter of fact, the failure of many corporate structure reform programs to produce any solid outcome is attributable to policy inconsistency during the

Roh and Kim Young-sam governments. “Foot-dragging” was the strategy most frequently opted for by the Chaebol, who simply waited for the replacement of aggressive economic administrators. In short, by frequently shuffling the economic ministers and thereby undermining policy consistency during the Roh and Kim Young-sam governments, the government lost a great deal of control over the private sector and of credibility for its policy measures.

Third, during the Park and Chun reign, the chief-executive’s long-term commitment to an economic technocrat had the effect of clarifying who was in charge of final decisions when there was policy conflict among economic agencies. An economic technocrat (often the head of the EPB or PES), who was given the mandate by the chief-executive of managing the national economy, carried out policy coordination and mediation himself by acting as an ambassador of the president, thus minimizing unnecessary “turf wars” among economic agencies. But the frequent replacement of the core ministers under Roh and Kim led to the breakdown of the power center which functioned as a policy coordinator. The frequent cabinet reshuffling did not allow new ministers to develop policy leadership over career bureaucrats who were more likely to promote the interests of their own bureaus. The lack of policy leadership by the core economic ministers led to “ministerial rivalry” because more decision-making was done by lower-ranking office-holders whose local interests were prior to the overall national economic performance (Lee Jang-kyu and others 1995:70-91).¹⁶

¹⁶ As we may notice by putting Table 2.8 and Table 2.6 side by side, there was a strong correlation between the increasing “turf wars” and the short office span of the core economic ministers during Roh’s and Kim’s reigns. The empirical indicator (the ratio of original bills passed without revision in the CEVM) in Table 2.8, signifying the degree of

The last distinct feature of elite assignment by presidents whose political coalition was based on “growth ideology” is that economic technocrats at the nuclei of economic apparatus were selected singularly on the basis of merit, not of regional background.

Through a close examination of the elites’ birthplaces, this study explores whether or not the proportion of economic technocrats who shared their hometown with the ruler and were assigned to the core economic agencies was significantly lower than the proportion of the population in the ruler’s region or the proportion of bureaucratic elites in general.

To state the conclusion first, when recruiting, Park and Chun used a double standard between high ranking bureaucrats and economic technocrats. Unlike their general inclination to pick their political proteges for the power apparatus, Park and Chun resolved not to subject elite assignment in the core positions of economic agencies to their imminent political interests. As seen in Table 2.7 (virtually all the elites listed in Table 2.7 were named by the chief-executive), throughout the entire developmental era (1963-1987), economic technocrats whose birthplaces were in common with the ruler and were appointed to economic planning,¹⁷ financial institutions, including major commercial banks and government-run banks, and financial supervisory commissions,¹⁸ constituted a smaller

bureaucratic coherence (or degree of policy coordination), declined steadily along with the shortening office span of individual economic technocrats in the core economic ministries in Table 2.6.

¹⁷ Economic technocrats include office-holders whose ranking is at level 2 (section directors) or higher (directors of bureaus) in the EPB during Park’s and Chun’s reign, and the EPB and MOF after that. The MOF was counted as a core agency from Roh’s reign on because the EPB was no longer predominant in macro economic management and supervising the financial markets and private sector.

¹⁸ Financial supervisory commission includes only top managers of the BOK (Bank of Korea) and Bank supervisory commission within the BOK because the financial supervisory function was divided into areas (bank, insurance, security, and non-bank

portion than the ratio of population in that region. For instance, as can easily be seen in Table 2.7 by comparing “economic-technocrats” and “ratio of population,” the average ratio of Youngnam technocrats to total economic technocrats (about 26.5%) stayed below the ratio of Youngnam population under the developmental state (1963-1979) except in financial supervisory institutions. Considering that the overall ratio of high ranking officeholders from Youngnam was much higher than the regional population ratio (compare the “ratio of hometown elites to total elites” with the “ratio of population” during Park’s and Chun’s reigns in Table 2.7), we can conclude that the authoritarian rulers during the developmental era did protect the institutional autonomy and integrity of the core economic agencies by using different recruitment standards for them from bureaucratic elites in general. Especially economic technocrats who were in charge of economic planning, price regulation, and policy-coordination bureaus were solely selected on the basis of their technical competency (Kim Byung-kook 1987).

However, this practice of merit-based elite assignment in the core economic agencies fell off slowly but steadily during the Roh and Kim Young-sam regimes, with a gradual decline in general bureaucratic and economic technocrats and a sharp decline in financial and supervisory institutions. As shown in Table 2.7 (Refer to “eco-tech”), elite structure in economic administration has remained relatively constant across different political regimes, although an increase is observed in the ratio of Youngnam elites. But, regarding financial and supervisory institutions, the number of Youngnam elites rose rapidly, especially in financial supervisory institutions (Bank of Korea, Monetary Policy

supervisory) and belonged to the BOK and MOF (which is included in the economic technocrats category).

Committee, Bank Supervisory Commission, Security Supervisory Board, Insurance Supervisory Board, and Non-bank Supervisory Authority), jumping from 33.9% in 1963-1972, and 37.1% in 1974-79, to 54.6% in 1988-1992 and 62.5% in 1993-1997. In both the government-run banks and major commercial banks, the ratio of Youngnam elites has been rising across different regimes. Looking at the row for the Kim Young-sam government in Table 2.7, under which the Korean economy went into outright bankruptcy, every single class of elites but one in the table contained considerably more than 30% of hometown appointments, setting a foundation for a collusive network. A closer look at the substance of elite assignment within the core economic agencies discloses the fact that the breakdown of merit-based assignments was apparent under Roh and became even more serious under Kim Young-sam. For instance, during the Kim Young-sam government, the three most powerful directors of bureaus (Taxation Bureau, Budget Bureau, Finance Bureau) within the EPB (later the MOEF) were repeatedly allotted to Kyoungnam (Kim Young-sam's hometown) elites (Song Mun-hong 1993; *Hankyeore* 9/21/1995; Kwon Young-gi 1993; Lee Jae-kyong 1995).

The rising number of Youngnam elites in economic and financial institutions throughout Roh's (1988-1992) and Kim Young-sam's regimes (1993-1997) implies that at least one important source for elite collusion across economic agencies, banking industries, financial supervisory institutions, and private business increased in a steady manner. As illustrated in the business column of Table 2.7, the high ranking managerial positions within the top 50 Chaebols were largely occupied by Youngnam elites, approximately constituting between 33-40% of total business elites over time (44.0% of the founders of the top 50 Chaebols were from Youngnam province). Unlike the school

alumni networks within major economic agencies which worked as a positive force in policy coordination and as a source of bureaucratic coherence,¹⁹ the region-based elite networks were more likely to turn into a source of collusion, mainly because, while the prestigious school associations developed through a merit test, including the highly competitive college entrance exam and civil service exam, the region-based networks did not have any such merit-based foundation. When a new president was sworn in and rearranged governmental elites, the Chaebol often reshuffled their own elite structure within a business group, so that presidents, executive directors and general managers were matched with their counterparts positioned within the government in terms of birthplace or school (Yun Young-ho 1998: *Shindongah* Feb.1998). The fact that the Chaebol were very sensitive to who was in charge within the government suggests that regional elite networks across business and state increasingly became a source for rent-seeking and biased-distribution of governmental resources. The “governance failure,” including supervising commercial banks and government-run banks and monitoring foreign borrowing by private firms, was rooted, to a large extent, in these increasing regional elite networks.

¹⁹The presence of a large portion of technocratic elites who graduated from the two or three most prestigious universities has been mentioned as a critical ingredient of bureaucratic coherence in the policy-making process during the developmental era, when most policy coordination was done via informal networks rather than formal institutions (Meredith Woo-Cumings 1995; Alice Amsden 1989; Peter Evans 1995). However, it is doubtful that the school connections remained an important positive force for policy coordination, because the increasingly complex policy-making process at the end of the developmental era required technocrats to rely upon formal institutions for policy coordination. Throughout even the post developmental era, between 55-60% of economic technocrats in the EPB and MOF graduated from Seoul National University (SNU), predominantly from the school of Business and Economics (Goh Seoung-chul 1990: Lee Jae-kyong 1995).

In summary, this study on the president's primary interests, coalition politics, and elite assignments proves empirically that the chief-executives who were more dedicated to economic progress and whose political coalition was more growth-oriented, were more likely to protect the institutional autonomy of economic agencies by the isolation of career technocrats from party politics, insuring long-term tenure to economic technocrats, and elite recruitment based on merit rather than region. In contrast with previous studies which were based on anecdotes, this study, by delving into changes in the distinct features of elite assignments by different presidents, clearly demonstrates how the dynamics of popular politics compelled the chief-executive to distribute more jobs to his coalition constituents, in compensation for having elected him. Party and presidential election politics, which are fundamentally divided along a regional dimension rather than socio-economic issue dimension in South Korea, drove popularly-elected presidents to allot not only the high ranking offices in general to their hometown elites but also the economic technocratic offices. Without the evolution of party politics which are anchored in institutional linkage with civil associations and divided along the socio-economic issue dimension, "procedural democracy" since 1987 has inculcated "pork-barreling" politics between the elected officials and their region-based constituents. And, it goes without saying that the institutional linkage of the business-state nexus, which has increasingly become dominated by elite groups who were from the same region, has become less effective in delivering economic transformative programs. In short, the region-based coalition politics in turn elevated the potential for collusion between the government and the private sector.

POLICY-MAKING PROCESS & POLICY COORDINATION SYSTEM

A close examination of the “policy-making process” is a necessary step toward an adequate understanding of the business-state nexus. The study of the “policy-making process” in this section is designed to grasp the “clarity of the location of decision-making,” the “degree of policy-making centralization,” the “policy coordination system,” and the “institutional autonomy of ‘pilot agencies’” over time. These factors are critical variables in explaining how the inner dynamics of business-state relations have been structured. For instance, the clarity of the decision-making location and the well-institutionalized coordination system would curtail bureaucratic rivalry among involved economic agencies and, in turn, the coherence of the policy-making regime limits the amount of political room in which big business can maneuver. In addition, these factors are strongly associated with the high credibility of economic transformative programs in the eyes of the private sector. Without clear signals that economic transformative programs issued by pilot agencies would be carried out without political interference, risk-averse private firms would not be engaged in designated industrial sectors. Thus, the government must deliver its message to private partners with the clarity of who is in charge, with a strong mandate delegated to “pilot agencies,” and with a strong guarantee that politics would not interfere.

The procedure for “policy making” in Korea has been organized throughout industrialization as shown in Figure 2.1. A bill is usually drafted by a competent section within an economic ministry, to whom the work of drawing up an original bill is delegated by a meeting of related ministers and the President’s Head Secretary. Once drafted, the bill will first be informally discussed among related sections and ministries and later the

preliminary version of the bill will be presented to the public in advance of the legislative process. By running through public hearings, seminars and ruling party consultations, the executive tries to build up public consensus on the suggested bill and test whether or not the bill would survive popular resistance. Although public opinion is becoming more influential on the legislative process under democratic rule, the fragmented civil society which lacks institutional linkage with political parties has hardly been a factor in determining the nature of legislation. After the public hearing, the bill goes through several important institutions under which the divergent interests of each agency would be intermediated and coordinated: the Office of the Prime Minister (Office of Administrative Coordination), the Government-Ruling Party Cooperation System, Presidential Secretariat, the Economic Planning Board (EPB), the Conference of Economic Ministers (CEM), the Conference of Economic Vice-Ministers (CEVM) and the Ministerial Cabinet Meeting (MCM) (Bek Wan-kee 1991:602-611; Lee Yeon-ho 1997:82). The CEM and CEVM, which are presided over by the head of the EPB, are the key institutions for economic policy coordination. Once a bill is revised through the policy coordination system, it will be submitted to the cabinet meeting which is usually presided over by the chief-executive. A bill passed in the MCM will move on to the National Assembly.

(1) Policy Coordination System during Developmental Era: Focusing on the EPB

Another component crucial to the construction of corporate coherence in bureaucracy is clear-cut clarification of the location of decision making within the bureaucracy. Without a carefully devised system of decision making and conflict settlement (also known as the coordination system) among various economic agencies and

elucidation of who is in charge, bureaucracy is likely to fall into “turf wars” due to the divergent objectives of each organization, overlapping extent of jurisdiction, and rivalry for scarce resources (Lee Seong-woo 1993). There are diverse methods and strategies for resolving organizational conflicts: (1) coordination by standardization; (2) coordination by planning and authoritative power; or (3) coordination by mutual adjustment.²⁰ Park Jung-hee primarily utilized the second means of coordination during his regime (1961-1979). Park preempted any potential for bureaucratic bickering among the different ministries of cabinet members by establishing a “Super-Ministry,” the Economic Planning Board (EPB), and placing it at the apex of various economic apparatus in July 1961. Unlike other ministries, the EPB was designed not to have its own constituents, so that the EPB maintained high autonomy from civil society with institutional flexibility in developing economic programs. More specifically, Park developed an organizational form in which the EPB had the upper hand over other ministries in order to subdue the rivalry of local interests (Choi, Byung-Sun 1991).

Whether or not the authority of the EPB over other ministries, that is, its coordination power, was sustainable depended upon four important factors: first, control over critical national resources, especially governmental budget, foreign aid and foreign borrowing; second, authority of personnel management and superior personnel capability over other economic agencies; third, the ability to cooperate with and coordinate among economic ministers to overpower other ministries challenging the EPB; and fourth, strong backing from the chief-executive. These elements were correlated with whether or not the

²⁰ “A Study on the Korea’s Policy Coordination System,” Seoul: Korea Institute of Public Administration (KIPA), *KIPA Report* 93-01, 1993.

EPB was successful in steering and orchestrating other economic agencies to follow its purposive economic programs, while maintaining high bureaucratic coherence within the government. Under EPB leadership, corporate cohesiveness among economic planning agencies, financial supervisory agencies, developmental banks, and budgetary bureaus was an indispensable factor in inducing businesses into profit-seeking productive investments, rather than speculative investments in land and curb markets (Lee Man-hee 1992).

At the request of a strong bureaucratic center which was able to carry out planned-economic development, the EPB seized the work of “planning, coordination, and foreign aid management” from the Ministry of Rebuilding (*Buheoungbu*, MOR, previously the “Ministry of Construction”), “budget management” from the Ministry of Finance (MOF), and the “administration of investigation and statistics” from the Ministry of Domestic Affairs (MDA) through the administrative reform which was carried out immediately after Park took power in 1961. After the incorporation of the core bureaus of several ministries into the EPB, the main functions to be carried out were divided into four major bureaus: (1) Economic Planning Bureau; (2) Price Policy Bureau; (3) Budget Bureau; and (4) Economic Coordination Bureau. These bureaus played the most critical role in orchestrating the national economy in the 1960s, 1970s and early 1980s. In addition, in order to provide the head of the Economic Planning Board with the power of coordination among economic agencies, Planning Bureaus were created at each economic ministry in connection with the Economic Planning Bureau at the EPB and the head of the EPB was elevated to the status of vice-prime minister in December 1963 (Lee Man-hee 1992:39-44; EPB (ed.) 1982:417-418).

More importantly, the institutional character of the EPB was distinguished from

other economic agencies in the sense that, unlike other economic ministries which tended to have their own constituents in civil society, the EPB was free from institutional obligations to represent any social group. For instance, the Ministry of Commerce (MOC) had close institutional ties with business and the Ministry of Agriculture (MOA) with peasants, and thereby were likely to advocate the interests of business and peasants respectively in the policy-making process. The fact that the EPB was autonomous from the pressure of social groups made it possible for the EPB to look at the broader picture of economic affairs and view the national economy in the long term perspective. The EPB's institutional independence from social groups provided economic technocrats within this economic planning agency not only with a non-biased and long-range perspective of the national economy but also with a passionate zeal for the institutional mission set by political leaders. In addition, the EPB's institutional autonomy from social groups bestowed this agency with institutional flexibility, so that the agency was able to adapt to changing internal and external economic environments in terms of economic planning (Choi Byung-sun 1990:247-250).

Now let us examine in detail the institutional resources of the EPB for policy coordination and bureaucratic leadership over other economic agencies. First, "control over the budget" meant that the EPB was given authority to expand or contract the policy realm controlled by other economic ministries and was able to force other ministries to comply with the overall economic agenda set by the EPB. Thereby, the overall economic agenda formulation and the control over the budget had a mutually escalating effect on the EPB's authority over other ministries (Kim Kwang-woong 1991:152; Lee Man-hee 1993). In addition, control over foreign aid earlier and over foreign loans later on had a similar

effect because the EPB's control over foreign aid and loans, which were an indispensable resource for spectacular postwar growth, was a decisive instrument for policy coordination (Jeong Jeong-gil 1994:44). As shown in Table 2.9, between 1962 and 1965, when Park's first five-year economic plan was launched, foreign aid was the major resource to be used for governmental budget and infrastructure construction, constituting 83.4% of total financial help from outside. Starting in 1966, the Park administration began to utilize public and commercial loans as the principal resources for development since the United States began to wean Korea as an aid recipient and adequate domestic savings was not yet available. As shown in Table 2.9, between 1966 and 1972, public and commercial loans constituted 72% of total foreign borrowing, while foreign aid shrank to 17.8% of total foreign capital inflow. Considering that foreign aid and foreign borrowing were almost the only resources in the early phase of industrialization, control over these funds granted the EPB not only power over other economic ministries within the government but also superiority over private business as a financial distributor. Therefore, the merger of two critical ingredients under the EPB, that is, control over the budget and foreign loans along with economic planning, obliterated any potential challenge to the EPB's authority from other ministries and concentrated multiple bargaining tools in one agency. In addition, the concentration of control over two critical resources (foreign borrowing and the budget) for developmental programs under the EPB improved efficiency in terms of adequate resource allocation (Kim Byung-kook, 1987:35-58 ; Lee Man-hee 1992:42-43).

Second, along with the EPB's control over the budget and foreign borrowing, the EPB maintained superior personnel power over other economic agencies. A close

examination of the personnel management also reveals that Park shrewdly promoted overall coherence in agency behavior and reduced possible rivalries of key bureaus across intra-ministries and within the EPB. First, the top notch young elites recruited through the competitive civil exam (*Haengsi*) were assigned to the EPB with the deliberate intention of building its technical authority over other cabinet ministries (Goh Seoung-chul 1990). Even within the EPB, the core bureaus such as the Economic Planning Bureau, Budget Bureau, and Price Policy Bureau were supplied with the best of the recruits. Once these elites were appointed to the core bureaus, their track was to continue in the same office over a relatively long period, so that each recruit could accrue experience and expertise in his policy realm (Kim Byoung-kook, 1987:37-39). The distinct career tracks for the Economic Planning and Budget Bureaus granted these bureaus technical supremacy over other bureaus. Second, the hegemony of the EPB over other cabinet ministries was amplified by appointing high ranking technocrats, who were trained within the core bureau of the EPB, to head up other ministries. As demonstrated in Table 2.10, the number of core bureau chiefs of the EPB who later assumed ministerial posts remained high throughout the Park regime and even in the 1980s and 90s.²¹ By appointing a large number of bureau chiefs to other ministries, such as the Minister of Agriculture and Fishery (MOAF), Energy and Resource (MOER), Construction and Transportation

²¹ President Park utilized various ways to insure that conflicting interests among economic ministries did not inflict damage on bureaucratic coherence or hamper swift policy enactment. First, the EPB was given institutional authority to coordinate and to cultivate collaboration among economic agencies. Second, the chief-executive often intervened in “turf wars” among economic agencies by utilizing his own chief secretary of economic affairs. The third means available to the chief-executive was assigning the chiefs of core bureaus from the EPB to other ministries.

(MOCT), and Science and Technology (MOST), the chief-executive attempted to ensure that primary economic ministries collaborated and acted upon industrial targets as a unitary actor, largely disregarding the interests of secondary economic ministries. The economic ministers, who spent most of their careers at the EPB and thereby shared the EPB viewpoint, sympathetically followed the EPB economic blueprint. For instance, the MOAF minister, who would have been likely to push for a higher officially-set price of rice had he not been associated with the EPB, was more willing to cooperate with the EPB's low inflation policy by putting a lid on rice prices. The economic planners at the EPB, who were devoted to "economic growth," frequently made scape goats of other economic ministries which were likely to champion environmental, welfare, labor and peasant issues, by utilizing the ministers, vice-ministers and top-ranking officeholders at different economic ministries, who were dispatched from the EPB after serving the elite bureaus at the EPB (Jeong Jeong-gil 1994:52-53).

The third important source for the hegemony of the EPB over other economic ministries was the establishment of the Conference of Economic Ministers (CEM) and Vice-Ministers (CEVM) as an important medium to control and mediate disagreements over critical economic policies under the leadership of the EPB. The CEM,²² which was composed of ministers from the EPB, MOFA (Ministry of Foreign Affairs), MOF (Ministry of Finance), MOAF (Ministry of Agriculture and Fishery), MOCT (Ministry of Construction and Transportation), MOER (Ministry of Energy and Resource), and MOL (Ministry of Labor), was formed to oversee economic planning and to develop more

²²The CEM was created by Park in 1963 for economic policy coordination.

coordinated efforts to carry out the targeted plan: (1) The CEM under the EPB's leadership prejudged economic legislation before these bills landed in the Governing Ministerial Meeting (GMM) presided over by the President. (2) The CEM made important decisions regarding diplomatic strategies in order to achieve their long-term economic objectives. (3) The CEM evaluated the agendas for the financial investments of the government. (4) The CEM dealt with major finance, budgetary and price policies. And (5) The CEM dealt with agenda items handed over by the GMM.

The CEVM (Conference of Economic Vice-Ministers) shared an almost identical role with the CEM. The CEVM must be considered more pivotal to an understanding of economic policy decision-making because most critical economic issues were predetermined by the CEVM, whose members were predominantly career economic technocrats (Bek Wan-gee, 1991:604-606). The vice-ministers, who possessed expertise and knowledge in the policy issues on the table, tended to be better prepared to deal with the technical and practical issues, so that economic programs and bills passed by the CEVM (about 86% between 1975-1978) were almost automatically passed by the CEM (Refer to Table 2.8). By administering the CEM and the CEVM, the EPB was able to foster collaboration and unity among different cabinet ministries, which often conflicted due to their divergent organizational interests. In addition, the control of the CEM and CEVM by the EPB led to the institutional endorsement that the economic agenda determined by the CEM and CEVM had priority over other programs submitted by other non-economic ministries to the Ministerial Cabinet Meeting (MCM) by nourishing solidarity among economic ministries against non-economic ministries.

Fourth, President Park's special concern and backing was also a critical factor in

elevating the EPB's status to supremacy over other ministries and making the EPB play a central role in developmental programs. The policy vision of the determined political leader, Park, was largely delegated to the EPB through his special relationship with this agency. Economic technocrats within this agency perceived the solid presidential backing as a clear mandate in dealing with economic affairs. Additionally, President Park protected economic technocrats in the EPB from political influence and secluded them even from business lobbying, as a consequence exalting their autonomous power in the economic policy making process (Choi, Byung-sun, 1987, 1990:251-257). Under the president's political protection, career technocrats were immune to any political charges rising from the failure of the economic programs they drafted. Park's determination to preserve the EPB as a politically untainted economic apparatus was well illustrated by the fact that the majority of career workers at the EPB were not from Youngnam Province, Park's birthplace. Rather, unlike other cabinet ministries which were often dominated by Youngnam-born workers, the EPB was composed of a majority of people whose birthplace was Honam Province, by a six to four margin (Rhee Suk-jung 1992:490-491).

(2) The Coordination System in Change: Shattering Bureaucratic Coherence

The end of the developmental era inevitably led to the breakdown of EPB leadership over economic agencies, mainly due to the dwindling resources under the EPB's control and the increasing complexity of the modern economic administration. In this section, our study will empirically examine the crumbling authority of the EPB within Korean bureaucracy, as a consequence of discontinuing the practice of following a "planned economy" and its effect on overall bureaucratic coherence. There were massive

changes in the institutional resources which had sustained the EPB's dominance over other ministries and over private firms. Accordingly, the EPB's ability to coordinate economic programs and arbitrate conflicting interests among different agencies quickly faded away and the cohesive cooperation among economic ministries built upon the leadership of the EPB has been in steady decline. During Park's regime (1961-1979), as mentioned earlier, the EPB retained extensive resources with highly concentrated power in its hands under President Park's firm backing, but during the post developmental period the EPB's power status was no longer sustainable for many reasons.

First, since the early 1980s, the EPB's control over foreign loans and the government budget no longer worked as a decisive instrument to influence other ministries. Public and commercial loans accounted for over 70% of foreign capital inflow in the last half of the 1960s, but only about 50% in the early 1980s, and about 34% in the late 1980s. The weight of foreign loans and aid relative to the size of the national economy dwindled, while that of domestic savings and financial institutions' loans from foreign lenders expanded rapidly in the 1980s. The size of foreign loans by financial institutions almost matched the sum of foreign borrowing (public and commercial loans) conducted by the government between 1982 and 1988 (MOF and KIB 1993). Considering that the privatization of commercial banks under Chun Doo-hwan in the early 1980s greatly diminished the Korean government's control over foreign borrowing ushered into the domestic market by commercial banks, it is readily apparent that the financial resources under the EPB's control decreased. In addition, price stabilization and the shrinking gap between domestic and foreign interest rates curtailed the appetites of national firms for foreign capital obtained by the Korean government (Jeong Jeong-gil

1994:159).

For instance, the average annual inflation rate between 1973 and 1981 had been 21.6%, whereas between 1982 and 1988 it dropped to around 5%. The domestic interest rate for bank loans dropped from an average of 17% between 1973 and 1981 to 11% between 1982 and 1987. Therefore, private firms, which had fixed their eyes on foreign loans because of their lower interest rates during the high domestic inflation of the 1960s and 1970s, were no longer desperate for foreign loans and this changed attitude inevitably led to a reduction in the influential power of the EPB on private firms (MOF and KIB, 1993). In addition, policy loans²³ controlled by the EPB and MOF had been in sharp decline in terms of size and influential power over private firms because of the shrinking gap between the interest rates of policy loans and general bank loans. From the mid 1980s on, the gap between the interest rate for policy loans and the interest rate for bank loans in general virtually disappeared, further weakening the leverage held by the Korean government.

This trend of shrinking EPB power was further accelerated from the mid-1980s, when Foreign Direct Investment (FDI) and equity related bond issuances by private firms were encouraged by the Korean government. Bond issuances by financial institutions and private enterprises were preferred by the private borrowers, because Korea's international credit rating had improved enough for bonds to be issued with favorable terms and conditions. FDI increased fivefold to \$5.6 billion in the early 1980s, with the help of the

²³ Policy loans, depending on their purpose, can be divided into three categories: (1) Lending for the machinery promotion fund; (2) Lending for the national investment fund; (3) Lending for export promotion.

government's liberalization policy and Korea's improved investment environment. With the domestic firms' high credibility rating, foreign bonds totaling \$4.5 billion were issued. From the end of the 1980s, equity related bond issuances increased dramatically. As a result of all this, the EPB's dominance over other ministries and private firms has faded away (MOF and KIB, 1993:613-635). As shown in Table 2.11, from the early 1990s on, most foreign borrowing was done by private corporations and financial institutions, while the share of foreign borrowing by the Korean government became negligible. For instance, between 1993 and 1997, foreign borrowing by financial institutions, private firms and FDI constituted 60.7%, while public loans constituted only 8.9%. We will discuss in detail the shrinking financial resources under the EPB's control, including foreign borrowing, policy loans and financial institutions, in a later chapter, where we will deal with the ability of private firms to mobilize industrial funds relative to that of the state.

Second, the EPB's control over the government budget no longer functioned as critical leverage to steer other ministries to cooperate with its transformative programs, although the authority of budget management was its only remaining instrument in handling other ministries. In the 1960s and 1970s, when the government budget was in a rapid growth mode, the EPB was able to control other cabinet ministries by providing or withdrawing its support for their economic programs through the use of the ever-growing budget. But under circumstances where the Korean government was in the process of downsizing in the 1980s and 1990s, the EPB discovered that budget management did not always provide it with enough power to compel other economic agencies to collaborate with its programs. Rather, the EPB found itself with fewer resources and in contention with other ministries demanding more financial support for their programs.

Third, the end of the developmental era also brought about changes in the structure of personnel resources between the EPB and other economic ministries. First of all, starting in the early 1980s, no longer were the top notch of *Haengsi* (civil service exam at the highest level) recruits assigned to the EPB, but to the MOF or other cabinet ministries. During the first half of the 1980s, the EPB could not help but give up half of the top *Haengsi* recruits to the MOF, reflecting the attitude that the EPB was no longer the most promising institution for young elite technocrats to begin their careers (Goh Seong-chul 1995; Park Soo-kyong 1996:127). At the end of the developmental era, the institutional resources under the EPB's control were quite exhausted except for government budget control, while many critical economic policies and institutional resources were still under the MOF's hand. For example, taxation policy, control over commercial banks, insurance firms, and the stock market, and interest and exchange rate regulations could be listed under the MOF's extensive power. The assignment of the top elites recruited through the civil exam mirrored this shifting power from the EPB to the MOF throughout the 1990s (Goh Seong-chul 1990). The overwhelming majority of the top ten *Haengsi* recruits were allotted to the MOF instead of the EPB, resulting in the leveling of the playing-field among the major economic ministries.

Although, as shown in Table 2.10, elite technocrats who originated from and served for the EPB still continued to take over deputy and ministerial posts in minor economic ministries, from the early 1980s on, presidential appointments of EPB elites to other ministerial posts were largely based on individual merit rather than purposive, institutional actions to construct bureaucratic coherence under the EPB's supremacy. This view is well supported by the fact that Chun (1980-1987) frequently replaced the head of

the EPB, shortening the average duration of EPB heads to about 15 months from the more than 28 months under the Park regime (1964-1979). There was no change in this appointment policy for the EPB during the Roh Tae-woo (1988-1992) and Kim Young-sam administrations (1993-1997). The frequent shuffling of EPB heads meant that solid presidential backing of the EPB no longer existed in the 1980s and 1990s. Without technical superiority over other economic ministries (due to elite technocrat assignments) or presidential backing, the EPB's dominance could hardly be expected to persist over the long run.

However, in Chun Doo-hwan's regime (1980-1987), the "potential turf wars" among economic agencies which could have been triggered by the EPB's diminishing dominance, were, by and large, curtailed by Chun's military-style command over economic agencies. Chun installed the principal presidential economic secretariat as the new nucleus of decision-making and policy coordination. The heads of the economic secretariat, Kim Jae-ik and Sah Kong-il in turn, with the entire delegation of presidential power on economic matters, were capable of coordinating and regulating the economic policy process (Lee Jang-kyu 1992; Jeong Jeong-gil 1994:162).²⁴ But this makeshift policy coordination and agency cooperation under Chun collapsed under Presidents Roh and Kim, because neither of them made it clear who was in charge of decision-making or policy coordination by elevating one single economic agency over others. In a later section of this chapter we will lay out in detail how, after the breakdown of EPB

²⁴ Some pundits hold that the tripartite relationship, composed of the EPB, MOF and the Presidential Secretariat of Economic Affairs (PSEA), substituted for the EPB-dominated decision-making system among economic agencies during this period (1980-1987) (*Shindongah*, Feb. 1994).

supremacy over economic agencies, different presidents managed policy coordination and agency cooperation with different types of elite assignments.

Another factor, concerning the EPB's power over other economic ministries, was the broader changing structure of personnel resources within the Korean government over time. According to Ahn Byong-young's recent study (1994), the absolute and relative number of civil service personnel allotted for "industrial and economic management" has been in decline since peaking in 1973, whereas the relative and absolute number of civil servants for "social and cultural management" has multiplied throughout the same period.²⁵ As shown in Table 2.12, civil service personnel allotted for "industrial and economic management" increased from 55,201 in 1963 to 94,194 in 1993, an overall increase of only about 70%, while the total number of civil servants jumped from 230,078 in 1963 to 568,351 in 1993, an increase of 147% from the beginning of planned economic development. The rate of personnel growth for "state management" closely matched the overall rate of increase for all civil servants.²⁶ Of course, this trend in personnel distribution in Korean bureaucracy made it difficult for the elite economic agencies to

²⁵ The primary work of the state can be divided into four areas: "Administration Management," "Industrial and Economic Management," "Social and Cultural Management" and others, according to Ahn Byong-young (1994).

²⁶ The governmental personnel working for social programs in advanced democracies constitutes about 44% of total civil servants. Therefore, as compared with Western democracies, the growth rate of personnel in the same area and its weight relative to the total Korean governmental personnel seems impressive at first glance, but a closer look at the personnel structure in social programs discloses striking differences between Korea and advanced democracies. The overwhelming majority of personnel in social programs (about 52%) are hired by educational institutions which are controlled by the Korean government, whereas only a negligible 1.66% work for public health and welfare programs. In short, the growth of personnel for social programs reflects the spiraling demands for higher education rather than expanding governmental resources for comprehensive social welfare programs (Ahn Byong-young 1994:73-74).

wield the same comprehensive power as in the past. The slash of personnel to be mobilized was, to a large extent, particularly correlated with the weakening status of the EPB, which was positioned at the pinnacle of economic decision-making and was supposed to carry out economic programs by mobilizing bureaucratic resources.

In addition, the modernization of Korean society forced the EPB to relinquish its dictatorial power over other economic agencies. The modernization of Korean society brought more complex issues into the policy-making domain and in turn demanded the division of policy-making within the bureaucratic apparatus. The specialization of individual economic agencies was indispensable in order to deal with very complex and multifarious policy agenda items such as environment, public health, and social welfare. The newly-unfolding policy environment made it difficult for the EPB to hold on to its technical supremacy over other agencies and impose its growth-first policy on other ministries with simplified planned targets.²⁷ In short, the spreading-out of technical competency on a wide range of issues had the effect of leveling the playing-field among economic agencies.

As a consequence of shrinking human and financial resources in the hand of the EPB and blurring the location of decision-making within economic agencies at the end of the developmental era, there was increasing schism within Korean bureaucracy. The

²⁷ As a matter of fact, the Korean government kept “economic growth” rather than distribution of wealth as its primary economic policy even after the end of the developmental state. The IMD category of “Government Economic Priority,” which is supposed to measure the “extent to which government policies favor investment and growth rather than distribution of wealth,” informs us that the Korean government (grade point 73.33 and national ranking 3rd out of the 46 largest economies in 1991) is still largely focusing on economic growth (Data source: the *World Competitiveness Yearbook* 1991, published by International Institution for Management Development [IMD]).

likelihood that significant economic programs initiated by an economic agency would get stymied before reaching the National Assembly floor became greater, simply owing to the absence of an effective coordination system under democratic rule. A new type of bureaucratic coherence based on “democratic and rational” procedures had not yet evolved to replace the break-down of the old-fashioned coherence, that is, the EPB-dominated coordination system.

However, in 1994, the Kim Young-sam government carried out a major overhaul of the bureaucratic system in its effort to respond to the changing economic environment. Under the governmental restructuring program which was carried out in December 1994, the EPB and MOF were merged into a single agency, that is, the MOEF (Ministry of Economy and Finance). The following rationale was often given for this merger: 1) There was no reason to preserve the EPB, whose key institutional role (e.g, economic planning and resource distribution) had died out, except for budgeting and policy coordination. 2) The maintenance of the EPB (which carried the institutional symbol of planned-economy) contradicted economic liberalization and deregulation during market-oriented reform. 3) The annulment of the EPB was an evitable step toward shedding institutional capacity of economic agencies while pursuing deregulation (Park Soo-kyong 1996:103). Thus, the Kim Young-sam government’s bureaucratic restructuring largely intended to constrict the EPB’s interventionist role in the economy rather than to promote its institutional capacity of policy coordination. As a consequence of the merger, the MOEF turned into a gigantic super ministry, which wielded a wide range of powers over budgeting, taxation, economic planning, finance, and pricing, and which consisted of 4 bureaus, 4 directors, and 29 sections with 991 personnel (Ibid., 134-136). Clearly the merger of the EPB and MOF

enhanced the concentration of power in the hand of the MOEF with institutional resource concentration. However, power concentration does not necessarily imply the effectiveness of policy coordination or institutional autonomy of an economic agency.

Notwithstanding its sheer size, the MOEF bore a few significant problems from the very beginning. As demonstrated in the frequent reshuffling of appointments to the head positions of the MOEF between 1995 and 1997 under Kim Young-sam,²⁸ the chief-executive's mandate was not solidly delegated to the MOEF. Rather, President Kim often changed his appointments according to his political needs. In addition, Kim did not categorically assign policy missions to a certain economic agency but delivered his mandate to various economic agencies, depending upon its agenda. This sort of mandate practice by the chief-executive obscures the location of decision-making not only within the bureaucratic system but also to key economic actors in the private sector (Ibid. 110-112). According to Choi Byung-sun (1996), the merger of the EPB and MOF into the MOEF in 1994 led to the breakdown of the policy coordination system, rather than its renovation, because the merger ignored the institutional characteristics of the EPB. The original institutional intent of the EPB was to initiate and execute transformative programs in each phase of economic development solely on the basis of strategic market analysis. The EPB was also designed to be secluded from societal and political pressure with the special assignment of strategic planning. But the merger stripped the MOEF of these institutional characteristics of the former EPB. Another significant problem was the breakdown of cohesiveness within the MOEF, following the sudden merger. The merger

²⁸ During this short period (1995-1997), the head of the MOEF was replaced three times.

of two different agencies brought about tension among mid-level managers who were from two different agencies, the MOF and EPB. The longstanding, traditional merit-based promotion system was replaced by promotions based on political considerations, resulting in the disintegration of cohesiveness within the MOEF. In short, the establishment of the MOEF did not repair the already deteriorating coordination system, but added more problems to it. Thus, the institutional confusion and disarray continued, despite the establishment of the MOEF.

(3) Empirical Examination of the Policy Coordination System: MCM, CEM and CEVM

Now, let us turn to the formal institutions of policy coordination which were presided over by the EPB (1963-1995). Under the EPB, there were two policy coordination institutions, that is, the CEM and CEVM. The Ministerial Cabinet Meeting (MCM)²⁹ acted as a supreme coordination institution over the CEM and CEVM. Before

²⁹ The MCM, which was composed of cabinet members and presided over by the president, was the formal institution where ultimate decisions were made. Thus, the MCM was designed as the intermediary and coordinator in order to resolve conflicting interests among economic ministries. But the MCM degenerated from a decision-making machine into a mere legal procedure in which executive-drafted bills were rubber-stamped and passed along to the National Assembly. As shown in Table 2.13, the ratio of bills passed without revision at the MCM table was extremely high across different regimes after the MCM was degraded to an insignificant process by Park Jung-hee, who largely relied upon informal lines to coordinate governmental policies and had a strong inclination to ignore non-economic ministers. More specifically, the ratio of bills passed without revision at the MCM prior to 1964 was only 58.5%, but this number jumped to 91.1% in 1969. From 1969 on, the ratio remained over 90%, although a closer look at the numbers discloses a slight difference between authoritarian and democratic regimes (for instance, the duration of time per meeting and duration of time per bill deliberated in the meeting grew longer during the Roh and Kim administrations, because of the more active involvement in the discussion by cabinet members under a more democratic environment). This extremely high ratio of bills passed without revision indicates that the substantive

being submitted to the MCM, economic bills and policies were supposed to go through the CEM and CEVM. As mentioned earlier, the CEM was presided over by the Minister of the EPB (vice-prime minister) whose budgetary power was often utilized to manufacture policy collaboration, whereas the CEVM was presided over by the Vice-Minister of the EPB. Although it is recognized that the CEM retained more substantive decision-making power than the MCM, a large number of decisions on economic programs were determined by the CEVM, because of the fact that CEVM members were career professionals and accordingly were likely to better comprehend the nature of drafted economic programs in detail. As may be seen in Table 2.8, the ratio of bills passed without revision at the CEM was much higher than at the CEVM. Considering that bills passed at the CEM must go by the CEVM before being submitted to the MCM, rather than vice versa, the higher ratio of bills passed without revision at the CEM implies that decisions made by the CEM were frequently overridden by the CEVM which spent more time on each item of legislation. Thus, it is quite clear that the CEVM was the location for genuine decision-making and that this study must look at the CEVM in order to identify changes in bureaucratic coherence. In short, the use of CEVM decision-making as an empirical indicator for the degree of bureaucratic coherence is justifiable.

There have been significant changes in the ratio of bills passed without revision at the CEVM across different regimes, while the variations in its counterpart, the CEM, are indistinct. From a glance at Table 2.8, we can see that there have only been modest changes in the ratio of original bills passed at the CEM since Park's *Yushin* regime (1974-

decision-making was done somewhere else for both authoritarian and democratic regimes.

1979), when the strict bureaucratic order and bureaucratic coherence under the Bureaucratic-Authoritarian regime, more specifically under the EPB's leadership, were institutionalized. The ratio of original bills passed during the *Yushin* regime was 86%, 79.2% during the 5th Republic (1981-1987), 78.3% during Roh's 6th Republic (1988-1992) and 72.6% during Kim's 6th Republic (1993-1997).³⁰ While there are meager variations in terms of original bills passed at the CEM, the changes at the CEVM are remarkable. For instance, the ratio of bills passed at the CEVM during the 1970s fell constantly from 80% during Park's regime (1970s), to 76.2% during Chun's, 65.6% during Roh's, and 58.4% during Kim Young-sam's administration. However, during the last years of the Kim Young-sam administration, the ratio increased, owing to the power concentration in the hands of the MOEF which presided over the CEM and CEVM.

The question comes to mind of why the ratio of bills passed at the CEVM plummeted substantially across different regimes since the 1970s. The bills placed on the CEVM table almost always involved numerous economic apparatus. Therefore, it was customary for an economic agency initiating a bill to consult with the other agencies involved in that item before submitting it to the MCM. Pre-coordination or pre-settlements among different agencies were arranged or manufactured by the EPB or technocrats who took the initiative for each bill, utilizing informal resources such as alumni networks and *Haengsi* colleagues. Informal and non-procedural coordination practices were quite often employed in Korean bureaucracy because of the shared alumni

³⁰ If we omit the data for 1997, when the Kim Young-sam government was alerted to the economic crisis and his economic agencies responded to the crisis with more collaborative efforts, the average ratio of bills passed without revision under the Kim Young-sam government would drop to 68.7%.

status of elites.³¹ The pre-bargaining or coordination across economic agencies has disintegrated since the mid-1980s due to the following reasons: (1) the breakdown of the hierarchical order within the bureaucracy which was built upon the principle of EPB supremacy over other economic agencies; (2) the emerging rivalry of departmental interests; (3) the weakening coordination power of the Presidential Economic Secretariat; and (4) the exhaustion of informal networks (including alumni and *Haengsi* colleagues) as a positive force in policy coordination.³²

In particular, the “rivalry of ministerial interests” (*Bu-chau-ee-kee-ju-ee*) and policy conflicts among economic agencies has been on the rise, inflicting serious damage on the Korean bureaucracy’s competence to initiate and execute transformative economic programs, as a large number of Korean scholars have pointed out in their recent studies (Lee Seong-uh 1993; Jeong Jeong-gil 1993; Park Keun-hoo 1992; Kim Young-pyong and Shin Shin-woo 1991; Hahm Sung Deuk and L. Christopher Plein 1997). The rise of “ministerial rivalry” is associated with mounting external pressure on each agency from social groups which began to raise their voices under democratic rule. For instance, the

³¹ According to our study, as of January 1995, more than 60% (18/29) of MOEF (Ministry of Economy and Finance) elite bureaucrats whose ranking was director of a bureau or higher, graduated from Seoul National University (SNU), and 47.5% (38 out of 80) of elite technocrats at MOF, as of January 1990, graduated from SNU. In addition, these graduates were predominantly from the School of Business and Economics at SNU, setting a strong foundation for alumni networks.

³² The informal networks, primarily based on school ties, *Haengsi* colleagues, and regional ties, were an invaluable source for smooth and swift policy coordination during the early phase of industrialization, when the policy agenda was straightforward and the scale of economic administration was simple with the infantile economic system. But the complexity of the policy-making process and increasingly complex agenda settings made it impossible for informal lines within Korean bureaucracy to work as a coordination engine. More formal and democratic procedural institutions had to substitute for the old machinery of coordination.

evolution of a strong peasant and labor movement put pressure on the Ministries of Agriculture and Fishery (MOAF) and of Labor (MOL) to represent their demands for higher official prices, protectionist policies of agricultural products, and higher wages at the Ministerial Cabinet Meeting (MCM). Interest group lobbyists penetrated the bureaucratic system more deeply, causing policy conflicts and delays all along the policy-making process (Lee Seong-uh 1993).

Democratization also compelled the popularly elected presidents to incorporate the issues of economic justice and public welfare as critical components of their economic programs, which in turn strengthened the executive power of cabinet ministries which were largely neglected under the authoritarian developmental state. The changes in the sequence of policy priorities has the effect of leveling the playing-field among economic agencies, because the economic agencies, for instance, MOAF and MOL, which had no say in economic programs under the “principle of economic growth first,” began to raise their voices. In short, the breakdown of bureaucratic coherence and policy collaboration was partially the unavoidable consequence of democratization and an accomplishment of industrialization as mentioned earlier. Our empirical indicator of policy coordination system, that is, the ratio of bills passed without revision at the CEM and CEVM, mirror the deteriorating bureaucratic cohesiveness over time. The lower ratio of bills passed at CEM and CEVM clearly signifies that Korean bureaucracy no longer works as an unitary actor but acts multifariously.

The breakdown of the policy coordination mechanism has important implications for the business-state nexus. First, the state, which is no longer able to act as a unitary actor, lost its capacity to monitor private firms and punish noncompliance, leading to the

loss of important leverage in inducing businesses to collaborate with governmental programs. Second, the fractures within the bureaucracy permitted the business lobbies to be more penetrating and effective. Individual business agents have a better chance to rent-seek successfully because of the dwindling bureaucratic coherence across economic agencies. In other words, the divided bureaucracy has become much more defeatable by business. As a matter of fact, the size of the slush funds mobilized by big business has sharply increased and graft paths have become diversified especially after democratization (Park Dae-ho 1991; Kim Seong-woo 1991). This topic will be discussed in detail in Chapter IV. Third, the dwindling policy consistency caused by the breakdown of the coordination system has undermined the Korean government's policy credibility from the business perspective, so that business has become unwilling to follow the governmental leadership in the pursuit of transformative programs. It has become increasingly difficult for the Korean government to induce business into profit-seeking productive investments and, as a consequence, more capital has flown into speculative investments.³³

(4) The Legislative Branch and its Relations with the Executive

Power distribution between the legislative and executive branches in the context of economic policy-making attracts the attention of political economists studying the business-state nexus. The executive's overpowering of the legislative makes it easier for

³³ For instance, between 1990 and 1992, the Korean government attempted to induce businesses to invest their massive surpluses generated during the economic boom (1987-1989) in R&D and high technology industries (major transformative programs at that time), but most of this massive surplus was sucked into speculative investments such as the purchase of real estate, due to the government's incompetency (Im Hua-chul 1997).

economic agencies to follow their own rationale in the economic policy-making process. On the other hand, extensive involvement of the National Assembly in drawing up economic bills is likely to put more political considerations into the final draft of economic legislation. Participatory politics does not necessarily lead to the inefficiency of the policy-making process, only when the particular interest of one or a few social groups overshadows the legislative process. As will be analyzed in the following chapters, the increasing legislative power in the hands of the National Assembly provided big business groups with ample opportunity to maneuver the policy-making process. Thus, the delay and distortion of key economic bills by big business groups has become routine during democratic rule. Big business groups, whose power has not been checked and balanced by other social groups in the legislation process, have capitalized on the open and democratic legislation process for the enhancement of their particular interests.

In this section, we will explore how and to what extent democratization transformed the legislative-executive nexus. Following the transformation in that nexus, what sorts of discrepancies in terms of economic management have taken place across different regime types, democratic and authoritarian? Did the economic policy-making procedure become more easily distorted by political pressures, owing to the fact that economic technocrats were more frequently forced to yield to the political demands of the National Assembly members? Did the diffusion of power in the economic decision-making process substantially curtail the range of strategic choices by the policy makers by making it easier for big business to manipulate individual National Assembly members?

In most democratic systems, the legislative is supposed to have four primary functions: representing the interests of constituents, law-making, supervision and

surveillance of the executive, and overseeing and approval of financial programs and budgeting. But under authoritarian rule in Korea (1963-1987), many of these functions were minimized or even usurped by the executive (Yun Hyung-Sub 1976:495-497). Especially the role of the legislative in the economic policy decision-making procedure was unduly limited because of the dictatorial rulers' determination to minimize the influence of politics on economic management. Before President Park took power in 1961, various interest groups had access to policy-making decisions through the political parties and the National Assembly since a large number of bills were still initiated by National Assembly members which tended to be more accessible than the executive branch to interest groups (Refer to Table 2.14). But President Park reshaped the legislative-executive nexus by putting National Assembly members under his firm control. The influence of individual Assembly members on economic policy-decision making became negligible because the ruling party was dominated by the President and the party leaders. For instance, under the 6th, 7th and 8th Congress, whose party-related legislation provided the party leaders with a wide range of authority to control National Assembly members, including the power to pick candidates, ban non-partisan candidacy, and prohibit the withdrawal of party membership by National Assembly members, the National Assembly members were forced to be loyal to the president and the party leadership (Yun Hyung-Sub 1976:506). The president's control over National Assembly members was even further strengthened by the institutionalization of the ruling party's automatic majority within the National Assembly as the president was given the authority to hand-pick one third of the National Assembly members under the 1972 *Yushin* constitution. Moreover, effective opposition to the ruling party or the government in the National

Assembly was impeded because the ruling party was almost always in a solid majority (Yeon-ho Lee 1997:79; Yun Hyung-Sub 1976:496-495). As a consequence, the President and party leaders were able to wield great discretionary power in terms of policy-making decisions. No challenge to the policy initiatives of the executive was expected from the congressional floor.

The diminishing proportion of bills initiated by Assembly members illustrates the trend toward the waning significance of the legislative in economic policy-making under the Park Jung-hee regime (1961-1979). For instance, the legislation introduced by the executive constituted 58% of the total number of bills in the National Assembly in the 1950s (Refer to Table 2.14). This proportion remained about the same during the early period of the Park regime in the 1960s, under which the regular electoral contests had at least institutionalized presidential and congressional elections, but this number rose to 84.6% under the *Yushin* regime (1972-1979) during which Park firmly established his dictatorial rule with the institutionalization of an automatic majority in the National Assembly. More importantly, there was a noticeable change in the ratio of executive-initiated bills passed in the National Assembly. Whereas the ratio of executive-initiated bills passed in the National Assembly was only 48.6% under the Rhee Syngman regime in the 1950s, that ratio rose to 72% during the early period of the Park regime and rose further to 96% during the *Yushin* period. This unprecedented proportion during the *Yushin* regime (1974-1979) clearly indicates that the National Assembly was reduced to a mere rubber stamp which simply followed the initiative of the executive in policy-making decisions (Jeong Jeong-Gil 1994: 37-41).

The influence of the ruling party on the economic policy making process was also

narrowly confined. The position of the ruling party on economic issues was decided in the “government-party joint meeting,” which was originally established with the intention of incorporating the ruling party into the policy making process in 1964,³⁴ but this joint meeting worked as an effective institutional conduit to channel the policy preferences of the ruling party into the policy making process only during the early period of the Park regime. As shown in Table 2.15, the number and the portion of bills proposed by the ruling party was reduced from 185 and 43.3% from 1963-1967, to 105 and 26.5% from 1967-1971, to 15 and 13.6% from 1971-72, and to 17 and 3.4% from 1973-1979 respectively. On the other hand, the ratio of bills initiated by the executive jumped from 56.75% between 1963 and 1967, to 96.6% between 1973 and 1979. Park, who became aware that the ruling party could not function as an effective conduit to channel the governmental policy preferences to the population in the late 1960s, attempted to minimize the influence of the National Assembly members on the policy-making process, especially during the Yushin regime whose revised constitution virtually endorsed his unlimited term in presidential office. Accordingly, the ruling party degenerated into a mere political device which was utilized to legitimize the legislation proposed by the executive.

The unity of National Assembly members behind the policy preferences of the

³⁴ The government-party joint meeting was originally constructed under Park’s ambitious scheme to utilize the ruling party as an institutional conduit to incorporate and mobilize every walk of life into his single most important national goal, swift industrialization. Thus, this institution included various committees at different levels which were linked to the bureaucratic offices at different levels. At the top of this joint meeting, the President, high-ranking party officials and the ministers concerned, were involved (Jeong Jeong-gil 1994:40).

government was manufactured by an institutional framework within the ruling party in which the chief-executive exercised the monopolistic authority to nominate candidates for National Assembly and provided these candidates with campaign financing. Especially the distribution of campaign funds by the President assured his commandship of the National Assembly members.³⁵ Thus, for members of the Korean National Assembly, there was no choice but to follow the directions of party leaders when a bill was put to a ballot (Young-gu Kim 1991:154). In addition, the bills initiated by the ruling party during this period were drafted mostly by incumbent or former government officials who were dispatched to the party. Thus, there was a high potential that even bills drafted within the ruling party reflected the governmental position on the concerned issues.

As a consequence of the diminished power of the legislative branch under the Park regime, the Korean bureaucracy was not accountable to the legislature, shielding the economic policy-makers positioned at the core economic apparatus from political pressures (Woo-Cumings 1995:161). In turn, the weakening of the legislative branch resulted in the denial of access of the overwhelming majority of interest groups to the core policy makers unless they could find a different access channel to the policy making procedures. Under political circumstances in which constitutional access channels

³⁵ During the early period of the Park regime (1963-1970), the power elites within the ruling circle were involved in mobilizing campaign funds from business, often by trading public construction projects. But during the *Yushin* regime (1972-1979) the means of mobilizing political funds was concentrated in the hand of the President and the budgeted sum of political funds, as the maintenance expense of the regime, was collected from big business on a yearly basis without pork-barrel trade between business and government (Kim Jin 1993:261-171). In addition, Park banned National Assembly members from being involved in graft at all and instead distributed political funds collected from big business to his party members (Han Seoung-jo 1991:86-87).

(legislative) were largely banned, the articulation of interests was directed toward the executive.³⁶ Another consequence of the powerlessness of the legislative branch was that the firm protection of economic technocrats from political pressures promoted their job motivation by insuring that their hard-thought out economic programs would not be tainted or twisted with political pork-barreling in the legislative process.

Under the Chun Doo-hwan regime (1980-1986), the nature of the legislative-executive nexus was the same as in the previous regime. Chun, who took power through a military coup in 1980, fabricated the Democratic Justice Party (DJP) in the midst of political terror, while he prohibited major political leaders from engaging in any political activities. Under the newly formulated political structure, the DJP was basically assigned a supportive role for Chun's economic leadership rather than having its own autonomous voice in the legislative process. In order to control his party members in the congress, Chun utilized the same resources as Park, including holding authority of candidate nomination and monopoly of political funds in his hands.³⁷ However, the DJP was slightly

³⁶ According to Young-Rae Kim's study (1990), the lobbying institutions of the two major interests groups, Federation of Korean Industries (FKI) and Federation of Korean Trade Unions (FKTU), followed this sequence in their lobbying attempts: economic ministries, EPB, President, office of prime minister, National Assembly and political parties. Kim's data clearly shows that the National Assembly and political parties were, by and large, overlooked by the business associations during 1961-1979 (pp.244-262).

³⁷ Regarding political funds, Chun adopted his predecessor's method of monopolizing political funds in his own hand and then distributing them to his party members. The overwhelming proportion of operating funds and campaign funds for the ruling party came from Chun's slush fund mobilized from big business. According to Chun's own words, he provided the DJP with about 2.5 million dollars a month. The concentration of political funds in Chun's hand by and large curtailed chances that politicians were involved in graft, the same as during Park's reign (Jo Kap-jae 1992:126-138; Park Jong-yul 1989:288 -291; Han Seoung-jo 1991).

more active in the legislative process than the Democratic Republican Party (DRP) during the Yushin regime in the 1970s. For instance, Chun recruited competent high-ranking government officials and assigned them as expert advisers to significant sections of the party organization, so that they were able to draft bills or develop campaign promises on behalf of the National Assembly members. They served as expert advisors between one and two years for the ruling party and then returned to their ministries, resulting in spontaneous collaboration between the ruling party and the executive branch (Sin Kum-Sik 1995; Jeong Jeong-Gil 1994:124). As shown in Table 2.16, the proportion of bills initiated by the ruling party rose from a negligible number to 12.5% in the 11th Congress and 25.3% in the 12th Congress, although the predominant proportion of bills (87.5% in the 11th Congress and 74.7% in the 12th Congress) continued to be initiated by the government. But close examination of Table 2.16 makes it clear that President Chun was determined to eliminate any political influence of National Assembly members on economic policy decisions and their implementation. During Chun's reign, the ratio of bills initiated by the government and passed in the National Assembly was 91%. Only 9% of bills proposed by the executive were turned down by the National Assembly. Additionally, the proportion of bills submitted by the executive to the total number of bills remained substantially high (73.5%), although this number was lower than that of the *Yushin* regime (9th Congress).

The democratization begun in 1987 inevitably changed the legislative-executive nexus. First, democratization revived the supervisory and surveillance authority of the National Assembly over the Executive and the Executive was forced to attain the approval of the National Assembly on significant economic policies. Second, the statute which

created the automatic majority in the National Assembly for the ruling party was dismantled. Accordingly, the chief-executive was often forced to handle economic legislation with a minority of seats in the National Assembly especially during the early Roh Tae-woo government between 1987-1989 (Jeong Jeong-gil 1994:202-204). Third, the ruling party tried to magnify its role by being independent of the chief-executive financially and improving its own staff by the replacement of incumbent government officials. Unlike their authoritarian predecessors, Park and Chun, who monopolized political funds in their hands and disbursed them to their ruling party, Roh and Kim Young-sam were hesitant to play the political fund mobilizer.

The restoration of the congressional authority to inspect the government offices each year, which was abolished under the *Yushin* Constitution in 1972, put the policy decisions of economic ministries under the surveillance of the National Assembly under democratic rule and forced economic technocrats to consider the political mechanisms involved when they drafted legislation. Along with this authority, the National Assembly was also given the authority to investigate specific national affairs (Constitution Article 61) and the new constitution (drafted on October 29, 1987) abolished limits on the total length of time and number of sessions in which the National Assembly could meet. In addition, the new constitution stipulated that significant policies drafted by the executive must receive the support of the National Assembly.

As a result of the restored constitutional authority of the National Assembly, the character of the legislative-executive nexus changed, as illustrated in Table 2.14. The proportion of bills initiated by the executive plummeted from 73.5% under Chun's authoritarian regime to 50% during Roh's democratic government between 1988 and

1990. But the ratio of the executive-proposed bills passed in the National Assembly has remained virtually unchanged from 91.2% under the Chun regime to 87% in the 13th congress under Roh. National Assembly members were actively involved in introducing new legislation during this period, with the result that almost half of all bills were introduced by National Assembly members. This trend in the legislation process was accelerated by the dominance of opposition parties in the National Assembly during Roh's reign.³⁸ The Roh administration, while his ruling party was a minority in the National Assembly during 1987-1990, clashed with the National Assembly on every single major economic policy.

But the strength of the National Assembly under Roh's government quickly diminished as the ruling party, the DJP, merged with two conservative opposition parties, the Reunification Democratic Party (RDP) and the New Democratic Republican Party (NDRP). The "grand conservative alliance," which consisted of more than two-thirds of congressional seats, provided President Roh with solid hegemony over the National Assembly and thereby returned the ultimate authority of decision-making to the executive. Before the construction of the "grand conservative alliance" in February 1992, only 72.5% of the bills submitted by the Executive were able to get through the National Assembly, but this percentage went up to 85% after the "grand conservative alliance" was forged (Refer to Jeong Jeong-gil 1994:203-206). Additionally, the number of bills initiated by the executive sharply increased whereas the number of bills proposed by National Assembly

³⁸ The ruling party, DJP, collected only 125 out of the total 299 congressional seats (only 87 out of 224 seats in electoral districts) in the congressional election which was held in April 1988.

members decreased. However, the effect of the political merger among the three parties did not last long as can be seen from the number of bills passed under the 15th Congress, although the “grand conservative alliance” held up throughout the 15th Congress.

Under the Kim Young-sam government (1992-1997), for the first time, the proportion of bills initiated by the executive relative to the total number of bills submitted to the National Assembly floor fell below 50% and the ratio of executive-initiated bills passed in National Assembly decreased sharply from 83.1% between 1990-1993 to 74.3% in the 15th Congress (May 30, 1996-October 31, 1998).³⁹ Closer examination of the legislation passed across regime types reveals that the constitutional power of the Korean National Assembly as a law-making institution has been in a recovery process. For instance, under authoritarian rule (1972-1986), about 90% of the executive-initiated bills were passed by the congressional floor without revision. This figure dropped somewhat in the 13th Congress to 84%, but plummeted to 46.6% in 14th Congress and 28.1% in the 15th Congress.

In conclusion, these numbers undoubtedly proclaim that the Korean legislature has been slowly but steadily reclaiming its law-making authority and thereby the hegemony of the chief-executive over the legislative process has been in decline. Party politics has also been in a recovery process especially since Presidents Roh and Kim relinquished the

³⁹ But the legislative power of the executive has not dwindled as sharply as the numbers superficially tell us. Expert advisors dispatched from the executive (who are likely to reflect the policy preferences of the executive) still play a significant role in drafting economic bills because a large number of National Assembly members are still incompetent. In addition, the executive often initiates new bills using a National Assembly member’s name for political purposes. Thus, the executive power in terms of economic legislation has not dwindled as much as the data from Table 2.14 presents (Refer to *Chosun Daily Newspaper*, 2/22/1999).

monopoly of political funds, although the ruling party has, by and large, remained under the chief-executive's control. As a consequence of both the legislative's and the ruling party's reclamation, although partial, of economic policy-making, the economic technocrats located at the core economic apparatus became exposed to public monitoring and political pressure, as the protective power of the president over career civil servants was curtailed. The effect of the dissipating protection of economic technocrats was that policy-makers began to pay more attention to politics and were discouraged from fully committing themselves to their economic programs. In addition, the increasing involvement of party politics in economic legislation provided big business with ample opportunities to influence economic policy-making, while other social groups were barred from being heard because of their political weakness. The costly electoral campaign and the limited sources of political funds (basically from business) made politicians vulnerable to bribery. With the use of their plentiful slush funds, big business often blocked legislators from passing bills which were against the pivotal interests of big business. In short, although democratization gave back at least partial authority of policy-making to the legislative and political parties, that authority fell prey to big business which essentially monopolized civil society in terms of the political resources they could mobilize when other parts of civil society were fragmented.

INSTITUTIONAL FOUNDATIONS FOR BUREAUCRATIC COHERENCE: RECRUITMENT AND REWARD SYSTEM

(1) The Recruitment System

Now we turn to each of the factors of a “Weberian bureaucracy” and attempt to detect changes in these factors over time. To begin with the conclusion, there have been few changes in the long tradition of the merit-based system of recruitment as the consequence of democratization or at the end of the developmental era. The Korean state has continued to be successful in recruiting a quality labor force, as shown in the highly competitive civil service exam (Refer to Table 2.17). Competition has remained fierce throughout the time period covered in the table (1949-1997). The ratio of successful applicants to those taking the exams at all levels has been extremely low. For instance, between 1970 and 1979 at the lowest ranking of the civil service exam, there were 20 exam-takers for every successful applicant.

The firm institutionalization of meritocratic recruitment in Korea was the combined corollary of several historical milestones. First, merit examinations have been used for recruiting career civil servants for over a thousand years in Korea (since 788 A.D.) (Kim Byung-kook 1987:100-102). This long tradition of bureaucratic statecraft has provided the Korean state with a nonmaterial source (social prestige) to recruit elite corps because bureaucratic careers have traditionally been considered prestigious. Thus, the state has traditionally been able to pick its staff from among the most talented members of the most prestigious universities.⁴⁰ Second, on top of the long tradition of the bureaucratic state

⁴⁰ Some scholars (Cumings, B. 1984b; Kohli, A. 1994) point out that, along with this long tradition under which government officials are highly honored, Korea gained valuable historic experience by adopting Japan’s well-defined bureaucracy during the

mentioned above, Park Jung-hee constructed the current merit system of recruitment by dismantling the clientelistic ties which were at work within the bureaucracy under the Rhee Syngman regime (1948-1958). Under Rhee, the civil service exam for upper-level bureaucrats was largely bypassed. "From 1949 to 1961, only 336 men passed qualifying tests, compared to 8,263 'special appointments'" (Cheng, Haggard, and Kang 1998:105). As shown in Table 2.18, only 4.1% of those filling higher entry-level positions (Level 3:b) came in via the civil service exam, while the rest of high-ranking officials were recruited through a highly politicized special exam which was presided over by the ruling party, the Liberal party. Nor were those who entered higher civil service able to count on making their way up through the ranks via a standard process of internal promotion. Instead, higher ranks were filled primarily on the basis of special appointments (Refer to "1948" in Table 2.18) (Kim Byung-kook 1987:101-2; Cheng, Haggard, Kang, D. 1998:105).

In contrast with Rhee, Park Jung-hee forged the institutionalization of a highly selective personnel policy with the installation of the Ministry of Government Administration (MOGA) in 1961, which was given the authority to monitor recruitment and to manage personnel matters within the government. Since 1961 there have been two different ways to recruit career civil service workers: (1) open civil exam; and (2) "special

Japanese occupation. The invaluable lesson that Korean bureaucracy learned was that bureaucracy can play a pivotal role in channeling capital into targeted industries during a certain period of industrialization. In addition, "the presence of Korean bureaucrats, trained and employed by the Japanese, was also sizeable; nearly 40,000 Koreans qualified as government officials just before the Second World War" (Woo-Cumings 1995:148). However, new studies (Haggard, Kang, and Moon, 1997; Lee, C. 1985; Haggard, Kim, B. and Moon, C. 1991) on the legacy of Japanese colonialism on Korean bureaucracy undervalue the Japanese contribution to the construction of Korean meritocratic bureaucracy. Rather this group of scholars gives most credit to Park's revolutionary turnaround in the context of developmental bureaucracy.

recruitment.” The ratio of usage between these two methods varies across regimes and years, dependent upon bureaucratic or political needs, but roughly 70% of recruits came through the open civil service exam, while 30% came via “special recruitment” (Refer to Table 2.19⁴¹). Civil service exams at the different layers⁴² and spheres of bureaucracy have been highly competitive throughout the modernization of Korean society, as illustrated in Table 2.17.⁴³ Although a greater variety of criteria for recruitment was involved, “special recruitment” was quite standardized with transparent procedures and criteria under Park. Especially in order to build a capable higher managerial corps, Park began to rely upon a

⁴¹ A close look at the ratio of recruitment through open civil exam (from Table 2.19) discloses that the ratio of recruits via open civil exam in central government dropped dramatically during Park’s late bureaucratic authoritarian regime (1974-1979) because Park relied upon “special recruitment” to mobilize regime supporters within the bureaucracy. Except for this period, over 70% of recruits have come through the open civil exam since the late 1960s.

⁴² Korean career civil servants have been divided into nine different levels throughout the entire developmental period. There have been civil exams at three different levels through which people entered civil service. The level 5 civil exam (previously level 3-b) is operated to recruit top elite bureaucrats, level 7 for middle-layer bureaucrats, level 9 for low-layer bureaucrats. Regardless of which level they enter at the beginning of their careers, they are permitted to climb to the top of the hierarchical ladder on the basis of their merit although it is expected that those who enter at a low level would have more difficulty gaining promotions than those entering at higher levels.

⁴³ As you may notice in Table 2.17, throughout the entire period listed in the table and at all different levels of civil exams, Korean civil exams have been highly competitive, indicating that only the competent would enter civil service. For instance, only one out of over 100 examinees in the level 9 civil service exam passed the test in the mid to late 1990s. Except for the 1960s, when civil exams, especially in levels 7 and 9, were relatively less competitive, civil exams have remained popular among young people. Examinees, especially those who attempted the level 5 test, were ambitious young people who were looking for prestige, job security, fortune and even a good marriage all at once.

civil exam (*Haengsi*, Level 5 civil exam, previously Level 3-b⁴⁴) and internal promotions, instead of the “special exams” utilized under Rhee. As a consequence, the proportion of mid-level managers hired via civil exam increased sharply from 4.1% between 1948 and 1961 to 20.6% between 1977 and 1980, while that of special appointees substantially decreased, for instance, from 52.9% between 1948 and 1961 in level 2 managers to a mere 6.8% between 1977 and 1980 (Refer to Table 2.18). Recruitment of middle-managers via competitive, open and transparent civil exams brought in new, competent college graduates with highly similar educational backgrounds. The injection of fresh blood into the bureaucracy resulted in the improvement of bureaucratic technicality, coherence, and cooperation.

Paying attention to the institutionalization of the civil service exam is worthwhile, especially the recruitment of mid-level managers under Park, in the sense that Park’s efforts to regenerate the Korean bureaucratic system elevated the availability of expertise and technical personnel to plan, monitor and implement policies and elevated cohesiveness within bureaucratic organizations: First, recruits via civil exam commonly shared similar school, academic, career and age backgrounds, leading to corporative unity among them.⁴⁵

⁴⁴ *Haengsi* is the highest civil exam through which the state recruits mid-level managers for its administrative apparatus. There were three different levels of civil exams, levels 7, 4 and 3-b (these levels were renamed “levels 9, 7 and 5” in 1990s). In addition, civil exams were divided into different domains (for instance, foreign service, administration service, and judicial service exams), depending upon the expertise of the recruits. Most economic technocrats are recruited via *Haengsi* (administration service exam).

⁴⁵ According to Kim Byoung-kook (1987), from early on the EPB was filled with *Haengsi* examinees who were from Seoul National University (SNU: the most prestigious university in South Korea). This trend has continued since then, so that, for instance, as of 1995, 78.7% of office-holders at the EPB above the level of section chief were SNU graduates (Lee Jae-kyong 1995).

Second, merit-based selection provided elite bureaucrats with the cultural and ideological legitimacy to rule over their civilian partners. As a consequence of recruiting elite corps, the core apparatus of economic planning was modernized with competent personnel (Kim Byung-kook 1994:172-179).

The institutional foundations for recruitment set by Park in the early 1960s has remained intact over the last four decades, regardless of regime changes. The low ranking civil servants have been increasingly enlisted via open, competitive civil exams since then, as demonstrated in Table 2.19 (Refer to years 1961-1965). Mid to top level managers were recruited via three different means: civil exam (*Haengsi*), special recruitment (*Teukchae*), and internal promotions (*Teukseoung*). Even in special recruitment procedures, which were utilized to inject fresh blood into the conservative and rigid bureaucracy and occasionally to maneuver skilled civilian experts into the core economic agencies, the likelihood that the political pork-barrel would be involved in the recruitment process became very slim by establishing transparent standards. As a matter of fact, many prominent economic professionals, like Kim Jae-ik and Kim Jaeg-wan, were recruited via this means (Kim Byung-kook 1987:105-107).

The pattern of internal promotion has been based primarily on seniority and merit. A proper and transparent exercise of seniority and merit as the criteria for promotion provided officeholders with high incentives to pursue their lifelong careers within the bureaucracy and provided bureaucratic cohesiveness (Rhee Jong-bum 1994; Jeong Jeong-gil 1994:74). A fair and transparent promotion system is a prerequisite for bureaucratic coherence and to motivate recruits to develop an attitude of devotion toward their work due to its strong correlation with job morale and career satisfaction. According to Hah

Sang-mook's recent study (1994) on high ranking officials, the promotion system has not been discriminatory against individual backgrounds, including high school, college, and birthplace. Rather, other factors, such as the agency for which one works and whether or not an office-holder began his or her career by passing the *Haengsi* (top civil exam), are more significant in determining the amount of time spent between promotions.

Considering that *Haengsi* entrants and technocrats who are assigned to certain bureaus are likely to be competent, it is safe to claim that the promotion system for high ranking office-holders has been based more on merit than anything else.

Top elite technocrats (Levels 1 & 2) in economic agencies were recruited via both internal promotion and special recruitment, but primarily through internal promotion. The overwhelming majority of top economic technocrats have been top notch graduates of prestigious schools who passed the *Haengsi* (highest civil exam) and climbed the ladders of the bureaucratic hierarchy throughout their careers. For example, as of January 1995, among 88 elite technocrats at the Ministry of Economy and Finance (MOEF⁴⁶) who were at or above the level of section chief, there were only five people who had not come in through *Haengsi*, but were recruited through *Teukchae* or in other ways (Lee Jae-kyoung, 1995:10-11).

The promotion system was also backed by educational and training programs at various levels by which the Korean state sought to improve ideological cohesiveness, general management skills, and the professionalization of officeholders in their areas. Although the educational programs tended to be geared towards ideological retraining (in

⁴⁶ In December 1994, the Economic Planning Board (EPB) and the Ministry of Finance (MOF) merged into MOEF (Ministry of Economy and Finance).

such areas as public ethics, the ruling ideology of the regime, and anti-communism) and general management skills rather than professionalization, retraining programs for officeholders at various levels definitely helped to upgrade organizational unity, develop an ideological common ground for economic development, and increase the proficiency of Korean bureaucrats (Jin Jae-gu 1994:334-338). In particular, the special programs under which elite technocrats were sent to foreign institutions and trained in master or doctoral programs with the government's financial sponsorship have provided career officeholders with opportunities to be exposed to foreign bureaucratic systems and to accumulate special knowledge in their own fields. The number of career bureaucrats who went through this program jumped from 234 in 1986, to 415 in 1991, 652 in 1992, and 1304 in 1995 (Refer to *The Yearbook of MOGA*, 1997). Therefore, the professionalization of elite bureaucrats progressed quickly under these circumstances in which each officeholder attempted to advance his or her capabilities.

The meritorious disposition of the recruitment and promotion systems has remained undiminished and has even been strengthened over time. Regarding the **competitiveness** of the civil exam, the rate of competition in all different levels of civil exams has varied slightly, but has remained persistently high. Since 1980, the rate of competition in the administrative service exam (level 5) through which mid-level managers are recruited, has been near or well over 60:1 (this indicates that there were 60 exam-takers for every successful applicant). And there has been an increase in competitiveness in the 1990s, especially in the level 9 civil service exam through which low ranking civil servants are enlisted (Refer to Table 2.17). With respect to the **openness** of the civil exam, the overall ratio of recruitment through the open civil exam to total recruitment has

steadily improved over time, whereas the ratio for civil servants for central government has remained almost steady since 1978 (See Table 2.19). In short, we can conclude that there has been steady improvement in the recruitment system in Korea over the last several decades. Governmental jobs have increasingly been distributed by more open and competitive civil exams over time. Thus, the technical competency improved via open and competitive civil exams has bred integrity and cohesiveness in the Korean bureaucracy for last four decades. However, the maintenance of high competitiveness and openness in the civil service exam does not necessarily mean that the Korean government has always been able to recruit high quality labor as compared to the private sector. Before rushing to conclusions, the reward system must be examined to determine whether or not the Korean state is still capable of attracting career officeholders.

(2) The Reward System

Now let us turn to the second important ingredient for efficient and coherent bureaucratic machinery, that is, the “reward system.” In order to insure a competent bureaucracy which is capable of maintaining the state’s dominance over civilian partners, the overall combination of rewards to government officials must be commensurate with those available to people of comparable qualifications in the private business sector. Up until the late 1970s, the overall rewards civil servants received were comparable to their civilian counterparts because their slightly lower salaries were offset with high job security, social prestige and generous retirement pensions and other benefits. But the reward system for officeholders in almost every single category has been depreciating since the mid 1980s (Park Young-bum and Rhee Sang-duk 1990:41-72).

First, regarding the salaries of civil servants, during the Park regime (1961-1979), the average civil servant collected a paycheck comparable to his or her civilian counterparts. But during the Chun Doo-hwan regime (1980-1987) under which the government adopted price stabilization as its priority policy and utilized the restraint of wage increases in the public sector as a primary means for controlling spiraling inflation at that time, civil servants received a much lower salary than employees in private firms. As seen in Table 2.20, since 1983, the nominal yearly salary increase rate for civil servants has always been way below the nominal wage increase rate for employees in the private sector except for one single year (1986). More significantly, the annual growth rate of average household expenses has exceeded the nominal yearly salary increase rate for civil servants if we exclude the exceptional case of 1986. Unless we incorporate other attractive benefits for civil servants, this means that civil servants' standard of living relative to the average household has declined. In short, between 1981 and 1996, although the nominal salary increase rate for civil servants has remained above the annual growth rate of the Consumer Price Index (CPI), the Korean government failed to adequately reflect the GDP growth rate in their paychecks and thereby the size of their salaries relative to private employees has been in decline. As a consequence, for instance, in 1988, employees with five years of work experience in the private sector collected 1.49 times the wages of civil servants with five years of experience. More strikingly, the disparity in terms of basic salary widened as job experience extended (employees with 10 years, 1.57; with 20 years, 1.63, considering the salary of civil servants as 1 at each level) (Park Young-bum and Rhee Sang-deuk 1990: 43-44).

Graph 2.3 (based on Table 2.20) provides a visual comparison of salaries in

government and private industry. The top tier of Level 7 career civil servants' nominal salary closely matched the average monthly cash earnings in all industries during the first half of the 1970s. As demonstrated in Graph 2.3, from the late 1970s on, the average earnings by private employees began to rise more sharply than their public counterparts. This trend has accelerated since 1988 when democratization lifted regulations restricting union activities in the private sector.

This trend toward a widening discrepancy between public officeholders and business employees since 1987 is, to some extent, related to the democratic transition. "Democratization" lifted the lid on wage constraints in private business by providing a favorable political environment for strikes and other organized labor activities, while keeping civil servants under tight control with the strict enforcement of statutes which do not permit any organized labor activities. Skyrocketing wage increases in private firms during democratic transition were not observed in the public sector except for state-run enterprises where workers were given almost identical political freedoms as those in the private sector right after political opening in 1987 (Soo-Chan Jang 1998).

Second, in addition to the depreciating salary of civil servants relative to employees in the private sector, the backlog of personnel increased, making deferrals of promotion more customary. During the 1960s and 1970s, officeholders were able to climb the hierarchical ladders of bureaucracy in a timely fashion since there was an inevitable increase in the number of civil servants needed to carry out state-led industrialization and the construction of infrastructure. Between 1960 and 1996, the total number of civil servants increased from 237,475 to 925,794 (3.9 times as many in 1996 as in 1960), exceeding the population growth rate. The growth rate in civil service was the

highest at 6.38% between 1960 and 1971, and was 3.58% between 1972 and 1980, 3.27% between 1981 and 1990, and 2.27% between 1991 and 1996 (*Yearbook of MOGA*, 1970, 1980, 1990, 1997). This steady slowdown in the civil service growth rate extended the amount of time required for officeholders to be promoted. Thus, the average time between promotions for general civil servants working for the central government soared from 4.3 years in 1978 to 7.5 years in 1993, while for overall civil servants, it rose from 5.1 years in 1978 to 7.6 years in 1993 (Refer to Table 2.21). There were similar increases in time spent waiting for promotions for general civil servants in local government. Looking at this data in greater detail (See Table 2.22) also presents a gloomy picture for officeholders' prospective careers. The personnel backlog has been especially serious at levels 3-5 where the work is perhaps the most critical to running the government. As illustrated in Table 2.22, in the case of general civil servants working for the central government at level 3, the time required for promotion expanded from 7 years in 1978 to 11 years in 1993, at level 4 from 7.4 years in 1978 to 11 years in 1993, and at level 5 from 5.8 years in 1978 to 9 years in 1993. This trend toward a growing personnel backlog is likely to offset the advantage of high job security that office holders are still enjoying.

Third, regarding other benefits: retirement plans, insurance, housing and educational subsidies, it is fair to say that civil servants still have some advantage over their private counterparts. No comparable data across private and public sectors is available at this point. But considering that private businesses have been under great pressure from organized labor for better subsidies for housing, education and retirement benefits, we can assume that the private sector has been catching up with the public sector even in this area. If we infer the overall benefit package of civil servants using home

ownership as the indicator, the benefit package of civil servants, as compared with employees in general, has been overwhelmingly preferable. First, according to surveys conducted by MOGA in 1978, 1983, 1987 and 1993, the percentage of civil servants working for the central government who own their own homes has overwhelmingly surpassed the average percentage of home ownership in the general public (Refer to Table 2.23). However, as shown in Table 2.23, the gap between civil servants and people in general in terms of housing ownership has been narrowing. For example, the specific contrast between central government civil servants and people in general signifies that the gap diminished from 42.1% in 1978, to 30.2% in 1987, to about 28.9% in 1995. At any rate, home ownership by civil servants presents some evidence that the overall benefit package of office-holders still holds an edge over employees in the private sector, although direct comparison is impossible at this point.

In conclusion, the worsening reward system for civil servants, including lower salaries and gloomy career prospects, has dampened their strong commitment to their jobs. In the first place, a poor compensation system compared to the private sector has inculcated an environment in which civil servants are more likely to get involved in graft. According to the recent survey conducted by Kim Kyong-soo (1994), more than 60% of civil servants admitted to using graft as a means of meeting their living expenses. A larger percentage of office holders in the lower ranks said that graft is commonly considered as inevitable to making ends meet. Lee Young-keun (1996) also contends that rampant embezzlement and bribery are by and large rooted in the shrinking compensation package of civil servants since the early 1980s. Unfortunately, there is no data which measures changes in the corruption level of the Korean bureaucracy over time. However, according

to *World Competitiveness Yearbook* reports, the Korean government ranked 27th in improper practices in 1991, 32nd in 1992 (recording a corruption index of 3.0⁴⁷), and 33rd out of 47 industrialized countries in 1998 (recording a corruption index of 2.5) (Refer to “improper practices” in Table 2.24). Based on the *World Competitiveness Yearbook* report, it is safe to say that corruption in Korean bureaucracy has been on the rise, especially considering that Korean bureaucracy was regarded as less-corrupted in the 1970s and 1980s, as compared with other Asian countries, except for Singapore and Taiwan.

The second important consequence of the deteriorating overall reward system was that the Korean government found it difficult to continue recruiting top notch students. For instance, the indicator signifying the quality of civil servant labor, that is, the proportion of college graduates relative to the total labor force in the government, discloses that the Korean government has failed to maintain a superior labor force relative to the private sector since the early 1980s. For instance, according to the civil servant censuses conducted in 1978, 1983, 1988, and 1993, the proportion of college graduates relative to the total number of civil servants has steadily increased, but the proportion in the private business sector has expanded more rapidly⁴⁸ (Refer to Table 2.15). The

⁴⁷ The corruption index is based on a scale of 1-10, with 1 being most corrupt. In 1992, Singapore was ranked as number one (least corrupt), with an index of 9.6; the Philippines was ranked 42nd with an index of 1.7; Taiwan was 22nd with an index of 5.8; and Thailand was 37th with an index of 2.5. (IMD, *World Competitiveness Yearbook*)

⁴⁸ The proportion of college graduates relative to total employees in private firms indicates the percent of employees who are working in administration, general clerical work, and service in private firms who employ more than 10 people. This labor force is considered equivalent with civil service workers in government in terms of the content of the work in which they are usually engaged.

proportional amount of bachelor degree holders in the private sector surpassed that of the public sector in the early 1980s. This implies that quality of the labor force in the private sector has become superior to the governmental administrative force and in turn the Korean government lost its bureaucratic competency to rule over civil society. The Korean government's ability to attract a more talented and better educated labor force than private society has been in slow but steady decline since the early 1980s, as its compensation system, which was preferable to that of private firms, has lost ground in terms of salary size and promotional opportunities, except for the benefits package. However, considering that competitiveness and openness of the recruitment system is still high and the benefits package in the public sector still has an edge over the private sector, it is too early to say that the Korean government is no longer able to attract the best crop of college students, although it has become more difficult for the Korean government to induce the elite crop into public office. All this study can say is that the Korean state, with its dwindling resources to induce the best quality labor into government, is now having a hard time maintaining cultural hegemony over the private sector, which was a vital ingredient for state autonomy (For this argument, refer to Peter Evans 1995:52).

CONCLUSION

In this chapter, this study explored the changes in the sources of state autonomy which are crucial to the goal-oriented collaboration between business and state, centering on the recruitment and reward system of Korean bureaucracy, the location of decision-making (or policy coordination system), the executive-legislative nexus, and the presidents' assignment of elites to the core economic agencies. This study found that, first

of all, the Korean state is no longer able to behave as an unitary actor in the pursuit of collective objectives. Rather, the Korean developmental state, which had worked as a cohesive actor for rapid industrialization under the command of the chief-executive, fell apart as each policy-making institution began to reclaim its constitutional authority, such as the legislative, or began to pay more attention to the local interests of their own department rather than the overall collective goal, such as the economic ministries. For instance, democratization, escorted in with the beginning of the post developmental era, has changed the dynamics of the power arrangement among various policy-making institutions. The presidential office lost a large part of its discretionary power in handling the bureaucracy. Within the bureaucracy, different economic agencies clashed against each other, owing to their overlapping policy scopes, different policy preferences, and the lack of new rules (policy coordination system) under which the conflicts among different agencies were regulated or intermediated. In a word, the critical sources of state autonomy, that is, the cohesiveness of the policy-making institutions, has worn away, especially since the late 1980s.

The second important finding of this study is that the chief-executives who went through open contests for power through presidential elections were more likely to subject economic agencies to their own political interests when the popularly-elected presidents were immune to public accountability except to their region-based coalition constituents. The institutional autonomy and integrity of economic planning agencies, financial institutions and supervisory machinery, which were secure during the developmental state, have largely faded away as region-based politics has crept into even the core economic agencies. When vital economic agencies were subject to the presidents' political pork-

barrel and thus were not independent from political influence, career bureaucrats within those economic agencies, regardless of regime type, were more likely to be involved in collusive exchanges with business. This subject will be explored in detail in Chapter IV. As demonstrated in the section on the Presidential Office, the rising proportion of Youngnam elites across big businesses, major economic agencies, financial industries and supervisory institutions under Roh and Kim Young-sam implied that the connectedness between state and power holders in the private sector had been transformed from the driving force of transformative programs into an important source for rent-seeking.

Third, we found that the primary foundation of institutional coherence within Korean bureaucracy, that is, the overall “reward system,” has been in decay. The overall compensation package for civil office-holders, which had been comparable to their counterparts in the private sector during the developmental state, has fallen far behind their civilian counterparts since the early 1980s. The relative decline of career bureaucrats in terms of overall income not only makes it difficult for the Korean state to entice the top notch college students into public service, but also exposed career bureaucrats to the bait of bribery. Under circumstances in which public office-holders still hold great discretionary power concerning the extensive regulations on business activities, office-holders, with shrinking incomes relative to their counterparts in the private sector, are highly likely to become involved in graft. As a result, corruption in the bureaucratic system seems to be on the rise.

Table 2.1

The Ratio of Votes Obtained by Major Presidential Candidates in Different Regions over Time (unit: %)

Election:	1963		1967		1971		1987			1992			1997		
Candidate:	Park	Yun	Park	Yun	Park	KimII	Roh	KimI	Kim II	KimI	Kim II	Chung	Kim II	Lee I	Lee II
Region: Seoul	32	68	47	53	40	60	30	29	33	36	37	18	45	41	12.8
Kyoung-kee	37	63	44	56	50	50	41	28	22	36	32	23	39	36	23.6
(Incheon)							39	30	21	37	31	21	39	36	23.0
Kang-won	45	55	55	45	61	39	59	26	9	41	15	33	24	43	30.9
Chungbuk	45	55	52	48	58	42	47	28	11	38	26	23	37	31	29.4
Chungnam	45	55	49	51	55	45	26	16	12	36	28	25	48	24	26.1
(Daejeon)										35	28	23	45	29	24.1
Kyoungbuk	61	39	71	29	76	24	66	28	2	64	9	15	14	62	21.8
(Taegu)							71	24	3	59	8	19	13	73	13.1
Kyoungnam	67	33	75	25	74	26	41	51	5	71	9	11	11	55	31.3
(Busan)	50	50	67	33	56	44	32	56	9	73	12	6	15	53	29.8
Jeonbuk	54	46	46	54	37	63	14	2	84	6	88	3	92	5	2.1
Jeonnam	62	38	49	51	35	65	8	1	90	4	91	2	95	3	1.4

(Table 2.1 Continued on next page)

Table 2.1 (Continued)

[illegible]

Reference: Candidates in each election: Park: Park Jung-hee, Yun: Yun Bo-sun, KimI: Kim Dae-jung, KimII: Kim Young-sam, Roh: Roh Tae-woo, Chung: Chung Ju-young, Lee I: Lee Hae-chan, Lee II: Lee In-jeh. The winner of each election is underlined. Source: The Central Election Management Committee (CEMC).

Table 2.2
Presidential Election Campaign Agenda by the Elected Presidents (1963-1992)
 (unit: frequency, percent)

	Political Issues	National Security, Diplomatic and Unification Issues	Social Issues	Economic Issues	Total
Park Jung-hee (1967)	231 (31.5)	141 (19.2)	25 (3.4)	337 (45.9)	734
Park Jung-hee (1971)	345 (26.5)	456 (35.0)	84 (6.5)	416 (32.0)	1301
Roh Tae-woo (1987)	449 (63.6)	55 (7.8)	102 (14.4)	100 (14.2)	706
Kim Young-sam (1992)	915 (58.3)	88 (5.6)	190 (12.1)	376 (24.0)	1569

Source : Song Keun-won, "The study on issue orientations of presidential candidates between 1963-1992", *Korean Public Administration Studies*, Fall, 1995.

Table 2.3
Data on Top Governmental Officials of Different Regimes According to Their Regional Origins
(Secretary and Assistant Secretary of Ministries)

Re-gime s	Class- ifica- tion	Seoul	Kyoung kee (In- cheon)	Kang won	Chung buk	Chung nam (Dae jeon)	Kyo ung- buk (Tae gu)	Kyo ung- nam (Bus an)	Jeon- buk	Jeon nam (Kwang ju)	Che- Ju	N. Ko- rea	Misc	To- tal
1st 2nd	total	59	35	16	19	42	37	36	17	12	1	77	7	358
	ratio	16.5	9.8	4.5	5.3	11.7	10.3	10.1	4.7	3.4	0.2	21.5	2.0	100
	com	-9.2	-1.1	-2.4	-0.2	+1.4	-5.3	-2.5	-5.1	-11.1	-0.9	++		39.2 *
3rd	total	40	10	9	11	27	47	46	16	29	8	50	5	298
	ratio	13.7	3.4	3.1	3.8	9.2	16.0	15.7	5.5	9.9	2.7	16.9	1.7	100
	com	+0.7	-7.2	-3.2	-1.5	-0.7	+2.2	+0.4	-3.1	-3.9	+1.5	++		24.4
4th	total	9	5	19	4	22	36	32	6	20	2	26		179
	ratio	5.1	2.8	10.7	2.2	12.4	20.2	18	3.4	11.2	1.1	12.9		100
	com	-14.8	-8.8	+5.3	-2.2	+3.9	+6.2	+1.4	-3.7	-0.3	-0.1	++		46.7
5th	total	33	33	22	13	19	86	56	19	20	-	32	1	334
	ratio	9.9	9.9	6.6	3.9	5.7	25.7	16.8	5.7	6.0	-	9.6	0.3	100
	com	-13.9	-5.4	2.3	0.5	-1.4	13.3	-0.6	0.3	-3.3	-1.3	++		42.3
6th	total	32	24	15	17	30	66	58	20	21	4	19	1	307
	ratio	10.4	7.8	4.9	5.5	9.8	21.5	18.9	6.5	6.8	1.3	6.2	0.3	100
	com	-14.0	-10.5	1.2	2.3	2.7	9.8	-1.7	1.7	-1.6	0.1			45.6

(Table 2.3 Continued on next page)

(Table 2.3 Continued)

Kim I	total ratio com	26 13.2 -11.2	15 7.6 -10.7	4 2.0 -1.7	9 14.5 11.3	20 10.2 3.1	35 17.8 6.1	46 23.4 6.2	14 7.1 2.3	15 7.6 -0.8	- - -1.2	13 6.6 ++	- 54.6	197 100 54.6
Kim II	total ratio com	6 10.5 -19.9	6 10.5 -7.8	2 3.5 -0.2	5 8.8 5.6	9 15.8 8.7	10 17.5 5.8	4 7.0 -10.2	3 5.2 0.4	9 15.8 7.4	1 1.8 0.6	1 1.8 ++	 66.6	57 100 66.6
TOT AL	total ratio	203 12.6	118 7.3	71 4.4	77 4.8	159 9.9	270 16.8	245 15.2	86 5.3	110 6.8	14 0.9	247 15.4	 100	1608 100

Reference: First and Second Republic (1948-1962): Rhee Syng-man

Third and Fourth (Yushin) Republic (1963-1979): Park Jung-hee; home region = Kyoung-buk

Fifth and Sixth Republic (1980-1991): Chun Doo-hwan and Roh Tae-woo; home region = Kyoung-buk

Kim I (Kim Young-sam Government) (1992-1997); home region = Kyoung-nam

Kim II (Kim Dae-jung Government) (1998-present); home region = Jeon-nam

“Classification”: ‘total’ stands for the total number of high ranking officials;

‘ratio’ is the ratio of each region’s elites relative to total number of elites;

‘com’ (combined) stands for the differential (in percentage) between the ratio of real elite assignment in the region and the ideal ratio (ie: a perfectly representative bureaucracy)

Source: *Kwang-Ju Daily Newspaper*, 9/11/96;

Korean Political Science Review, Vol.20, no.1, p.104, 1996;

Joongang Daily Newspaper, 8/28/98.

* Total of absolute values for “com” row, representing differential from the ideal representative bureaucracy.

Table 2.4
Elite Assignment at Power Apparatus Across Different Presidencies
According to Their Birth Places. (Unit: months)

	KCIA (ANSP)	AG	COPB	DONTA	ACS	Total
Park Jung-hee (12/1963-12/1972) TK	TK:14 PK:28	CC:90 CC:30		TK:43 SK:42	SK:17 TK:36 PK:34	TK:93 (27.8%) *46.4%
Park Jung-hee (1/1973-12/1979) TK	CC:36 TK:34	TK:72		TK:41 Etc: 69	PK:32 Etc: 58	TK:147 (43.0%) *52.3%
Chun Doo-hwan (9/1980-2/1988) TK	TK: 17 HN: 26 Etc: 40	TK:26 PK:15 SK:9 CC:33	TK:37 PK:12 SK:18 Etc:20	TK:15 PK:10 Etc:60	TK:48 PK:35	TK:143 (33.5%) *51.1%
Roh Tae-woo (2/1988-2/1993) TK	TK:40 PK:7 Etc:3	TK:51 SK:9	TK:36 CC:25	TK:33 PK:14	TK:12 PK:20 Etc:17	TK:172 (64.4%) *79.9%
Kim Young-sam (2/1993-2/1998) PK	TK:67 CC:4	TK:29 PK:31	TK:15 PK:30 Etc:14	PK:34 TK:26	PK:46 SK:21	PK:141 (44.5%) *87.4%
Kim Dae-jung (2/1998-present) HN	SK:12+	HN:12 plus	HN:12 plus	CC:12 plus	HN:12 plus	HN:36+ (60%) *80%

Reference: Birthplaces

TK: Taegu-Kyoungbuk HN: Honam (Kwang-ju, Jeon-nam and Jeon-buk)
SK: Seoul and Kyounggi CC: Chungchung (Daejeon, Chung-nam, and Chung-buk)
PK: Pusan-Kyoungnam Etc: North Korea, Cheju, and Kangwon

Agencies: ANSP: Agency for National Security Planning (previously KCIA: Korean Central Intelligence Agency); AG: Attorney General; COPB: Chief of Police Bureau; DONTA: Director of the Office of National Tax Administration; ACS: Army Chief of Staff.

* Indicates the ratio of the time this office was occupied by elites who are from the rulers' broader home region in the power apparatus

Source: Park Young-chul 1994: appendix 524-1036; *Report 97*, published by United Communication; *Joongang Daily Newspaper*, March 4-9, 1998.

Table 2.5

Elite Structure in Economic Ministers According to Their Career Background Before Appointment to the Position (1963-1999)

	Major Minister (EPB, MOF)				Major vice-minister (EPB, MOF)				Minor Ministers							Minor vice-ministers			
	B	S	P	M	B	S	P		B	S	P	M	Etc.	B	S	P	M		
Park (1963 -72)	5 (50)	5 (50)	. (0)	. (0)	8 (73)	2 (18)	. (0)		8 (38)	2 (9)	1 (5)	9 (43)	1 (5)	8 (62)	1 (8)	1 (8)	3 (23)		
Park (1973 -79)	3 (75)	1 (25)	. (0)	. (0)	6 (100)	. (0)	. (0)		2 (18)	. (0)	1 (9)	8 (73)	. (0)	2 (67)	. (0)	. (0)	1 (33)		
Chun (1981 -87)	7 (58)	5 (42)	. (0)	. (0)	9 (90)	1 (10)	. (0)		21 (57)	2 (5)	1 (3)	10 (27)	4 (11)	15 (65)	4 (17)	1 (4)	3 (13)		
Roh (1988 -92)	3 (37)	2 (25)	3 (37)	. (0)	9 (100)	. (0)	. (0)		15 (45)	3 (9)	10 (30)	4 (12)	1 (3)	21 (84)	. (0)	4 (16)	. (0)		
Kim I (1993 -97)	5 (56)	1 (11)	3 (33)	. (0)	9 (100)	. (0)	. (0)		18 (53)	7 (21)	8 (24)	0 (0)	1 (3)	14 (82)	1 (6)	0 (6)	2 (12)		
Kim II (1998- 99)	2 (100)	. (0)	. (0)	. (0)	2 (100)	. (0)	. (0)		1 (20)	1 (20)	2 (40)	1 (20)	. (0)	10 (100)	. (0)	. (0)	. (0)		

Table 2.5 Continued on next page

Table 2.5 Continued

Reference: B: stands for elites with the career background of Bureaucratic technocrats
 S: Scholars P: professional politicians M: Military Officers
 Etc: includes lawyers and businessmen

During Park's regime (1963-1979), Minor Economic Ministers and Vice-Ministers were counted only from the MOC (Ministry of Construction), MOCO (Ministry of Communication) and MOT (Ministry of Transportation). During other regimes, all minor economic ministers, including MOC, MOCO, MOT, MOCI (Ministry of Commerce and Industry), MOAF (Ministry of Agriculture and Fishery), MOST (Ministry of Science and Technology), MOL (Ministry of Labor), MOIC (Ministry of Information and Communication), and MOER (Ministry of Equipment and Resources), were counted due to their rising significance for the national economy.

Source: Data was created using *Maidas Dongah Inmul Information* (Personnel Information Bank, created by *Dongah Daily Newspaper*) and lists of Ministers from various newspaper.

Table 2.6

Average Duration of Service by Individual Ministers and Vice Ministers in Major and Minor Economic Agencies

Unit: Month

Regime	Period	Average Duration of Service for Periphery Economic Ministers (Agriculture-Fishery-Forestry, Transportation, Construction, Communication)		Average Duration of Service for Core Economic Ministers (Economic Planning Board, Finance, Commerce and Industry)		Average Duration of Service for Head Economic Secretary (a)
		Minister	Vice Minister	Minister	Vice Minister	
Park Jung-hee	3rd Republic (1963.12-1972.10)	15.4	18.0	19.1	20.3	18.4
	4th Republic (1972.10-1979.10)	17.7	25.8	31.5	25.2	18.4
Chun Doo-hwan	5th Republic (1980.9-1988.2)	14.8	20.9	16.7	16.7	31.3 (45)
Roh Tae-woo	6th Republic (1988.3-1992.2)	12.6	16.0	15.0	13.8	15.0
Kim Young-sam	(1992.3-1998.2)	12.0	14.2	10.4	10.0	10.0
Kim Dae-jung	(1998.3-present)	longer than 18	longer than 18	longer 18	longer than 18	longer than 18

Source: The data was created using 'list of elites' in *Material 97* (pp.179-191), published by United Communicator (Yeonhabtaengshin).

The data in column (a) was created using *Monthly Chosun* (various years), published by *Chosun Daily Newspaper*.

Table 2.7
The Economic Elite Structure in Change (1963-1999)

	Public Administration		Financial and Supervisory Institutions			Business	Ratio of overall hometown elites to total elites	Com Ratio of population
	General	Eco-Tech	Big 6	Gov-run	Supervisory	Top 50		
Park Jung-hee (1963-72)	-	34/129 (26.4)	-	-	21/62 (33.9)	(34.2)	31.7%	29.1% (1966)
Park Jung-hee (1974-79)	-	27/98 (27.6)	-	11/38 (29.0)	13/35 (37.1)	(33.6)	38.2%	30.6% (1975)
Chun Doo-hwan (1981-87)	-	23/88 (26.1)	23/103 (22.3)	23/73 (31.5)	32/61 (52.5)	(37.2)	42.5%	29.8% (1985)
Roh Tae-woo (1988-1992)	372/1326 (28.0)	28/83 (33.7)	32/127 (25.2)	22/78 (28.2)	18/33 (54.6)	258/790 (32.6)	40.4%	28.9% (1990)
Kim Young-sam (1993-1997)	316/873 (36.2)	29/88 (33.0)	40/145 (27.6)	23/60 (38.3)	20/32 (62.5)	297/832 (35.7)	41.2%	28.9% (1990)
Kim Dae-jung (1998-present)	186/806* (23.1)	5/40 (12.5)	-	-	-	46/779 (6.0)	21.0%	13.2% (1990)
	276/806** (34.2)	14/40 (35.0)	15/62 (24.2)	12/43 (27.9)	6/18 (33.3)	257/779 (33.0)	31.6%	28.9% (1990)

The numerator indicates the number of elites who were from the ruler's home region during his reign, while the denominator indicates the total number of elites.

The number in parentheses represents the ratio of elites from the ruler's home region relative to the total number of elites in each

(Table 2.7 Continued on next page)

(Table 2.7 Continued)

section.

*Elites from Jeonla-Do, Kim Dae-jung's home province.

**Elites from Youngnam.

Reference:

General: indicates the career civil servants working for the general administration whose class ranking is equal to level 3 or higher.
Eco-Tech: indicates economic technocrats working in the nuclei of economic agencies (EPB, MOF, MOEF).

Big 6: indicates six major commercial banks (Choheung, Sangub, Jaeil, Hanil, Seoul, Foreign Exchange Banks) and counting only officers ranking at or above executive directors.

Gov-run: indicates 6 government-run banks; KDB, Export/Import Bank, Bank for SMEs, Housing Bank, and Shinyoungbojoongkigum.

Supervisory: includes high officers of the BOK, Bank Supervisory Commission, Monetary Policy Committee, Security Supervisory Board, Insurance Supervisory Board, and Non-bank Supervisory Authority.

Top 50: indicates business elites from top 50 ranking Chaebols.

Ratio of population: stands for the ratio of the population which resides in the incumbent President's home region.

Sources:

General: data were created by information provided by MOGA.

Eco-tech: data were created using lists of economic technocrats published by Shindongah, Wolgan-Chosun and Donga Personnel Information Bank (DPIB).

Big 6, Gov-run and Supervisory: data was created using the list of bank officers and DPIB.

Top 50: data was created using lists of business elites published by various business journals and DPIB.

Ratio of population: data is from *Korean Population Statistics*.

Table 2.8
Comparison of the Conference of Economic Ministers (CEM) and the Conference of Economic Vice-Ministers (CEVM)

Regime	Period	Ratio of original legislation passed without revision (%)	Economic Ministers' Conference		Vice-Ministers Conference	
			ratio of original bills passed (%)	duration of time consumed per case (minutes)	ratio of original bills passed (%)	duration of time (min.) consumed per case
Park Jung-hee	1960 (65,67,69)	--	62.9	12.8	38.5	9.8
	1970 (75,76,78)	--	86.0	6.2	82.8	--
Chun Doo-hwan	1981-87	73.0	79.2	4.6	76.1	8.0
Roh Tae-woo	1988	65.1	74.0	7.1	66.1	17.5
	1989	63.0	69.6	7.4	62.4	15.3
	1990	70.2	87.2	8.1	64.2	11.0
	1991	65.8	73.5	10.2	67.1	11.8
	1992	73.1	87.0	9.7	68.1	9.2
Average		67.4	78.3	8.5	65.6	13.0

(Table 2.8 Continued)

(Table 2.8 Continued)

Kim Young-sam	1993		69.1		62.8	
	1994		62.8		49.8	
	1995		65.8		52.6	
	1996		78.2		54.3	
	1997		86.7		72.4	
	Average		72.6 *(68.7)		58.4 *(54.9)	

Source: Data was provided by legislation section of MOEF.

Reference: The numbers marked () * indicate the average ratio without 1997 data.

Table 2.9
Foreign Capital Inflow: 1966 to 1972

(Unit: million dollars, %)

	1962-65		1966	1967	1968	1969	1970	1971	1972	1966-72	
	Amount	Share								Amount	Share
Public Loans	63	7.1	73	106	70	139	115	303	324	1,130	26.4
Commercial Loans	71	8.0	110	124	268	410	367	345	326	1,950	45.6
Bank Loans	--	--	--	--	40	30	25	90	20	205	4.8
FDI	13	1.5	14	11	19	13	66	43	61	227	5.3
Sub-total	147	16.6	197	241	397	592	572	781	731	3,512	82.2
US & UN Aid	739	83.4	103	97	106	107	83	51	5	552	13.0
Claim Fund	--	--	30	30	34	31	25	31	27	211	4.8
Total Foreign Capital	886	100.0	330	368	537	730	680	863	763	4,275	100.0

Sources: MOF, EPB, BOK

Table 2.10

The Probability of Higher Post Appointment among EPB Bureau Directors

Director's Bureaus	Vice-Minister(1961-82)	Minister (1961-82)	Vice-Minister(1982-92)	Minister(1982-92)
Economic Planning Bureau	8/12	7/12	6/6	5/6
Budget Bureau	6/6	3/6	5/6	4/6
Price Policy Bureau	2/5	1/5	6/8	2/8
Economic Cooperation Bureau	3/12	1/12	2/5a	2/5a

Reference: The numerator indicates the number of bureau chiefs who later assumed higher ministerial posts. The denominator is the total number of bureau chiefs who completed the posts between 1961 and 1982, and between 1982 and 1992.

The numbers in the last row are about bureau chiefs who were in charge of Policy Coordination Bureau, instead of Economic

Cooperation Bureau. The chief office of Economic Cooperation Bureau was reorganized in 1981, so the author collected data on the office of Policy Mediation Bureau.

Source: The date between 1961 and 1982 is from Byung-Kook Kim, "Bringing and Managing Socioeconomic Change: The State in Korea and Mexico," Unpublished Ph.D. dissertation, Cambridge: Harvard University, 1987, pp.35-58. The data between 1982 and 1992 was created using an appendix in *The Thirty Years of EPB II (1981-1992)*, published by EPB, and an appendix in *Dongah Yearbook*, published by *Dongah Daily Newspaper*.

Table 2.11
Foreign Borrowing 1993-1997
(Unit: million dollars, %)

	1986-92		1993	1994	1995	1996	1997	1993-97	
	Amount	Share						Amount	Share
Public Loans	4,688	15.4	643	742	464	387	5,395	7,631	7.5
Commercial Loans	5,206	17.1	-	-	39	108	1,302	1,449	1.4
Financial Institutions'									
Loans:	10,296	33.9	2,360	3,580	7,530	9,570	8,300	31,340	30.8
(Bank Loans)	4,318	14.1	560	530	1,050	980	1,370	4,032	4.0
(Foreign Bonds)	5,978	19.8	1,800	3,050	6,480	8,590	6,930	26,850	26.4
Private									
Foreign Bonds	4,515	14.9	1,920	3,250	3,900	4,040	4,000	17,110	16.8
(Equity Related)	2,161	--							
FDI	5,684	18.7	515.7	757.5	1,940	3,200	6,970	13,383.2	13.1
Total	30,389	100.0	7798.7	11,909.5	21,403	26,875	34,267	101,795.2	100.0

Sources: MOF, EPB, BOK

Table 2.12

Civil Service Personnel According to Their Functions

Role	Year				# of personnel increase and percentage
	1963	1973	1983	1993	
State management role	66,496 28.90	96,935 27.64	134,939 29.94	168,854 29.71	102,356 153.9
Industrial and economic management	55,201 23.99	90,708 25.86	84,316 18.71	94,194 16.57	38,993 70.6
Social, Cultural role	98,542 42.83	160,601 45.79	227,969 50.58	305,139 53.69	206,597 209.7
Misc.	10,737	2,501	3,483	164	—
Total # of civil servants	230,078 100	350,745 100	450,704 100	568,351 100	338,273 147.0

Source: Ahn Byung-young, "Developmental Process of Korean Bureaucracy" p.73, in Ahn Hae-Kyun, et. al. (ed.), *Korean Bureaucracy and Policy-making Procedures*, Seoul: Dasahn Publisher, 1994.

Table 2.13
The Results of Deliberation on Bills in the Ministerial Cabinet Meeting

Regime	Year	Average number of cases deliberated per meeting	Average duration of time (minutes) per meeting	Average duration of time (minutes) per bill deliberated in the meeting	Ratio (%) of bills passed without revision
Rhee Syngman	1/1959 - 4/1960	3.8	--	--	72.3
Park Jung-hee	3rd Republic (1964-72)	13.7	54.2*	3.5 ¹	84.6
	Yushin Period (1973-79)	14.2	45.8**	3.2 ²	92.5
Chun Doo-hwan	(1981-87)	14.4	57.05	4.01	91.0
Roh Tae-Woo	(1988-92)	14.0	101.42	7.32	91.4
Kim Young-sam	1993	15.9	91	6	93
	1994	18.6	77	4	89
	1995	20.4	84	4	86
	1996	17	56	3	90
	1997	17.2	81	5	91
Kim Dae-jung	(Average '93-97)	17.0	80.0	5.0	90.0
	1998	12.4	87	7	91

Source: Data on Chun, Roh and Kim Administrations was provided by the Ministry of Home Affairs (Haengjeong Jachiboo), but the rest of data is from Jeong Jeong-gil (1994:323). *Average of 1965, 1968 and 1970. **Average of 1974, 1976 and 1978.

Table 2.14
Legislation Passed in the National Assembly

Regime	Congres-sional periods	Total		Legislation initiated by executive		(B/A) (%)
		No. of cases (A)	Ratio of passing (%)	No. of cases (B)	Ratio of passing (%)	
Rhee Syngman	2nd Congress (1950.6-1954.5)	216	54.3	138	63.9	63.9
	3rd Congress (1954.6-1958.5)	167	38.3	85	35.3	54.1
	4th Congress (1958.6-1960.6)	75	23.3	44	21.8	58.7
Park Jung-hee	6th Congress (1963.12-67.6)	332	50.0	164	63.5	46.4
	7th Congress (1967.7-71.4)	357	66.7	234	80.4	65.5
	9th Congress (Yushin) (1973.3-79.3)	544	65.3	460	96.0	84.6
Chun Doo-hwan	11th Congress (1981.4-85.4)	340	69.5	257	89.5	75.6
	12th Congress (1985.4-88.5)	222	58.6	156	92.9	70.3
Roh Tae-woo	13th Congress (1988.5-92.5)	938	52.4	368	87.0	39.2
	14th congress (1992.5-1996.5)	902	72.7	581	92.4	64.4
Kim Young-sam	15th Congress (1996.5-1998.10)	932	45.9	416	74.3	44.6

Source: Data up until the 12th Congress is from Jeong Jeong-gil 1994:320. Data in 13th, 14th and 15th Congress was provided by the National Assembly Administrative office.

Table 2.15

Proportion of College Graduates Relative to Total Employees Across Government and Private Firms

(unit: percent)

	1974	1978	1983	1988	1993
Central government civil servants	15.6	13.7	14.7	18.2	23.4
Local government civil servants	12.2	10.2	9.0	10.5	17.3
Employees in private firms	10.8	13.8	21.9	34.9 (1989)	39.3

Source: *Civil Servant Statistics*, published by the Ministry of Government Administration, 1978, 1984, 1989, 1994.

Report on Wages according to job classification, published by the Ministry of Labor, 1978, 1984, 1989, 1994.

Table 2.16

Comparison of the Ruling Party and the Government in Initiating Statutes in the National Assembly

	Ruling party No. of cases	Ruling party %	Government No. of cases	Government %	Total No. of cases	Total %
3rd Republic	185	43.3	242	56.7	427	100
6th Congress (1963-67)						
7th Congress (1967-71)	105	26.5	291	73.5	396	100
8th Congress (1971-72)	15	13.6	95	84.4	110	100
4th Republic	17	3.4	479	96.6	496	100
9th Congress (1973-79)						
10th Congress (1979-80)	2	1.6	124	98.4	126	100
5th Republic	41	12.5	287	87.5	328	100
11th Congress (1981-84)						
12th Congress (1985-88)	57	25.3	168	74.7	225	100
6th Republic	117	46.6	134	53.4	251	100
13th Congress (1989-90) first half						

Source: National Assembly Administrative Office

Table 2.17
Rates of Competition for Select Government Examinations

	1949-59	1960-69	1970-79	1980	1983	1986	1989	1992	1993	1994	1996	1997
Level 9 Civil Service Exam (Low ranking)	—	17:1	20:1	36:1	52:1	56:1	49:1	47:1	68:1	127:1	168:1	143:1
Level 7 Civil Service Exam	27:1	14:1	33:1	40:1	55:1	79:1	96:1	41:1	53:1	79:1	222:1	156:1
Foreign Service Exam (Level 5)	—	23:1 (1966-69)	29:1	45:1	78:1	108:1	89:1	70:1	86:1	70:1	51:1	53:1
Administration Service Exam (Level 5)	53:1	38:1	39:1	61:1	120:1	164:1	103:1	59:1	59:1	75:1	97:1	68:1
Judicial Service Exam (Level 5)	49:1	76:1	49:1	35:1	28:1	48:1	47:1	59:1	66:1	68:1	45:1	34:1

Source: *The Statistical Yearbook*, published by the Ministry of Government Administration, each year (before 1990, this data book was named the *Yearbook of the Ministry of Government Administration*).

Reference: for example, "27:1" at level 7 in 1949-59 column indicates that there were 27 exam-takers for every successful applicant.

Table 2.18

Recruitment Patterns for Mid and Upper Managers										(Unit: percent)
8/1948-5/1961		1/1977-12/1980					1993*			
Level	Haengsi	Special	Internal	Haengsi	Special	Prom.	Haengsi	Special	Prom.	
Recruitment Promotion										
L1	63.9		36.1	L1	34.5	65.5	L1	27.5	72.5	
L2	52.9		47.1	L2:a	6.8	93.2	L2	19.0	81.0	
				L2:b	6.5	93.5	L3	19.1	80.9	
L3:a	39.8		60.2	L3:a	8.1	91.9	L4	19.2	71.2	
L3:b	4.1	30.6	65.3	L3:b	20.6	68.5	L5			

Source: Ministry of Government Administration (MGA) and Ahn Yongsik, *Han guk gogeuip gongmunwomul mobility* (The Mobility of Korean Higher Civil Servants), Unpublished Ph.D. Dissertation, Yonsei University (1977), pp 25 and 46.

*The data for 1993 was created using 1993 *Civil Servants Statistics*.

Reference: There have been three different ways to enter the high level bureaucratic echelons; 1) taking the civil exam, called 'Haengsi'; 2) special recruitment; and 3) internal promotion from a lower-ranking. These high ranking officials were divided into four or five tiers during different periods of time. The ranking systems have been reorganized across the three different periods listed above. However, levels in the same row are basically the same, regardless of their numbers.

Table 2.19
Ratio of Recruitment Through Open Civil Service Exams: 1961-1998 (unit: percent)

	1961-65	1974	1978	1983	1988	1993	1998
General Civil Servants for Central Government	60-65	48.9	64.5	75.3	76.2	73.2	71.7
General Civil Servants for Local Government		63.9	74.9	76.3	75.7	77.9	80.3
Law enforcement		86.9	88.6	87.6	86.9	86.7	90.3
Total	about 60	59.7	71.1	78.2	78.3	78.8	80.7

Source: MOGA, *Civil Servants Statistics, 1974, 1978, 1983, 1988, 1993, 1998*

Reference: The number in parenthesis indicates the percentage of civil servants entering bureaucracy through open civil exams relative to special recruitment and internal promotion.

Table 2.20

Comparison of Compensation Between Government Employees and Non-agricultural Employees (unit: %)														
	1983	84	85	86	87	88	89	90	91	92	93	94	95	96
Nominal salary increase rate for civil servant (a)	7.6	2.7	5.2	9.6	8.0	11.0	13.8	13.9	12.7	9.8	3.0	6.2	6.8	9.0
Nominal wage increase rate for employees in private sector (b)	11.0	8.7	9.2	8.2	10.1	15.5	21.1	18.8	17.5	15.2	12.2	12.7	11.2	11.9
Growth rate of Consumer Price Index (CPI) (C)	3.4	2.3	2.5	2.8	3.0	7.1	5.7	8.6	9.3	6.2	4.8	6.2	4.5	4.9
GDP growth rate (d)	11.5	8.7	6.5	11.6	11.5	11.3	6.4	9.5	9.1	5.1	5.8	8.6	8.9	7.1
Growth rate of household expenses (e)	9.3	8.5	10.1	7.0	12.9	20.4	27.9	12.8	14.5	15.3	11.2	14.1	14.8	10.8

Sources: Data in rows (a) and (e) were collected from *The Yearbook of the Ministry of Government Administration*, published by MOGA, each year. Data in rows, (b), (c) and (d) were collected from *KLI Labor Statistics*, published by Korean Labor Institute, 1997.

Table 2.21
Average Time Between Promotions For Civil Servants: 1974-1998 (unit: years)

	General Civil Servant for central government	General Civil Servant for local government	Average years (overall civil servants)
1974	3.8	3.6	4.2
1978	4.3	3.9	5.1
1983	5.0	4.0	5.3
1988	6.1	5.2	6.3
1993	7.5	6.1	7.6
1998	9.1	8.6	8.6

Source: *Civil Servant Statistics*, published by the Ministry of Government Administration, 1975, 1979, 1984, 1989, 1994, 1998.

Table 2.22
Average Time Between Promotions for Civil Servants at Each Level: 1978-1998 (unit: years)

		level 1	level 2	level 3	level 4	level 5	level 6	level 7	level 8
Civil Servants by central government	1978	4	3.6	7.0	7.4	5.8	4.4	4	4
	1983	4	3	3	5	6	6	5	4
	1988	7	5	9	9	7	6	6	6
	1993	6	5	11	11	9	7	7	7
	1998	6	6	9	11	11	10	9	7
Civil Servants by Local government	1978	-	5.5	5.9	7.9	6.5	4.0	3.1	3.8
	1983	-	6	4	4	5	5	3	3
	1988	-	5	8	10	8	6	5	5
	1993	6	8	10	12	10	7	6	4
	1998	8	7	8	11	11	11	9	6

Source: *Civil Servant Statistics*, published by the Ministry of Government Administration, 1975, 1979, 1984, 1989, 1994, 1998.

Table 2.23
Home Ownership by Civil Servants: 1978-1999 (unit: percent)

	Civil Servants					General
	Central government	Local government	Police, fire-fighters	Education	Total	Total
1978	59.0	65.2	54.8	64.9	61.9	17.8
1983	57.3	58.3	52.3	68.1	60.7	14.5
1987	49.7	51.2	50.9	62.1	54.6	19.5
1993	56.1	54.0	53.6	67.9	58.8	29.9
1998	60.4	62.1	53.1	74.0	64.4	(1995)
						-

Source: EPB, *Social Indicators in Korea*, 1988, 1995.

Social Indicator, National Statistical Office, 1990, 1995.

MOGA, *Civil Servants Statistics*, 1979, 1983, 1989, 1993, 1998.

Table 2.24

Korean Government Capability over Time										(Unit: grade, rank)			
Country	Category	1991	1992	1993	1994	1995	1996	1997	1998				
Korea	Government responsiveness	6.2 (5)	4.2 (34)	4.2 (34)	4.5 (33)	5.3 (22)	4.2 (33)	3.3 (43)	3.7 (39)				
	Transparency	-	3.8 (30)	3.8 (30)	3.7 (37)	4.7 (25)	3.3 (36)	3.1 (38)	3.2 (43)				
	Improper Practices (corruption)	5.02(27)	3.0 (32)	3.0 (32)	2.9 (34)	4.6 (26)	4.5 (26)	2.6 (36)	2.5 (33)				
	Overall government-effectiveness	2.8 (30)	3.2	3.2	3.2	4.3	3.7	2.9	2.8				

Source: International Institute for Management Development (IMD), *The World Competitiveness Yearbook*, each year.

Reference: "Government responsiveness": The government's ability to quickly adapt policies to new economic realities.

"Transparency": The degree to which the government successfully communicates its intentions to the private sector.

"Improper Practices": The extent to which improper practices (such as bribery or corruption) prevail in the public sphere.

Overall government-effectiveness: IMD measures "Overall government effectiveness and transparency" using six different areas. The three above-mentioned areas are included in overall government effectiveness and transparency.

The first number is a "grade" based on a 10 point scale, with 10 being best. The second number is an international ranking out of 47 countries.

CHAPTER III

THE CHANGING BUSINESS-STATE NEXUS AND DENSE INDUSTRIALIZATION

This chapter involves three different economic transformative programs: 1) The revolutionary turnaround from import-substitution economy to export-led economy (1963-1971); 2) Heavy-Chemical Industrialization (1972-1979); and 3) Industrial Restructuring and Rationalization (1980-1987). As will be demonstrated with detailed empirical evidence, the business-state nexus was effective in the distribution of capital resources, largely replacing the market mechanism. It has been widely assumed that the interventionist approach was indispensable for the Korean state, as a late-late developer, to catch up with the advanced industrial countries. Why did the business-state nexus not fall into the super-cartel of rent-seeking but rather, remained in the track of developmental-oriented collaboration? Why was the Korea state so successful in carrying out economic transformations across the different periods covered in this chapter?

This inquiry into these questions will begin by defining and specifying the structural characteristics of the business-state nexus in South Korea. This concerns the following questions: 1) Who governed or dominated the business-state nexus? 2) Did the business-state nexus remain on the track of productive collaboration for economic development? If so, how and why? 3) To what extent was the state autonomous from its private partners? 4) To what extent did the business-state nexus respond flexibly to outside shocks and adapt to a newly evolving economic environment?

The above-mentioned aspects of business-state connectedness are assumed to be

Chapter II, changes in three critical variables were presented (institutional foundations for political leadership, the policy-making regime and Weberian Bureaucracy) with extensive empirical evidence which accounted for the internal structure of the state over different periods (Refer to Tables 3.1-a and 3.1-b). Thus, the discussion of these three variables will not be repeated here. However, defining the different patterns of business-state ties over time involves the question of how the Korean state has reformulated its policy-making regime and connected that regime with private partners. So, this chapter offers detailed descriptions of the different policy-making regimes, which changed substantially along with the different transformative programs.

The second category of variables (Refer to Tables 3.1-a and 3.1-b) which determine the nature of the business-state nexus involves the “share of the Chaebol in the national economy” (Graphs 3.1 & 3.7 and Table 3.25), “governmental control over capital resources” (Graphs 3.1 & 3.2 and Table 3.22) and “organizational characteristics of the Chaebol”: financing structure (Graph 3.3 & 3.4 and Table 3.10 & 3.11), degree of business diversification (Graph 3.5 and Table 3.28), and degree of indebtedness (Graph 3.8 and Table 3.29). Concerning these variables, this study tried to determine the degree to which these variables influenced and constrained the Korean state’s leverage to induce its private partners into transformative programs. It is hypothesized that: 1) The rise in the share of the Chaebol in the national economy eventually reduced the state’s capability to swiftly enact transformative programs; 2) The high dependency of businesses on external funds, low diversification, and high indebtedness gave the government control over extensive policy choices by holding the Chaebol captive of governmental policy loans (Refer to Chapter I). In any case, different combinations of these variables, including political

variables, could lead to unexpected effects on the strategic interactions of business-state in different historic periods.

My empirical analysis for each period is organized in the following way: I 1) defined the institutional traits of business-state connectedness such as the degree of centralization, institutionalization, and rent-seeking super cartel or goal-oriented collaboration; 2) described how the state induced its private partners into the designated industrial targets; 3) described business-state interactions around the economic transformative programs; 4) determined why the major economic transformative program was a success or failure; and 5) described the growth of the Chaebol as the consequence of the transformative programs. In the empirical analysis, my main concern was to sort out which variables have the most explanatory power in determining the success or failure of transformative programs for each period. It is my belief that the effects of an explaining variable differ at different historic conjunctions. In other words, each variable works differently in the context of different combinations of variables in a given historic period. In addition, certain characteristics of actors, that is, the state or big business, could have either positive or negative effects on economic progress, depending upon the phase of economic development and the type of economic transformative programs. For instance, the Chaebol's diversification of business-lines had been recommended by the government and worked well with rapid economic transformation under the "comprehensive developmental state" (1960-1979), but became more or less problematic under the "limited developmental state" (1980-1987), and, later on, evolved into a serious problem during the era of deepening globalization. Thus, this study takes a close look at changes in the effects of different variables and major actors (state and business) on economic

progress.

BUSINESS-STATE NEXUS (1948-1960): RENT-SEEKING COLLUSION

This section is concerned with the origin of big business in Korea and how the state accelerated capital accumulation by liquidation of the remaining vestiges of Japanese colonial rule. But the main objective of this section is to demonstrate the key point that the large capital resources held by the state do not necessarily insure the state's dominance over business nor keep the business-state nexus on a productive collaboration track.

Although the Korean state during this period of time was backed by plentiful foreign aid and the acquisition of former Japanese properties and thereby was quite free from infant capitalists, the Rhee regime nevertheless became a captive of rent-seeking private business. This period of time clearly reveals a textbook case in which, without the construction of a specific kind of internal structure of state, the capital resources retained by the state could not be operated as leverage to induce business into profit-seeking, productive investments but rather were devoured by private business.

(1) Institutional Aspects of the Business-State Nexus

During this period (1948-1960), there were no institutionalized channels between state and business such as regular conferences or monthly meetings. The absence of any institutional linkage was primarily attributable to the fragmented internal structure of policy machinery on the government's side and the weakness of peak business associations. The absence of a policy coordination center (such as the Economic Planning Board during the Park regime) which could intermediate and organize institutional

resources across economic agencies, especially hindered the establishment of business-state channels (Lee Man-hee 1992:16-44). On the opposite side of the table, business associations remained feeble and fragmented. As a result, there was no systematic conduit through which the government's policy directives could flow. Business usually utilized individual connections to obtain more preferential treatment from the government.

Now let us turn our attention to the factors which are considered highly influential on the interactions of business-state. First and foremost, the recruitment system of civil servants, which was presided over by the ruling party, was highly politicized and, as a consequence, incompetent professionals flowed into the bureaucracy via patron-client networks and engaged in illegal gains through the abuse of public offices (Kim Byung-kook 1987; Kim Suk-joon 1991:276-177). Second, as mentioned in detail in Chapter II, the policy-making lines were compartmentalized with no joint center which would have been able to coordinate diverse economic ministries and mobilize institutional resources into industrial targets. The Economic Planning Office during this period remained a simple bureau dealing with short-term stability programs under the Prime Minister.

Although elite technocrats within the inner circle of economic agencies became aware that a joint center with institutional supremacy over other involved parties was a prerequisite for a sweeping industrialization drive, this vision did not completely materialize until Park Jung-hee took over power in 1961 (Sakong Il and L. Jones 1981:71-72). In short, fragmentation with scattered institutional resources (including budget, foreign aid control, economic planning and finance) across different economic agencies characterized the policy-making instruments during this period of time (Refer to the discussion on the location of decision-making in Chapter II).

Third, the primary institutional resources were structured to win over the then haunting socialist movement rather than oriented for industrialization, owing to President Rhee Syng-man's political survival strategy based on an anti-communist campaign and the USA's selection of the Korean peninsula as the outpost of anti-communism in East Asia. (Kim Suk-joon 1991:275-277). The overwhelming amount of resources which were allocated for national security led to the rapid growth of the military with refined management and technology, while the construction of a modern bureaucratic system was largely neglected. In addition to the bureaucracy being in shambles, the primary interest of elites within the ruling circle, including President Rhee, was the maintenance or expansion of their political power, rather than industrial and economic progress, with heavy reliance upon the anti-communist campaign which was fueled by American aid (Whang In-jung 1968).

(2) Capital Resources Held by the State and their Distribution: Original Capital Accumulation

The state held sufficient material resources in its hands to steer private business into profit-seeking productive investments if it desired to do so. These capital resources included the repatriated property from Japanese occupants, policy loans, which were a large portion of the total amount of borrowed money, foreign aid, and import licensing authority. First, the Rhee administration retained authority over the disposal of repatriated property. The former Japanese properties, which constituted about 80% of the total national wealth at that time, were first entrusted to the American Office of the Property Custodian (Lee Yeon-ho 1997:22). The rest of the Japanese properties, which accounted

for 21.6% of the total number of factories and 80% of large corporations, were transferred to the Rhee regime in August 1948. According to the Repatriated Liquidation Law (RPLL), announced in 1949, the vested properties were to be sold to private business. Due to the low prices, which were set at pre-1945 book values rather than the higher current values, the lengthy repayment schedule, high inflation (for high inflation during this period, refer to Table 3.3), and the generous credit allowances to the procurers of vested properties, the businesses which attained the repatriated properties gained enormous advantages in the accumulation of wealth (Chung Young-Iob 1987). One important factor in relation to how the disposal process helped big businesses accumulate wealth so quickly was that the state-owned shares of commercial banks were privatized between 1954 and 1956. Most of these bank stocks were sold to the largest ten Chaebols (Byun Hyung-yun 1983:133-136). In the process of distribution of the vested properties, under the conditions of the RPLL, which set vague distributional standards, entrepreneurs who had personal ties with the political elites within the power circle were overwhelmingly favored over those who had none. Businesses were given special benefits beyond the above-mentioned advantages in the acquisition of the properties in exchange for large donations to political funds.

The second critical resource controlled by the state was the control of policy loans and the interest rates of bank loans. A large portion of bank loans were distributed through the Korea Developmental Bank (KDB), which was established in December 1953, to manage the developmental fund. About 77% of total loans for the installation of machinery and other facilities were done through the KDB between 1954 and 1960, while about 10% of managerial funds came from the KDB during the same period (Refer to

Table 3.5) (Kong Jae-uk 1992:28-29). Of these funds distributed by the KDB, 49% were created by selling foreign aid to civilians, and 38.6% by the issuance of government bonds for industrial funds. As a matter of fact, the aid offered to Korea between 1953 and 1960 accounted for 69.1% of governmental policy loans. Most of these loans were channeled to big businesses with long-term credit at lower interest rates than commercial bank loans. Accordingly, securing loans through the KDB was a windfall gain for a debtor, owing to the negative real interest rate. As illustrated in Table 3.3, any loans with a fixed official interest rate, even from commercial banks, meant that business had a golden opportunity to gain capital simply because of the high inflation rate during this period. Up until 1956, real interest rates for bank loans remained deeply negative and thereby gave a windfall profit to a handful of business people (Refer to Table 3.3) (For a detailed explanation of credit allocation by the KDB which was skewed toward big business, refer to Kong Jae-uk 1992:28-52).

Even after 1955, real interest rates grossly favored the borrowers, except for 1957 and 1958, when the real interest rate fell below the average earning rate of corporations (Refer to Table 3.3). The distorted interest rate system inevitably led to high demands for bank loans and consequently invited the government to intervene in the credit allocation process. State intervention in the allocation of credit without a specific kind of institutional arrangement offered politicians and office-holders ample rent-seeking opportunities. Loan distributions were made, not on the basis of the credibility of a debtor and the significance of business, but often on the basis of the patron-client network, bribery, and political pay-offs. The Liberal Party was believed to control at least 50% of aid transactions via various policy instruments and therefore a large part of the commercial

bank loans were kicked back to the Liberal Party for campaign funds. The extent to which bank loans were determined by the pork-barreling between business and politicians was reflected in the “Special Law for Punishment of Illicit Capital Accumulation,” which was promulgated after the “April 19 Student Revolution” in 1960. The special law defined an illicit capitalist basically as a big businessman whose loans from domestic banks totaled more than 100 million *won* or whose foreign debt was more than 200,000 US dollars (Sakong and Jones 1981:138-139).

The third important source of capital controlled by the state was foreign aid¹ and the issuance of import licenses under an unrealistic exchange rate system. Under circumstances in which the US dollar was under-valued in terms of Korean currency, on average by more than 200% of the market price between 1955 and 1960, (for instance, between 1955 and 1960, the distorted rates ranged from 220% to 365%; refer to Table 3.4), the procurement of a license to import made it possible for selected importers to make enormous profits through simple trade, because the under-valuation of the US dollar meant that the importers could realize gains equivalent to about 60-70% of the value of

¹ Along with the disposal of appropriated properties, foreign aid was a critical source for the growth of the Chaebol during this period. From 1945 (liberation from Japanese Occupation) to 1961 (the year when the Kennedy Administration shifted its foreign aid policy in Korea), South Korea received a total of 3.137 billion dollars from the U.S. Out of this total US aid, GARIOA (Government Aid Relief in Occupied Area), between 1945 and 1949 accounted for 13.0% and amounted to 409 million dollars; ECA (Economic Cooperation Administration) and SEC (Supplies Economic Cooperation) between 1949 and 1954 accounted for 6.4% and amounted to 202 million dollars; ICA (International Cooperation Administration) between 1954 and 1961 accounted for 55.6% and amounted to 1.744 billion dollars; and PLS 400 accounted for 6.5% and amounted to 203 million. Besides US aid, there was aid from the U.N.: CRIK (1950 -1956) which accounted for 14.6%, totaling 456 million and UNKRA (1951-1960) accounted for 3.9%, totaling 122 million. Between 1953 and 1960, foreign aid accounted for 69.1% of the governmental budget and investment (Hong Sung-yu 1962).

the imports by simply reselling imported raw materials and services in the domestic market. In addition, the selected importers were privileged to receive foreign exchange which was acquired from the inflow of foreign aid. Although foreign exchange was given to industrialists who submitted plans to establish manufacturing plants because of the government policy which intended to induce businesses into productive investments, most foreign exchange ended up in the hands of industrialists who wanted to gain large profits by quickly reprocessing imported raw materials. Therefore, sugar refineries, cotton milling industries, and spinning and weaving manufacturing were the major business importers during this period of time (Cho Dong-sung 1990:163). All top ten big businesses in 1960, listed in Table 3.2, attained foreign exchange and, except for Dongyang and Doklip, “importing” was their leading business (Kim Seok-ki 1987:57-76).

It was widely believed that the distribution of import authorizations largely favored big business in exchange for campaign donations. For instance, the “*Joongsukbul*” incident in 1952 epitomized the then on-going pork-barreling between business and politicians. The Rhee government allotted 4.7 million dollars created by the export of tungsten (which was one of the two major export goods at that time) to Samho (then the second largest Chaebol). Samho imported fertilizer and grain with the use of the 4.7 million dollars and charged five times the import price for these items in the domestic market. It was believed that a large part of the windfall profit collected by Samho was transferred into the campaign fund of the Liberal Party (Kang Chul-kyu et.al. 1991:129-130). In short, foreign exchange allocation and import licensing were utilized as two important means of rent-seeking, rather than being utilized as a critical source by the state to induce businesses into profit-seeking productive investments. The ineptitude of the

Korean state during this period was largely attributable to the absence of pivotal institutional resources, including the foundation of meritocratic bureaucracy (institutionalization of recruitment and reward systems), the clear location of decision-making (or coherent policy coordination system), and the institutional autonomy of economic planning machinery from political pork-barreling.

(3) Evolution of the Chaebol: 1948-1960

Most of the top 10 Chaebols as of 1997 (listed in Table 3.2), except for Daewoo, Sunkyung and Lotte, accumulated their primary capital for rapid growth during the 1950s, through the quick exploitation of repatriated properties from Japan, the unrealistic exchange rate system, the preferential allocation of foreign exchange (or foreign aid), and the cheap interest rate system. Big business during this period was involved in the simple processing of foreign aid, producing consumer goods, trade, and speculative investments in real estate. In short, the period was characterized by “corruptive merchant capitalism” in which business accumulated capital basically through transactions and trade through the use of personal ties with power elites within the ruling circle (Cho Dong-sung 1990:167-68; Sakong and Jones 1981).

Most business groups were in the embryonic stage with a small number of affiliates. For instance, the average number of subsidiaries in the top ten business groups, as of 1961, was only 5.2 (Kang Chul-kyu and others 1991:128, refer to Table 3.6) and there were only 50 firms with over 300 employees as of 1958. Among these 50 firms, 25 of them were involved in spinning, weaving and synthetic textiles, 8 in rubber industries, 5 in fertilizer, make-up and rudimentary medicines, 6 in sugar refinery, flour milling, and

food industries, 4 in other industries, with only 2 of them in steel and machinery industries (Kong Jae-uk 1992:40-42). Among the 13 firms with over 1000 employees, 10 of them were cotton spinning mills, 2 synthetic textile manufacturers, and one rubber company (Ibid p. 43). In a word, business groups during this period were far from the current portrait of the Chaebol and limited themselves to two or three industries with a small number of units. For instance, Samsung group, which was the largest business group in late 1950s, had six affiliated firms specialized in spinning and weaving, and sugar and flour (in 1956), with 267 employees (in 1953) (Samsung group, *60 years of Samsung History*). Their total assets are believed to account for a small portion of the national wealth, considering that over 40% of GNP was produced by primary industries at that time. For instance, the proportion of Samsung's total sales to the Gross National Product (GNP) was 1.1% in 1963.²

In conclusion, despite the fact that the state held ample capital resources over their civilian partners, as demonstrated by the four resource categories: policy loans by the KDB, official interest rate control, disposal of repatriated property from Japan, and allocation of foreign aid and import licensing, the state failed to lead businesses into transformative economic programs. As a matter of fact, there were no articulated transformative programs by the Rhee regime. Rather, the state was trapped in a vicious cycle of rent-seeking in relation with business mostly because of the absence of the specific kind of state structure laid out earlier in this section.

² That proportion went up to 19.3% in 1996 (Samsung, *60 years of Samsung History*).

REVOLUTIONARY TURNAROUND IN THE BUSINESS-STATE NEXUS: AN OUTWARD-LOOKING STRATEGY AND ITS SUCCESS (1961-1971)

This period of time was the showcase of how the business-state nexus could be transformed from a rent-seeking collusion to an efficacious instrument for economic and industrial progress with the reconstruction of the institutional framework, while the economic power balance between state and business remained unchanged. The main features of the business-state nexus during the early period of the Park regime, which was distinct from the previous nexus, were as follows: First, the business-state linkage, which was based on personal ties during the Rhee regime (1948-1960), became institutionalized with the construction of the organizational centers on both sides, the EPB for the state and the Federation of Korean Industries (FKI) for business. Major actors from both business and state got together at a formal and open table. Second, the connectedness changed from a short-term and transient basis into official and non-official networks on a regular and long-term basis, providing both sides with the long-term horizons of economic management. Third, bureaucratic technocrats stepped forward to replace politicians in the connection, leading to a slow but steady expulsion of career politicians from the round table (for empirical evidence, refer to the ratio of bills initiated by the executive in Table 2.14); Fourth, the state's dominance over the nexus was firmly anchored by jailing all the proven entrepreneurs for their illicit accumulation of wealth during the Rhee period, and later on incorporating businesses as junior partners into the nexus. Fifth, unlike the Rhee regime, the Park regime established relatively transparent and fair standards for credit allocation, business licensing, and the distribution of foreign loans, cutting down the role of personal ties in the distribution of capital resources. With the construction of clear

criteria for credit allocation and business licensing, the government manipulated the opportunity setting perceived by business and thereby turned the nexus around into a resourceful instrument for carrying out export-led economic growth.

Now, let us explore how the dramatic turnaround in the business-state nexus was attained, how the state maintained the nexus on the track of productive collaboration, to what extent and why the state was successful in carrying out transformative economic programs, and the extent to which the credit allocation of the government was associated with the growth of the Chaebol during this period.

(1) Institutional Restructuring and State Dominance over the Business-State Nexus

Park Jung-hee, who took power through a military coup in 1961, first demonstrated his power to the private sector by prosecuting entrepreneurs for their illicit accumulation of wealth during the Rhee period. Park attempted to usurp a large part of properties owned by business groups at the beginning of the military revolution. But Park eventually became aware that the collaboration of business was indispensable in accomplishing fast, visible, quantitative growth, and struck a deal with business: First, the businessmen would be immune to criminal prosecution under the subsequent conditions. Second, the stock shares of commercial banks held by big business were returned to the government (nationalization of commercial banks) but the government legitimized their other belongings. Third, instead of paying the penalty fines for illicit wealth accumulation in currency, businesses were permitted to donate the stock of new firms to the government, which were supposed to be key industries, such as oil refineries, cement and chemical industries (Sakong and Jones 1981:99-100; Lee Man-hee 1992:55-56). This

political contract did not materialize for various reasons but transformed the business-state nexus into a lasting pattern under which business was subordinated to the state.

Being aware that, without a vigorous, energetic, and well-organized civilian partner, the government was not capable of channeling and implementing its industrial policy, Park attempted to transform his disorganized private partners into a coherent organization which could fulfill his reform ambitions. For instance, the Korean Businessmen's Council, which was the lobbyist arm of big business, was dissolved with the arrest of its leadership by Park's revolutionary junta and reconstructed under the name of "Special Council for the Promotion of Economic Reconstruction" in 1961, which, later on, evolved into the Federation of Korean Industries (FKI). The FKI, with a strong recommendation from the Park administration, extended its membership to embrace a much larger number of business groups, resulting in a rapid rise of membership from 13 in 1961 to 125 in 1968 (Hong Deuk-yul 1992:62-66). More importantly, Park helped to change the persona of the FKI, from rent-seeking lobbyist to entrepreneurial business society, by taking the corrupt leadership on an industrial excursion and thus exposing them to the advanced technology and management in industrialized societies (Sakong and Jones 1981:100-101).

In addition, the Korean Traders Association (KTA), which was the virtual manifestation of the export-led strategy, was also established with the intention to communicate with exporters in a systematic way. Other peak associations which were restructured under Park were the Korean Chamber of Commerce, which had existed before 1961, and Korean Council of Small/Medium-sized Industries (KCSMI). Except for the FKI, the other three associations were chaired by former ministers of economic

agencies in order to maintain a close relationship with the economic bureaucracy. Additionally, industrial and trade associations along different industries were rearranged, including the Korean Council for the Promotion of the Electronic Industry, Korean Council for the Promotion of Machinery Industry, and the Korean Textile Industry Association (Kim Suk-joon 1991:371-372).

Park's reconstruction of more inclusive peak business associations meant two critical changes in the institutional linkage with the state: First, the openness and competitiveness of the nexus (which was a critical element in keeping the business-state nexus on a productive track) were substantially improved by lowering barriers to the entry of other businessmen into the connection. Second, the installation of a more refined associational center on the private side cut down transaction costs with quicker and more effective information distribution and an extensive volume of interactions between the two parties.³ Trust and cooperation built up as both parties began to understand the other side's intent through the intimate and direct interactions of business-state. It is hard to imagine that, without this mutual trust, Park's government would have been able to induce business into risky and uncertain export industries.

Along with this reconstruction of more encompassing peak business associations, Park established an economic bureaucratic center, that is, the EPB, which was able to join and coordinate the policy planning bureaus installed at each economic agency. The EPB, as a "super ministry," was given extensive authority to manufacture bureaucratic coherence not only in initiating and implementing transformative programs but also in

³ To understand how to construct open, competitive and transparent private-public networks, refer to Stephan Haggard, Sylvia Maxfield and Ben Ross Schneider (1997).

dealing with their private partners. The cohesive policy coordination system under the EPB, revolutionary restructuring of bureaucratic foundations such as the recruitment, promotion and reward systems, and the chief-executive's determination to protect the institutional autonomy of economic planning, supervisory and disciplining machinery were critical institutional anchors in preventing the business-state linkage from degenerating into a rent-seeking super-cartel. Additionally, Park signaled to his private partners that he was determined to carry out the export-oriented programs through the delegation of his mandate to the core developmental agencies. His determination to delegate this mandate to economic technocrats was demonstrated through the long duration of service of individual economic technocrats (Refer to Table 2.6).⁴

In the subsequent establishment of organizational pillars in both bureaucracy and business, Park invited the leadership of both sides to the "Extended Conference for the Promotion of Trade (ECPT),"⁵ which was held every month. The participants of the ECPT were the key figures of broad business circles, economic technocrats including the heads of economic ministries, and the President himself. The topics of the discussions, which usually lasted about three hours, were the prospects of international markets, plausible export items, specific target markets and exchange of market information (Kim Jeong-raem 1995:133-134). The Korea Trade Promotion Corporation (KOTRA) was

⁴ See Chapter II for a detailed description of the structural characteristics of the EPB and how the construction of the EPB at the hierarchical peak of the bureaucratic system changed the internal dynamics of economic planning, monitoring and disciplinary machinery.

⁵ The ECTP has been considered the most important meeting between 1961-1972 by President Park. The programs initiated, ideas, and decisions made during the ECTP were promptly carried out without bureaucratic holdup (Refer to Kim Suk-joon 1991:372).

also installed to promote systematic interactions between business and state and to channel export-oriented programs to private partners with diverse services and subsidies (Sakong and Jones 1981:128-129).

The reconstruction of connectedness on the basis of a centralized bureaucratic system and business society and of regular and institutionalized interactions implied several significant changes in the nature of the interactions:⁶ First, trust and cooperation sprang up from the enduring interactions of both parties. This deepening trust made it possible for entrepreneurs to plan their investments on the basis of long-run profitability rather than short-term gain. In other words, business' horizon of investment projects extended greatly, as compared with the past. Second, the increasing credibility of government policy and commitment to transformative programs motivated entrepreneurs to take bold moves in export industries. Entrepreneurs would have been reluctant to engage in risk-abundant export industries without a belief in the long-commitment of government and trust in its programs. Third, the institutional linkage also dramatically reduced the uncertainty involved in launching inventive, transformative programs. As the duration of interactions grew longer, mutual trust and confidence in each other built up positive behavioral assumptions.⁷ However, to understand why a close internal linkage

⁶ Except for the above-mentioned institutional and organizational changes on both the private and public sides, the change in the chief-executive's policy priority (placing economic development at the top of the regime's value hierarchy) and the class origin of new state elites, who were predominantly from the peasant class and therefore who did not share class background with the owners of big business at that time, also helped maintain "embeddedness" on the track of productive coalition (for the class origin of new state elites during this period, refer to Kim Eun-mee 1997:118).

⁷ Refer to the discussion by Douglass C. North (1990) on how long-duration, frequent human interactions generate cooperation and trust and thereby lower the cost of transactions. North explains how different institutional settings channel human

between business and state did not degenerate into a rent-seeking coalition, we also need to examine the extent to which critical capital resources were controlled and distributed according to transparent and non-discretionary standards by the state.

(2) Resource Control and Manufacturing Incentive Structures Toward Transformative Programs

Park Jung-hee set economic development as the regime's top priority and reorganized the financial system, so that the government could mobilize capital and feed it into fast, visible, quantitative growth. First, Park nationalized commercial banks by forcing the business leaders accused of illicit wealth accumulation to give their equity shares in the banks to the government. Second, Park made it clear that the government, not the Bank of Korea (BOK), was in charge of monetary and financial policy by revision of financial institutions. With the "Temporary Measure for Financial Institutions"⁸ and the "Bank of Korea Act"⁹ in 1962, the Korean government took over managerial authority

interactions into positive collaboration with an evolution of mechanisms in which credibility and good reputation can be used as incentives to carry out some innovative programs.

⁸ The "Measure" was originally designed to prevent the monopoly of big business over commercial banks. To do so, this measure limited the voting rights of large shareholders. More specifically, no one single share-holder was permitted to have more than 10% of voting rights in the general meeting of stock-holders. In addition to that, the selected executives of banks in the general meeting of stock-holders had to get approval from the Bank Supervisory Commission (BSC) and the Head of the BSC was given authority to fire the selected executives if the decisions made by the executive were saliently against public interests (Choi, Pil-sun 1990:45).

⁹ The Bank of Korea Act, amended in May 1962, included the following: First, the head of the BOK was appointed by the President, not by consent of the Cabinet-Ministerial Conference, but by the initiative of the MOF. Second, the Minister of the MOF was given authority to review decisions made by the Monetary Management Committee which was the ultimate authority for monetary policy. Third, the BOK must

and began to control the personnel matters of commercial banks. The BOK was relegated to the status of a subordinate arm of the MOF (Ministry of Finance) by the limitations on the authority of the BOK and operated as machinery for financing the government-designated programs (Choi Byung-sun 1993:26-27).

Moreover, in 1962 Park established a number of specialized banks, including the Central Federation of Agricultural Cooperatives, the Citizens' National Bank, the Medium Industry Bank (MIB), and the Central Federation of Fisheries Cooperatives.¹⁰ The establishment of the specialized banks reflected the Park regime's political intention to bring the peasants, fishermen and small-and-medium-sized businessmen under his broad political coalition, who were left outside the banking institutions that were monopolized by big business in the 1950s (Choi Byung-sun 1993:27). Along with these newly-founded, specialized banks and the nationalization of commercial banks, all financial intermediaries were quickly lined up under the direction of the Ministry of Finance.

However, the most critical change by Park was the authorization of the KDB (the Korea Development Bank) to borrow funds from abroad and guarantee foreign commercial loans. The KDB was given the authority to issue licenses to borrow from foreign countries and to guarantee foreign commercial loans under the EPB's tight control

undergo not only accounting inspections by a National Audit Commissioner but also by the MOF. Fourth, the managerial authority of foreign currency was taken over by the EPB (Choi, Pil-sun 1990:45).

¹⁰ First, they were established to provide funds to particular sectors whose supply of funds through commercial banks was insufficient due to limited availability or low profitability. Second, they relied heavily on deposits from the public for their sources of funds in addition to the issue of debentures and borrowing from the government.

and supervision over foreign loan negotiation and allocation. Declining foreign aid¹¹ and the still low domestic savings rate (Refer to Table A.1 in appendix)¹² forced the Park regime to turn its eyes to foreign capital as a major source of financing industrial development. In order to secure adequate foreign borrowing to feed the First Five-Year Plan, the government eliminated certain discriminatory measures and announced several important provisions, including the “Foreign Capital Inducement Promotion Act” (passed in 1960 and amended in 1961) which regulated tax benefits for those investing foreign capital, the “Law for Repayment Guarantee of Foreign Borrowing” in July 1962, and the “Special Law to Facilitate Capital Equipment Imports on a Deferred Payment Basis” introduced in 1962 (These laws were merged into a single, broad new law called “The Foreign Capital Inducement Law,” MOF & KDB 1993:617-620).

The government also granted tax concessions for foreign borrowing and sent an economic mission abroad as an effort to procure financing for target industries. In addition, Korea joined international financial institutions, like the IBRD, the IMF and the IDA, in order to guarantee a steady source of public loans. The normalization of diplomatic relations with Japan, despite strong national political protest against it, also opened new avenues for public and commercial loans because Japan was the most

¹¹ From 1964 on, the amount of foreign aid began to decline sharply. In 1958, foreign aid amounted to \$222.2 million, in 1961, \$207 million, in 1963, \$217, in 1964, \$158, in 1965, \$132 and in 1966, \$103. See Anne O. Krueger, *The Developmental Role of The Foreign Sector and Aid* (Cambridge: Harvard University Press 1979), MOF & KDB, *30 Years of Foreign Borrowing in Korea*, Seoul: MOF & KDB 1993.

¹² From 1954 to 61, the domestic savings rate was only 3.2%, so that only 26.3% of total investment funds were generated through domestic savings and the rest were from foreign borrowing. Even in early 1962, the domestic savings rate as a percentage of GNP remained as low as 8-11%. Between 1962 and 1970, the total savings rate was 14%, which accounted for 59.6% of total investment funds (Kim Jung-woong 1986:50).

promising source of foreign capital and technology at that time.

Another important measure taken by the government in relation to financial policy was the Interest Rate Reform of September 1965. In order to mobilize domestic savings to feed an ambitious Five-Year Economic Plan, the measure attempted to reflect market interest rates at the time, by almost doubling the annual time deposit rate from 15% to 26.4% and by improving the commercial banks' annual lending rate from 14% to 24% (Choi Pil-sun 1990:47). It brought forth a nearly sevenfold increase in total bank deposits over the four years from 1965 through 1969. The national savings ratio jumped from 3.3% in 1962 to 15.1% in 1968. In addition, the Korean government began to increase its intervention and control in the financial system especially since Korea switched its Import-Substitute Strategy to Export-Oriented Strategy in the middle of the 1960s. The above-mentioned financial reforms contributed to a massive inflow of foreign loans from the mid 1960s.

Now, let us examine foreign borrowing in detail during 1962-1971 (Refer to Table 2.9). Between 1945 and 1961 foreign borrowing totaled only \$5 million dollars, accounting for only 0.1% of foreign capital inflow into the Korean market, while US aid amounted to \$2.527 billion dollars, which accounted for 81.3% of total foreign capital inflow. From 1962 to 1965, despite the government's strong efforts to secure foreign capital, foreign borrowing totaled only \$147 million, 16.6% of the \$886 million in total foreign funds including borrowing and aid, reflecting Korea's very low credit rating at that time. However, foreign borrowing began to boom with the increasing confidence of foreign lenders in the Korean economy as the result of the successful First Five-Year Economic Plan and with the increased efforts of the government to secure foreign capital,

which became confident in its strategy of industrialization based on foreign borrowing. Therefore, during the Second Five-Year Economic Plan (1966-1972), foreign borrowing, instead of foreign aid, became by far the largest source of foreign capital. From 1966 to 1972, \$3.5 billion was borrowed from foreign sources, which accounted for 82.2% of total foreign capital, with commercial loans totaling \$1.9 billion and public loans totaling \$1.1 billion. Public loans were spent almost solely for infrastructure development such as power plants, railroads and highways. Commercial loans were used by the key industries-chemical, petrochemical, cement and iron (MOF & KDB 1993:107-157).

Besides the amount of capital inflow into the domestic market, there was another important reason why foreign capital was a critical source for both state and business. As can be seen in Table 3.8, the foreign rate of interest between 1966 and 1970, adjusted for an exchange rate change, was lower than the rate paid on domestic borrowing by 12.9%. This was an incredible gap, particularly in comparison to the figures for 1971-1975 and 1976-1980, which stood at 1.3 and 1.0 percent, respectively. In short, whoever had access to foreign borrowing would have had a windfall under this interest system. Accordingly, this incredible gap swayed private investors to turn their eyes to foreign capital as a new and profitable source of financing. In short, the control of foreign borrowing gave the government enormous power to induce business into its export-oriented industries.

In addition to the authority to distribute foreign capital, the government also utilized other sources such as policy loans and official interest rates for bank loans to set incentive structures for import-substitution industries in the early 1960s and for the promotion of labor-intensive industries, such as textiles and plywood in the late 1960s.

The government also controlled a large part of bank loans in the name of “policy loans” during this period. Between 1962 and 1971, the average percentage of policy loans relative to total money lent each year was 54.7%, although the annual growth rate of policy loans remained below that of total loans, except for in the early 1970s. Low interest rates were applied to policy loans, in particular, export financing and funding of export industry equipment at that time. A large proportion of policy loans relative to total loans, with low interest rates, controlled by the government, had given a wide range of policy choices to the economic planning machinery during this period. As shown in Table 3.9, low interest rates for export financing were a lucrative financial source for investors because of the high inflation rate, especially in the early 1960s. Considering that the interest rates for the curb market, to some extent, reflected the real price of money, real interest rates for export financing would have dropped below the numbers in column (h) from Table 3.9, which were calculated by subtracting the “inflation rate” from the “interest rate for export financing” each year, although real interest rates for export financing were all negatives throughout the 1960s.

The last incentive held by the government to induce businesses to pursue its planned targets was the official interest rate. Notwithstanding that the government-controlled interest rate for commercial bank loans was not as profitable a source of financing as policy loans, securing bank credit undoubtedly benefitted the recipient greatly. The comparison of “real interest for bank loans” (column (g) in Table 3.9) with the “average earning rate of corporations” or the “interest rate for curb markets” makes it clear that procuring any bank loan was gainful for investors. The above-mentioned sources of power reserved in the hands of the state, that is, the authority to distribute

foreign capital, the large ratio of policy loans relative to total loans, and official interest rate control, seem even more powerful when one considers that Korean businesses relied heavily upon bank-loans as their source of financing business.

A close look at the structure of financing in the manufacturing sector during 1961-1970 discloses that Korean businesses's dependency upon external borrowing was overwhelming. More than 80% of corporate funds came from external borrowing between 1962 and 1971.¹³ The external sources of financing consisted of commercial bank loans, government lending, issuance of stock and corporate bonds, borrowing from the curb market, and foreign borrowing, whereas the internal sources of financing were internal savings, savings for equipment depreciation and appropriation. The external sources can be divided into two different categories: 1) borrowing from banks, non-banking institutions, and foreign lenders; and 2) direct capital mobilization from the security market (Refer to Table 3.11). Between 1962 and 1966, 83.5% of financing was from external sources, rather than internal sources. Among external sources, direct financing from the security market accounted for only 27.6% of total financing, whereas the rest of financing came from deposit banks, non-banking institutions, and foreign borrowing. Even in the Second Five-Year Economic Plan (1967-1971), businesses had become more reliant on external sources to finance their industries, enlarging the external share of financing to 86.5% (Refer to Table 3.11). The predominant trend of debt-driven management (or external source-reliance) by Korean businesses was rooted not only in the high profitability of bank loans, policy loans, and foreign borrowing (due to the gap

¹³ The sources of corporate funds can be broadly divided into two categories: 1) internal savings; 2) external borrowing (Refer to Table 3.10).

between the interest rates of loans and the real interest rates of the market), but also in the shortage of financial resources available within firms in the early stage of development. At any rate, the loan-ridden financial management by most Korean corporations resulted in that the government was in a solid position to sway businesses to comply with its transformative programs.

Thus far I have examined what sorts of institutional and material resources were controlled by the state during this period. It is clear that the Korean state, both in terms of institutional structure and resource control, was capable of manufacturing an incentive structure to induce business into transformative programs or force business to follow its leadership. Now let us explore what sort of incentive structure was constructed by the state and how the state remained on track as a positive credit distributor rather than falling into a rent-seeking coalition with business during this period. As mentioned earlier, measuring empirically the traits of the business-state nexus is a tricky job in which subjective judgement could be involved. In order to measure whether the business-state nexus remained in productive collaboration rather than collusion, I will determine if there were transparent criteria in credit allocation, and whether or not transformative programs were accomplished.

(3) Transformative Programs and Standards for Licensing and Credit Allocation

a) Setting policy targets: During the early 1960s (1961-1964), the government fostered import-substitution industries which produced such basic intermediate materials as cement, fertilizer, refined oil, and electronic machinery. After 1963, the government turned its eyes to export activities. It promoted labor-intensive export industries, such as

textiles, synthetic fiber, synthetic resin, and plywood, which had international competitiveness, thanks to cheap labor costs, and were capable of absorbing the unemployed and underemployed human resources. The relatively quick and graceful turnaround from an import-substitution strategy to an export-led economy in the mid 1960s was attributable to the state's dominance over private partners in terms of capital resources and institutional coherence of the economic planning machinery, although business, which was used to protectionist policies under the import-substitution strategy, was quite resistant at the beginning of the export-drive.¹⁴ The outward-looking developmental strategy began with the dismantling of non-tariff barriers, including the export-import link system, quota system, compensation trade system, and subsidies. Joining GATT, in May 1966, symbolically signaled that the export-led strategy was anchored in Korea as the primary way of industrial progress. Another important institutional provision for export-led development was the exchange rate reform, which was done at the beginning of the First Five-Year Plan. The reform in the exchange rate system, which effectively eliminated the opportunity for business to attain enormous profit gains simply with the use of foreign exchange market distortion, also restructured the incentive structure under which business was forced to pursue profits by engaging in export-manufacturing.¹⁵

¹⁴ Refer to Kim Jeong-Ryom (1990:114-134), to see how the government redefined the incentive structure with revision of taxes, export-import system, exchange rate system, tariff system and financial provisions for exporters in order to transform the import-substitution economy to export-led economy in the mid-1960s.

¹⁵ To see how the exchange rate system reform set the foundations on which business was induced into the profit-seeking manufacturing, refer to Sakong and Jones 1981:119-124.

b) Picking winners: For each Five-Year Plan, the government carefully selected target industries on the basis of the prospective international market and the potential domestic resource mobilization. Anyone who adopted target industries was given strong financial backing by the government with preferential credit allocation, governmental guarantees for foreign borrowing and other beneficiary policies such favorable taxes, tariff systems, and subsidiaries.¹⁶ However, the bar of entrance into these target industries was quite high, because of the high uncertainty and risk the new enterprises were bearing with this large scale investment. As for the government, who wished to attain its planned goals with limited resources, managerial skills and business experience flavored with an entrepreneurial spirit were considered prerequisite conditions for the entrance of target industries.

The government used a non-discretionary approach in the selection of who got into target industries amongst a large pool of competing entrepreneurs. Mostly big businesses were licensed to invest in major target industries due to the scale of investment¹⁷ and based on their previous records, not due to their personal ties with power elites in the government.¹⁸ Up until the mid 1960s, the economic concentration in a small

¹⁶ These preferential policies, including the tax system, tariffs and subsidiaries, are also important in understanding how the government set incentive structures using these policies and induced business into the target industries across different periods of time. But this study is limited to the most critical source, governmental control, due to limited space. Concerning other preferential policies, refer to Kim Suk-joon 1991:371-374 and Sakong and Jones 1981.

¹⁷ For example: Samsung was licensed to invest in Korean fertilizer, Yookong in oil refinery, Shinjin in automobile, Dongyang in cement and Gaepung in Incheon Steel (Kang Chul-kyu and others 1991:133).

¹⁸ For instance, in October 1961, the EPB announced that the government selected 19 enterprises as “qualified receivers for foreign capital” who were in pursuit of seven

number of big businesses was not extensively consolidated, so that the economic planners could enjoy a wide range of choices in picking winners. For instance, the government made use of the applicants' track records (for instance, previous volume of export) and current financial status as the criteria for an investment license. Under a mutual agreement between the private and public sector during 1962-1966, fertilizer and oil refinery industries were allotted to state-owned enterprises, whereas cement, electronic equipment, synthetic fiber and resin, and plywood were assigned to private business (Kim Ju-ho 1995:218).

In addition, regarding financing export industries, the government used a non-discretionary approach and of itself reduced the weight of political factors in credit allocation (Kang Myung hun 1996:37-61). Any business who received an export letter of credit was guaranteed "export financing." Because obtaining "export financing" meant the procurement of extensive profitable capital, including bank loans with lower interest rates, the KDB's guarantee on foreign borrowing, tax breaks, tariff deductions on imported raw materials, and reductions on electronic fees and transportation expenses, most businesses were desperately in pursuit of exports and the government-designated target industries. Accordingly, regardless of the size of the business, anyone who failed to show exporting ability and adopt to the governmental transformative programs was effectively destined to fade away (Kim Ju-ho 1995).

Along with the extensive use of a wide range of incentives to induce business into

different industries, out of 55 applicants. The business licensing process was practiced on the basis of previous performance record, managerial experiences, and capital size of applicants.

export industries, other government measures followed to assure private industry's close compliance with the government's plan. The "carrot and stick" approach was adopted in order to compensate good performers with automatic availability of credit and punish bad performers with abolishment of licenses or credit guarantees. For instance, on "export day," distinguished performers were awarded with national medals. In compensation for their performance, credit was automatically available to those honored businesses. It goes without saying that relatively effective credit allocation and subsequent monitoring of compliance of private business was only possible owing to the rearranged institutions of policy planning, financial industries and financial supervisory machinery under Park.

c) Rationing of Finances to Target Industries and Export-oriented Economy:

Once target industries were selected, massive capital inflow into these target industries followed. In order to examine how the government allocated bank credit to promote target industries, this study took a look at loans of the KDB (which was the major distributor of policy loans) and of deposit money banks. The combined loans by these two distributors accounted for the overwhelming majority of total money lent at that time. A glance at Table 3.12 and Table 3.13 tells us several important features of credit distribution: 1) The KDB showed leadership to commercial banks in its feeding of credit into target industries. The KDB poured about 10% of its total loans into three target industries (textile, fertilizer, and metal & machinery) early on, but commercial banks did not follow these proportions in their loans in 1961-1967. However, the commercial banks followed suit of the KDB in the late 1960s. 2) Textile, fertilizer, and metal & machinery stood out as the largest recipients of policy loans from the KDB throughout the 1960s and from the deposit banks in the late 1960s. 3) A large proportion of loans (about 29% each

year) by the KDB flowed into “electricity, gas & water” as the Korean government started to put forth an effort to provide infrastructure. 4) The deposit banks dramatically cut down on the credit allocations to “agriculture, forestry & fishing,” while promoting the credit share of “manufacturing.”

As the result of this rationing of finance into target industries, the Korean economy turned toward export-led economy from import-substitution. As shown in Table 3.14, up until the First Five-year Economic Plan (1962-1966) was launched, the volume of exports was not only negligible but also varied greatly each year. More importantly, the manufactured exports accounted for only about 10% of total export volume. The majority of export goods were minerals and agricultural products. In addition, the proportion of foreign trade (exports plus imports) to GNP remained below 10%. However, these figures changed dramatically from 1962 on. As illustrated in Table 3.14, the export volume began to grow explosively, reaching an average of 43.9% annually between 1962 and 1966. Manufactured goods also began to claim the lion’s share of the export volume. It goes without saying that those target industries (textile and fertilizer) were the leading export items. From 1965 on, manufactured merchandise accounted for more than 60% of the export volume. The last two columns in Table 3.14 demonstrate the extent to which the Korean economy became dependent upon trade across different time periods. The proportion of foreign trade (exports plus imports) to GNP jumped from below 10% in the 1950s to 24.3% between 1962 and 1966 and continued to grow to 41.6% between 1967 and 1971. According to Amsden (1989), Korea’s high proportion of foreign trade to GNP was unprecedented, considering the size of the economy. In short, the outward-looking economy was set in motion early on in Park’s export-drive.

Now, let me demonstrate the effects of the designated target industries on the composition of principal export commodities. As shown in Table 3.15, during 1961-1964, primary and unmanufactured commodities such as food, raw silk, and metalliferous ores accounted overwhelmingly for the bulk of all exports. From 1966 on, textiles (weaving), apparel, and plywood became the predominant export items, while other target industries, such as cement and fertilizers, were oriented for domestic consumption, so that these items did not make much contribution to export volume. Textiles and apparel remained the most predominant export commodities until 1980. The export value of electrical machinery and other industries, thanks to heavy credit allocation to these industries, also began to rise rapidly from the mid-1960s. In short, over the long run, the composition of export commodities reflected the credit allocation into target industries, as demonstrated in Table 3.15.

Other convincing evidence of the success of the first transformative program (turning toward an outward-looking economy) was observed in macroeconomic indicators. As shown in Table 3.16, the Korean government obtained an even larger average annual growth rate than it had planned in the First (1962-1966) and Second (1967-1971) Five-Year Plans, 7.8% and 9.6% respectively. Per capita GNP more than tripled from 87 to 285 U.S. dollars during this period. As the result of active growth of the manufacturing sector, the unemployment rate also nose-dived from 8.2% in 1962 to 4.5% in 1972. On the other hand, Korea also dramatically increased its ability to feed new investment projects with the improvement of the domestic saving ratio from 3.2% in 1962 to 14.6% in 1972. In almost every single category of general economic indicators, except for the "transformation of industrial structure," the Korean government was ahead of what

it had planned to accomplish during that period. In short, the Korean government's first transformative program, that is, the export-drive, was successful by any standard.

(4) The Growth of Big Business during the First Export-drive

Before taking a closer look at the growth of big business, let me explain why the Korean government decided to support big business, instead of small/medium-sized firms. First, Park thought that attaining fast, visible, quantitative growth, which was prerequisite for regime survival, required quick and solid capital accumulation by a handful of effective entrepreneurs (Kim Eun-mee 1997:118-119). Second, giant corporations were regarded as the best way to attain "the economy of scale" (Amsden 1989). Third, effective administration of the export-led strategy required the promotion of big business (who had a larger scale of economy) as the front runner of the Korean economy in competition with foreign traders (Kim Ju-ho 1995:212).

The first distinctive change in big business groups during this period (1961-1972), as shown in Table 3.6, was that the overwhelming majority of them redeemed themselves by casting-off simple processing industries and mere trading companies and adopted target industries, including oil refinery, electronics, machinery, chemical and construction industries. Except for a few Chaebols, the main business lines pursued by the top ten Chaebols were manufacturing and export industries. Business groups who did not wholeheartedly embrace the new challenges stemming from the development-driven government or were not successful in effectively transforming their business lines into

target industries, simply went out of existence at the end of the first big push.¹⁹

Second, there was great turmoil in the ranking of the top ten Chaebols. As shown in Table 3.2, seven out of the top ten big businesses were newcomers to the top ten list of 1965. By 1972, when the first two Five-Year Economic Plans were completed, only three Chaebols from 1960 remained in the top ten list. This means that, between 1960 and 1972, those businesses who did not revolutionize themselves by abandoning rent-seeking as the predominant profit-seeking method and adjust to Park's winner-picking strategy, dropped off the top ten list. For instance, Samho, Chunwoo and Whashin, whose major business lines were spinning, plywood and miscellaneous goods in the 1950s and early 1960s, failed to accommodate the rapid industrial restructuring with specialization in target industries. In contrast with these older Chaebol, Ssangyoung was swift and decisive in abandoning its out-dated industries (ie: Kumsung Textile: spinning and weaving) and adopted cement as its core business (Shin Hyung-sung 1995:84-85). Thus, only innovative and adaptive groups survived.

Third, during this period, most Chaebol got involved in a wider range of industries by adding affiliates. Growing diversification of business lines resulted from a combination of several factors: First, business groups endeavored to respond to the governmental transformative programs by entering growing industries and restructuring the decaying

¹⁹ For instance, Chosun Textile, Hanyoun Textile, Samho Textile and Daejeon Textile, which were front-runners in the 1950s and early 1960s in spinning and weaving, retreated as ailing businesses, because they failed to adopt the synthetic fiber and resin industries which become more popular products in the international market. The Korean government attempted to restructure textile industries from cotton spinning and weaving to synthetic fiber during this period of time in order to encounter the changing global market structure (Kim Ju-ho 1995:227).

industries and as a consequence added more subsidiaries. Second, business groups used diversification of business lines as a method of diffusing the high risks and uncertainty involved in new enterprises. Third, diversification is also the result of bold challenges to innovative business lines which arose in the process of dense-industrialization (Hwang In-hak 1997). The top ten Chaebols added 38 affiliates between 1961 and 1972, totaling 90 units in 1972. The average number of units of each Chaebol increased from 5.2 in 1961 to 9.0 in 1972 (Refer to Table 3.6). In terms of the top 30 Chaebols, the total number of affiliates rose to 126 as of 1970, averaging 4.2 units for each Chaebol.

THE BUSINESS-STATE NEXUS UNDER THE BUREAUCRATIC-AUTHORITARIAN REGIME: DEEPENING INDUSTRIALIZATION (1972-1979)

In the third period (1972-1979),²⁰ state dominance over the nexus was most thorough and comprehensive. With respect to the institutional arrangement, policy-making power was extremely concentrated at the center of the economic planning machinery and in the chief-executive, allowing the state to work as a unitary actor in carrying out developmental programs. The constitutional change into a Bureaucratic-Authoritarian regime granted the Korean government almost unlimited power. The president became the constitutional authority with no rival institutions which could check his power. The legislature during this period (1972-1979) fell into almost negligible status

²⁰ This period is called the “Yushin Regime” during which Park abandoned procedural democracy and adopted a Bureaucratic-Authoritarian regime. Under the *Yushin* Constitution, Park got elected as president without popular ballots. As long as his handpicked members of the “*Tongiljuche-Kookminhae*” gave him a vote of confidence, he was able to stay in power.

in the context of the economic legislation process, as compared with the previous period (1961-1971). The high degree of power concentration and state dominance over business was said to be indispensable for the Heavy-Chemical Industrialization (HCI) drive, to offset Korea's poor technology, manpower and managerial experience at that time.

However, this period showed that the concentration of power in the hands of a single ruler could be dangerous in economic management, if the ruler attempted to subject economic planning machinery to his imminent political interests. An authoritarian regime is not necessarily conducive to deepening industrialization, as many B-A scholars have contended. Thus, the main focus of this section is on whether or not the high degree of power concentration is positively associated with the success of transformative programs.

(1) Institutional Rearrangement for HCI Programs: Intimate and Direct Linkage of Business-State

In order to promote HCI programs, several critical changes in the internal structure of the state and in the business-state linkage were carried out. The first and most significant was the establishment of a policy coordination system at the top of the EPB.²¹ The "Committee for the Promotion of Heavy-Chemical Industrialization" (CPHCI) was launched by the law of government organization (Clause 2, Article 2) passed in the Ministerial Cabinet Meeting on January 1, 1973. The CPHCI was composed of seven automatic ministerial members (from the core economic ministries) and two appointed

²¹ Although the EPB did not lose its previous status completely (strategic market analysis, macroeconomic policies such as price regulation, budgeting and control over foreign capital borrowing), the special Committee for the Promotion of HCI programs increasingly came to be in charge of policy coordination regarding HCI programs, while the EPB downgraded itself to the executive committee of the CPHCI.

technocrats (from developmental and research institutes),²² and operated as the commander-in-chief of HCI programs, mostly examining the economic validity of new programs and making critical decisions on target industries and credit allocations. But the practical matters were mostly carried out by the Planning Executive of the CPHCI, which was led by the special secretary from the Presidential Economic Secretary Office.²³

Strong backing by President Park for the Planning Executive made it possible for the Planning Executive (comprised of the directors of critical bureaus from EPB, MOF, MOC and other ministries) to act quickly in the context of programming and mobilization of funds without bureaucratic interference. For instance, there were eighteen meetings of the CPHCI between 1973 and 1974. Out of eighteen meetings, seven were chaired by President Park himself, although the Prime Minister was supposed to chair the meetings under the presidential decree. Under the B-A regime, the chief-executive's backing meant that the net power of the Planning Executive went far beyond the legal authority assigned to the office (Kang Sung-nam 1992:141-142). Since 1974, the HCI Planning Executive virtually steered HCI programs, especially after Oh Won-chul, who attained full support from Park with his technocratic competency, took over the Planning Executive.

In accordance with the construction of the headquarters of HCI programs, the economic ministries were restructured to support HCI programs. First, the EPB was

²² Automatic members were the ministers of EPB, MOF, MOC, MOE, Bureau of Science and Technology (BST), and the second cabinet member with non-ministerial position, whereas the appointed members were the heads of the Public Corporation for Development of Industrial Parks (PCDIP) and Korea Development Institute (KDI) (CPHCI, *the Planning Executive, Hidden History of Policy Making* 1979, p.322).

²³ CPHCI, *the Planning Executive, Hidden History of Policy Making* 1979.

strengthened with more personnel and reorganization of planning bureaus.²⁴ Institutional reinforcement and restructuring of the EPB centered on the enhancement of institutional capability to control foreign capital, and to control and monitor critical investment projects, rather than on the institutional capability to do strategic market analysis, to develop long-term economic plans and macroeconomic policies. This restructuring was quite a departure from the institutional characteristics of the EPB in which the EPB was mandated to carry out the chief-executive's long-term economic vision, rather than engaging in practical and daily policy matters (Choi Byung-sun 1990:261-262). In other words, the EPB was partially transformed from the central planning agency, which was supposed to initiate and coordinate new economic programs, into the executive office (which carried out the detailed plans) of the CPHCI. The CPHCI largely took over the essential authority of the EPB during the HCI-drive in 1970s.

Other institutional restructuring involved the MOCI (Ministry of Commerce and Industry), MOC (Ministry of Construction), MOF (Ministry of Finance), MOE (Ministry of Education) and BST (Bureau of Science and Technology). In particular, the MOC, which had close organizational links with business, went through extensive organizational restructuring. Industrial Bureaus under the MOCI were divided into more detailed categories and a bureau in charge of industrial parks was added in 1977 (Kang Sung-nam 1992:144-145). The MOC also added a bureau which could carry out infrastructure

²⁴ During the pursuit of HCI programs between 1973 and 1979, the EPB was restructured eleven times to meet organizational needs for the effective execution of HCI programs by Presidential Decrees. For instance, in January 1973, three policy offices (price control, investment promotion, and foreign capital control) were transformed into more powerful bureaus and a third office for economic cooperation was added to the economic cooperation bureau (EPB 1982:427-437).

construction projects such as industrial parks, export seaports, plant water and plant locations. In order to finance the HCI programs, the MOF was also reorganized with additional bureaus such as “Assistant Secretary for International Finance,” who set up long-term financial plans for HCI programs and made sure that capital flowed into HCI programs (Kang Sung-nam 1992:145-146). Institutional mobilization also reached the Ministry of Education and the Bureau of Science and Technology, so that these institutions reshaped their emphasis on their resources and programs. More high schools with an emphasis on manufacturing skills were established across the country and academic programs of universities were more geared toward science and technology under MOE’s forceful guidance and control.

The second important change in terms of developmental agencies was that Park, who became confident in his economic management with improved knowledge, began to increasingly and directly intervene in administering economic affairs. Not at the very beginning of HCI programs, but later in the programs, Park increasingly authorized the presidential economic secretariats more power than the EPB to handle the HCI drive. The chief-executive’s reliance on presidential secretariats (the second principal secretary for the Presidential Economic Office, Oh Won-chul, had led the Planning Executive for CPHCI) meant that management of transformative programs and strategic policy analysis could be swayed according to political needs, because, unlike the EPB which was equipped with strategic policy analysis institutions such as KDI (Korea Development Institute) and a broad check-and-balance system among different specialized bureaus, the presidential secretariat office was originally designed to carry out limited functions such as advising the President and coordinating between the president and other economic

agencies (Choi Byung-sun 1990; Lee Man-hee 1992). As a matter of fact, in the late 1970s, the second economic secretariat took over a large part of HCI programs. In addition, the EPB often failed to raised an autonomous voice in the context of HCI programs under Park's B-A regime, although its strategic policy analysis was not supportive of a sweeping HCI drive.²⁵ This period shows that the institutional autonomy of core economic planning apparatus and the financial machinery were quite vulnerable under the highly powerful authoritarian ruler. Accordingly, the claim of B-A theory, that the establishment of an authoritarian regime was necessary and conducive to "deepening industrialization," is false in this case. Power concentration in the chief-executive office, despite the fact that power concentration made certain that the initially implausible HCI programs were carried out swiftly, also placed the core economic agencies under institutional distress, because the authoritarian chief-executive was more easily tempted to subject the developmental machinery to his imminent political objective.

For instance, Park, who wanted to establish more loyal bureaucratic machinery in his regime, widened his discretionary power to recruit office-holders, so that, as shown in Table 2.19, the ratio of civil servant recruitment through the open civil exam dropped

²⁵ For instance, according to the Third Five-Year Economic Plan (1972-1976) originally blueprinted by the EPB, Korea was supposed to carry out import substitution activities of steel, machinery and oil-chemical industries for the time being, instead of jumping into an all-out drive of heavy-chemical industries, while focusing on electronics and shipbuilding (which were considered to have a comparative advantage due to cheap labor) as export industries in the early phase of Heavy-Chemical Industrialization. But the blueprint of HCI programs drawn by the Planning Executive of the CPHCI included the outright export-drive of the whole range of heavy-chemical industries. Thereafter, the EPB was forced to revise its original plan to match the blueprint of the CPHCI (EPB, *The Third Five-Year Economic Plan, 1972-1976*, 1971 and CPHCI, the Planning Executive, *The Plan for the Promotion of HCI* 1973).

from about 60% in the 1960s to 48.9% in 1974. There were also significant changes in the recruitment of the mid-level bureaucratic managers. From 1976 on, the percentage of mid-level managers recruited via open competition diminished and instead military officers were induced into the mid-level bureaucratic offices via the special recruitment (Kim Byung-kook 1987; Kim Suk-joon 1991:429), although they did not get into the core economic planning agencies. However, his attempt to construct a more loyal bureaucratic machine did not shake the institutional foundations of the developmental economic apparatus because most military officers recruited via the special process were assigned to the Ministry of Domestic Affairs, National Taxation Office and other offices which were critical for the survival of regime (Kim Suk-jun 1992:446). But during the later phase of HCI programs, President Park detoured a bit from the critical principles of Weberian bureaucracy that the bureaucratic machine must not be exploited just for the ruler's political survival.

The third important facet which evolved during 1972-1979, regarding the internal structure of the state, was that the legislative body completely transformed into a subordinate arm of the executive. Accordingly, the National Assembly plainly functioned as a rubber-stamp for executive-initiated economic bills (Refer to empirical evidence presented in Chapter II). The executive's dominance over the legislative sealed out the influence of interest groups (especially big business) on the policy-making process. The firm control of the legislative was part of Park's political endeavor to construct a monolithic ordering system at the hierarchical peak of which Park himself was positioned. The construction of a monolithic ordering system implies that the internal conduit of interactions between business and state had become more narrow and directly controlled

by the chief-executive. This study will explore the effects of the “monolithic ordering system” during the B-A regime on economic transformative programs in a later section.

Along with the establishment of a highly monolithic policy coordination and ordering system, the Korean state invited a very limited number of entrepreneurs to the HCI-table. The characteristics of the business-state connection had become more narrow, intimate, direct and dense. In other words, a classical internal organization (a so-called “quasi-internal organization”) was constructed. In order to understand the evolution of the business-state nexus during this period, we must explore the primary characteristics of transformative programs. Above all, heavy-chemical industries require a large scale of investment and skillful management. In addition, plentiful industrial experience must follow the large scale investment. Therefore, the Korean government was compelled to pick giant conglomerates as its private partners. According to the principles laid-out by the MOCI as a follow-up of the Presidential declaration (“Policy Declaration of Heavy-Chemical Industrialization,” announced in President Park’s New Year Speech in January, 1973), any firm planning to invest in strategic target industries had to mobilize 30% of the required capital for the project by itself (MOCI, *Plan for the Promotion of Heavy-Chemical Industries*, June 1973). In fact, no small-and-medium-sized firm would be able to bear that large a share. Therefore, among big business groups, those who had shown their managerial skills and entrepreneurial spirits during the first drive of strategic industries (1961-1971), were selected as partners for HCI programs (Kim Ju-ho 1995:235). Limiting private partners to big business constrained the choices in the Korean state’s “winner-picking process” during this period. In turn, the limited number resulted in undesirable effects on the business-state nexus later on. There was a great risk of misuse

of the discretionary power of “winner-picking” especially under an inflexible, monolithic ordering system, due to the gigantic rent available to private partners. The political dilemma embedded in the HCI-drive was that both the construction of the monolithic ordering system on the government side and the limited number of private partners on the business side were a prerequisite step for the HCI-drive, but this ascending interdependency elevated the potential of collusion between them.

Now, let us turn our attention to the concrete internal organization of the business-state nexus. Besides the institutional connectedness installed during the early Export-drive (1963-1970), such as ECPT and KOTRA, the head of HCI programs, that is, the HCI Planning Executives (HCI-PE: composed of the principal secretary of the presidential economic office and directors of planning bureaus from the core economic ministries), structured a special linkage with big business via the Ministry of Commerce. Almost exclusively big businesses were invited to the HCI table organized by the MOCI. This discrimination against small-sized businesses and more discretionary approach in licensing investments increased the potential for the business-state nexus to become more collusive in character.

(2) Heavy-Chemical Industrialization (HCI) Programs: Manufacturing Incentive Structures and Financing HCI

a) Evolution of HCI Programs: The HCI program began with an unprecedented measure, that is, the political declaration of “Heavy-Chemical Industrialization” by President Park in 1973. Following the political declaration, the Planning Executive of the CPHCI laid out the *Plan for the Promotion of Heavy-Chemical Industries* (June 1973).

The planners intended to limit the target industries to those which were thought to be suitable to the Korean economy, giving consideration to those industries that had the maximum industrial linkage effects, that would make the largest contribution to economic growth and value-added, obtain the largest trade surplus, maximize the use of domestic resources, and induce foreign capital into HCI investments (Planning Executive of CPHCI 1973:6). Target industries included iron and steel, machinery, nonferrous metals, electronics, shipbuilding, and petrochemicals. The governmental approach to the selected industries under HCI programs can be summarized as follows: First, even within a selected strategic industry, the planners narrowed it down to a specific type of plant. For instance, concerning the iron and steel industry, only a synthetic steel plant was chosen, banning general steel and iron plants, whereas petrochemicals were permitted. The promotion of basic industries such as steel and petrochemicals was emphasized to ensure a more stable supply of these key materials. Second, heavy-chemical products were designated as the strategic export items, considering that the small domestic market would consume only a part of HCI products. Third, developing industrial parks was considered the best way to accommodate heavy-chemical plants. The target industries would benefit from being in one central location because of their distinctive traits, such as the mutual dependence among raw materials, intermediate and finished products, the close linkage between production and technology, and the high demands for infrastructure such as plant water, energy, and transportation. The locations of the plants were authorized by the government (EPB, *White Paper of Korean Economy* 1973:14-15). Fourth, national security interests also played a critical role in the designation process of specific target industries. For instance, Park wanted to substitute domestic products for the highly

import-dependent nonferrous metals, such as aluminum, copper, zinc, and lead, which were crucial for independent defense industries, as soon as possible. Fifth, regarding investment fund mobilization, individual investors were obliged to raise more than 30% of the total capital required for their projects by themselves, but foreign investors were not permitted to hold more than 50% of total shares in joint projects with national industrialists (Kang Sung-nam 1992:171).

According to *The Long-run Prospects of the Korean Economy* (October 12, 1973) co-authored by the EPB and KDI, Korea planned to raise its ratio of heavy-chemical industries relative to total manufacturing production from 35.2% in 1972, to 51% by 1981. And in terms of the ratio of HCI exports relative to total export volume, the original plan aimed at 65.0% by 1981. The total investment funds required in order to carry out this target amounted to 9.6 billion dollars under the original blueprint drawn up by the CPHCI, out of which \$5.8 billion was supposed to be mobilized from foreign lenders and \$3.8 billion from the domestic market between 1973 and 1981.

b) Manufacturing Incentive Structure: Before jumping into a discussion of the incentive system the government constructed to induce business into the HCI target industries, let us look at the prevalent attitude among businesses toward HCI programs at the very beginning of this program. The leading business groups were quite hesitant to get involved in the HCI-drive, because their general viewpoint was that the Korean economy was not ready to hop on the HCI-drive, but rather must continue to relish its comparative advantage in the global market of light manufacturing goods, such as textiles (FKI 1982:270). In addition, large scale investments carried “high risks” and “uncertainties,” especially under conditions in which raw material supplies were not guaranteed and

marketing of HCI products was a daunting task. Other problems with the HCI-drive from the viewpoint of private business was that the time span of returning profit was too long for private business, who tended to be interested in collecting quick profits. Thus, only private businesses who were willing to spare a large amount of capital for a while without profit-taking could go along with the HCI programs. Consequently, unless the government substantially cut down the “high risk” and “uncertainty” involved in making huge investments in technologically unfamiliar lines of business, no business would be willing to become involved in the HCI-drive.

Manufacturing an “incentive structure” involved the demonstration of strong commitment to heavy industrialization from the government side, especially the chief-executive, the follow-up actions of mobilizing and channeling massive financial resources (including foreign capital) with preferential interest toward heavy industrial sectors, and other inducement programs such as tax breaks and tariff exemptions. First, the government must assure the private sector that their resource commitment to HCI programs would be supported by all means from the government. President Park’s extraordinary commitment to HCI programs played a critical role in discounting the business groups’ uneasiness with the risk and uncertainty involved in the HCI-drive and Park’s pledge to HCI programs was well demonstrated by his direct involvement in the decision-making about important investments through CPHCI. Park’s apparent control over and enthusiastic participation in the Planning Council of CPHCI convinced Chaebol groups to engage in HCI programs (Choi Byung-sun 1993:36). The construction of a special policy coordination system (that is, CPHCI) and the net power designated to that agency also manifested the Korean state’s pledge to HCI programs. Responding to the

governmental commitment to HCI programs, from 1977 on, when the fourth Five-Year Economic Plan began (1977-81), all the Chaebol, who became convinced that the HCI business was lucrative, madly engaged in a licensing battle to expand their share of HCI business, eventually leading to excessive and duplicated investments in six target industries around the late 1970s (Kang Sung-nam 1992:178).

To finance HCI programs, the government enacted the Corporation Disclosure Promotion Law, National Investment Fund Law (1973), and Law for Foreign Capital Inducement (1977). Another measure to support HCI programs was the Short-term Financing Business Act of 1972, which was enacted to encourage the establishment of a variety of Nonbank Financial Intermediaries (NBFIs), including investment and finance companies, mutual savings firms, and general finance companies. Regarding financing of HCI programs, this study mainly focused on three critical capital sources: 1) National Investment Fund (NIF); 2) KDB's policy loans (NIF and loans from KDB together constituted more than 98% of total HCI policy loans. Kim Ju-ho 1995:242); and 3) foreign borrowing. The National Investment Fund and foreign loans were distributed via the state-run banks or the "designated commercial banks," which were supposed to supervise the borrowers' operations using the loans. Thus, the designated banks played the watchdog to closely monitor the use of money borrowed by corporations during the HCI-drive (Woo Jung-en 1991:150-151).

According to the *Long-run Prospects of the Korean Economy: 1972-1981*, written by the EPB (1973), the total investment funds (19.7 trillion won) required for the HCI program was supposed to be mobilized mostly through domestic savings (89.7%) rather than foreign borrowing (10.3%). Thus, the Korean government launched a massive

national campaign to raise the saving rate during this period²⁶ under the NIF program. The NIF was blueprinted by the vice-minister of Finance with technical assistance from the KDI and KDB under the special directive of President Park. The major sources of the NIF could be listed as follows: 1) issuance of investment bonds to citizens; 2) government investment; and 3) temporary loans from the BOK. Once the NIF was mobilized, funds with low interest rates were distributed to target industries via banks or used to build infrastructure such as plant water, roads and industrial parks (Korean Chamber of Commerce [Korean Economic Research Institute], *HCI and Capital Mobilization* 1975:133). A large portion of the NIF was superficially procured by the issuance of investment bonds to citizens, but, in fact, about 15% of increased savings in banks were forcefully drafted into the NIF. Thus, the NIF did not work as machinery to mobilize new savings through the issuance of the governmental bonds, but rather as machinery to intensively channel the increasing savings to HCI programs (Kang Sung-nam 1992:156-159). As shown in Table 3.17, between 1974 and 1980, a large portion of NIF funds (59.6%) were conveyed into HCI programs, while the rest of the funds were divided into primary industry, infrastructure and the New Village Movement during this period.

The second primary resource for HCI programs was the KDB. It provided long-term loans, underwrote corporate bonds and stocks, and guaranteed foreign loans to the target industries. As shown in Table 3.17, a large portion of KDB funds were distributed

²⁶ In response to the governmental programs to encourage domestic savings, the domestic savings rate soared to almost 20% by the mid-70s. During the HCI-drive (1972-1979), the average domestic saving rate was 23.5, as compared with 8.0 during the first Five-Year Economic Plan (1962-66) and with 16.0 during the second Five-Year Economic Plan (1967-1971) (BOK, *Yearbook of Economic Statistics*, each year).

into HCI projects, averaging 36.6% of total KDB lending between 1974 and 1980. More precisely, the share of money lent to HCI programs, relative to total loans to the manufacturing sector, rose from 51% in 1962 and 52.4% in 1966, to 76.7% in 1972 and 90.7% in 1976 (KDB 1994:310,314). Table 3.18 also illustrates that a large portion of KDB finances were rationed into five major target industries. Electricity and gas industries received the largest share of KDB funds under the government's endeavor to build thermo-electric power plants for the supply of electricity for manufacturing industries, and, in sequence, metal-machinery industries followed. On the other hand, textile-clothing and mining industries, which were supplied with a large share of investment funds as target industries in the 1960s, did not gain much KDB support in the 1970s. For instance, the KDB funds given to the textile-clothing industries, which peaked in 1962-1971 as the third largest recipient, shrank from 9.2% of total funds given during 1962-1971 to 3.7% during the HCI-drive (1972-1979). During the HCI-drive, about 36.6% of KDB funds (out of total loans which were assigned to manufacturing) were allotted to heavy industries (KDB 1994:314). Table 3.18 clearly shows that, while the KDB, as a financial instrument to channel funds into government-designated industries, has pumped the largest share of its investment funds into the construction of infrastructure such as electricity, gas, transportation, and communications throughout industrialization, the KDB has switched its investment targets over time along with deepening industrialization.

The third source of capital for the HCI program was foreign borrowing. The massive infusion of foreign capital was critical in fulfilling Korea's fervent investment ambitions in heavy industries. In order to promote the influx of foreign capital into the

domestic market, the Korean government introduced the “Public Loan Inducement and Supervision Law” in 1973 and amended the “Foreign Capital Inducement Law” in order to provide for more effective management of foreign capital inflow. As a consequence, as shown in Table 3.19, during the HCI-drive (1972-1979), foreign borrowing reached \$16.1 billion and bank loans amounted to \$2.8 billion, 17.1% of total foreign borrowing. Commercial loans had decreased subsequent to the enforcement of the selective foreign capital inducement policies in the mid-60s. However, they increased sharply, to \$7.8 billion, accounting for 48.1% of the total foreign borrowing during 1972-1979. Public loans from international organizations like the IBRD and the ADB steadily increased, reaching \$4.8 billion, 30.0% of total foreign borrowing.

As for the distribution of foreign borrowing, the overwhelming portion of public loans were used to build infrastructure which was supportive of the HCI-drive. More specifically, the share allotted for infrastructure building (including social service expenses) in public loans soared from 43.6% between 1966-72 to 75.3% between 1973-78, whereas the share allotted for primary industries dropped from 45.3% between 1966-72, to 20.3% between 1973-78. As this shift demonstrates, the Korean government, fully aware that the construction of infrastructure was urgent and indispensable for the HCI-drive, began to pump the massive foreign loans into infrastructure building (Refer to the table on page 170 in KDB & MOF, *30 Years of Foreign Borrowing*, 1993).

The distribution of commercial loans more directly reflected the fervent drive of HCI programs by the Korean government. Because commercial loans were carried out under the government’s license and loan guarantee, the distribution of commercial loans can be used as a good indicator of the government’s intent. As shown in Table 3.20,

heavy industry, which secured only 31.3% of commercial loans between 1966-72, attained 48.6% of total commercial loans between 1973-1979, while the share received by its counterpart, light industry, decreased by 2.3%. For instance, the shares of the chemical and metal industries, which were meager between 1966-1971, inflated to 17.7% and 21.5% between 1973 and 1978. On the other hand, the shares of food processing, textiles and plywood industries shrank to 0.1%, 13.4% and 0.8% respectively between 1973 and 1978 (KDB & MOF 1993:170). In short, the overall distribution of foreign loans clearly shows that the Korean government increasingly emphasized HCI programs with greater capital resources throughout the period.

Now let us turn our attention to the broader picture of “policy loans” and the “incentive structure” embedded in policy loans. What are policy loans? All bank loans are divided into two categories: policy and general. A policy loan is simply a business subsidy, the allocation of which is determined and scrutinized by the government. Policy loans carried exceedingly low interest rates (as compared with “general loans” with longer periods of maturity), and were virtually non-defaultable because of state backing. As shown in Table 3.21, three types of policy loans (“export,” “equipment investment” and “National Investment Fund”), carried lower interest rates than general bank loans. The composition of policy loans varied distinctively over time, so that it is quite difficult for researchers to grasp the yearly variation over a long period. However, “policy loans” during the HCI-drive were composed of “BOK rediscount,” “specialized banking funds,” the “directive loans” (i.e., ad hoc policy loans designated by the government and not covered through BOK rediscount), “compensation for interest rate differentials,” National Investment Fund, and government budget allotted for industrial investment (Woo Jung-en

1991:163).

First, let us look at the proportion of policy loans. As shown in Table 3.22, the ratio of policy loans relative to total loans began to rise again from 1973 (when HCI-drive began) on to finance HCI programs. By 1979, 64.7% of total bank loans were specified as “policy loans” by the government. The overwhelming portion of policy loans were used to bolster target industries (HCI programs) and other projects supervised by different economic ministries, as Table 3.17 demonstrated earlier. The expansion of preferential policy loans provided business with great motivation to get involved in HCI programs.

In order to grasp the “overall incentive structure” of financial policy, we must examine not only the distributional size of critical capital resources but also its substantive content within the loan package, that is, the interest rate. As Table 3.21 readily shows, policy loans carried exceedingly low interest rates during the HCI-drive. As compared with “general bank loans,” all three critical policy loans (“Equipment Loans,” “National Investment Loans” and especially “Export Loans”), were distributed with substantially lower interest rates. Considering that the real interest rate of not only “policy loans” but also all the money loaned by banks during this period (1971-1979) remained at a deep negative number because of high inflation, anyone who had access to bank loans was able to rake in large benefits. A close look at the high corporate earning rates, high curb market interest rates and high inflation rates also gave tremendous incentive to businesses to be engaged in the governmental programs. Simply speaking, under the high inflation rate, 19.8% between 1971 and 1979, the use of policy loans with their overall average interest rate of 11.4%, instead of borrowing from the curb market whose interest rate averaged 40%, benefited the borrowers in an extraordinary way.

As a consequence of the preferential policy loans with low interest rates, businesses who were hesitant to make investment commitments at the beginning of the HCI programs began to perceive the HCI-drive as an opportunity to dramatically upscale their business size and domain. During the period from 1976-1979 (during which active investment in heavy-chemical industries was done), 64.8% of total manufacturing investment poured into heavy and chemical industries, whereas only 35.2% flowed into light industries. The overall period of the HCI-drive (1972-1979) observed 61.6% of total manufacturing investment flowing into heavy-chemical industries (Kang Sung-nam 1992:201). And the investment programs in heavy and chemical industries were way ahead of schedule by 1979, accomplishing 97% of the planned investments within the first three years of the fourth Five-Year Economic Plan (1977-1981). The Chaebol began to engage in hot battles to attain investment licenses in target industries, especially from 1977 on, when the fourth Five-Year Economic Plan began. The territorial war among major Chaebol eventually resulted in excessive and duplicated investments in most target industries in the late 1970s (Kang Sung-nam 1992:178-179).

c) Results of the HCI-drive: The results of the HCI-drive were also evident in the structure of manufacturing and export-goods. As shown in Table 3.23, the weight of the heavy-chemical industries in the manufacturing sector bypassed that of light industries in 1979 for the first time. Right before the HCI-drive was launched (in 1970), only 37.8% of manufacturing goods were produced by heavy-chemical industries but this number jumped to 52.1% by 1979, while the ratio of light industries shrank from 62.2% to 47.9% during the identical period. In addition, the HCI-drive also led to a shift in the structure of export-goods in Korea. Table 3.23 also shows that in 1970, heavy-chemical products

constituted only 12.8% of total export goods, light-industrial products 69.7% and primary products 17.5%. But this composition of export-goods changed dramatically in the 1970s. By 1980, heavy-chemical products accounted for 41.6% of export goods. More specifically, machinery & equipment, which accounted for only 8.2% of exports in 1971, accounted for 22.2% in 1981. However, even in the late 1970s, light-industrial products accounted for the largest portion of export goods in South Korea, because the duplicated investment and excessive competition in HCI programs curtailed the industry's ability to sell their products in the global market. A close comparison between the structure of manufacturing and export-goods discloses that the heavy-chemical industries, despite their bigger share of products than the light industries, remained behind the light industries in terms of export-contribution. In short, the HCI-drive deepened the structure of manufacturing. It goes without saying that the shift in the structure of manufacturing was the result of the government's successful development of an "incentive structure," which was, in turn, able to induce business into profit-seeking activities through engaging in heavy-chemical industries.

More convincing evidence of the success of the HCI-drive was seen in macroeconomic indicators. As shown in Table 3.16, the annual GNP growth rate was 9.7% in the third Five-Year Plan (1972-1976) and 5.8% in the fourth Five-Year Plan (1977-1981). If the years 1979 and 1980, during which there was a recession, are omitted from statistics for the fourth Five-Year Plan, then even during that period, Korea obtained about a 9.0% annual growth rate. The per capita GNP increased sixfold from the beginning of the HCI-drive, jumping from US \$285 in 1971, to US \$1719 in 1981.

(3) HCI programs and Chaebol Growth

The government's massive infusion of foreign capital and domestic savings into HCI programs resulted in the rapid evolution of giant conglomerates in South Korea. Before the HCI-drive, the Korean Chaebol were engaged, in most cases, in small-sized light industries, but by the end of the HCI-drive, the Chaebol had transformed themselves into national flag-carriers in the global market with their well-known brand names, such as "Three Stars," "Gold Star" and "Hyundai." The Korean state was no longer able to set up the transformative programs without consulting big business. The increase of capital in the hands of a few Chaebol as the result of the HCI-drive carried important political implications in the business-state nexus and subsequent transformative economic programs.

As mentioned earlier, at the beginning of the HCI-drive, giant corporations were considered the best agents to be entrusted to carry out HCI programs due to the large scale of investment, managerial experience and skills required. Accordingly, the giant corporations ransacked the HCI programs to their own great benefit. Unlike the previous period (1962-1971), the government utilized a discretionary approach to business licensing and credit distribution. Within the limited choices of giant conglomerates, the EPB, which was in charge of "picking-winners," tried to draw the finest entrepreneurs into the selected industries under the HCI programs. The critical institution in the process of "picking-winners" was the "Judging Committee to Screen the Validity of Investment Proposals" under the EPB. With the authority of "licensing investment," the government acted as an entrepreneur and controlled capital movement tightly during this period (Lee Man-hee 1992:141).

The “Judging Committee” under the EPB basically screened the investment projects submitted by business on the basis of three criteria: technical efficiency, economic profitability, and financial soundness. Under the “economic profitability” category, the Judging Committee included not only the actual profitability of submitted investment projects but also their linkage-effect over other industries, potential as export products, the effect of value-added and effect on employment. The judging committee even made decisions on the size and time of investments and the time of plant construction under its pre-estimation of the prospective market. “Technical efficiency” concerned the validity of applied technology, possibility of raw material supply, sufficient engineer reserve, and the location of plants. And with “financial soundness,” the Judging Committee examined managerial skills and whether or not the business was able to mobilize sufficient foreign and domestic capital to carry out the designated project (The Government of Republic of Korea, the third Five-Year Economic Plan: 1972-1976, 1971, p.120).

Big business experienced not only brisk expansion but also structural changes in terms of the industries they got involved in during the HCI-drive (1972-1979), by exploitation of preferential bank credit, profitable foreign borrowing, and tax and tariff exemptions. The average number of subsidiaries of the top ten Chaebols in 1972 was 9.0 while each individual Chaebol was involved in 7.7 different industries, but in 1980 these numbers jumped to 34.6 and 18.6 respectively. In 1979, the top ten Chaebol attained a 47.7% compound average annual growth rate in terms of assets during the HCI-drive. Daewoo underwent the speediest growth from two member firms in 1972 to thirty-four, involving 20 different industries, in 1979 (Kim Seok-ki 1987:171). And, according to Sakong Il’s study (1980:5), the top 20 Chaebols increased their affiliates from 152 in 1973

to 284 in 1978, while the top 46 added 131 member companies to their original number, 290, in 1973. In addition, as shown in Table 3.24, the growth of big business groups in terms of total value-added during the HCI-drive was impressive. The average annual growth rate in terms of value-added for each category of Chaebol groups by far surpassed the annual growth rate of the GDP between 1973 and 1978. As a result of the unprecedented growth rate of the Chaebol, the 30 largest Chaebols came to account for 24.5% of total employment, 35.2% of total sales, and about 30% of total value-added in the manufacturing sector by 1979 (Refer to Table 3.26). By the end of the HCI-drive, the top Chaebol had taken over the lion's share of the Korean economy in terms of employment, sales, assets and value-added and have remained unchanged in terms of their weight relative to the Korean economy since then.

The second important change during this period was that, as illustrated in Table 3.26, the core business lines of top Chaebol shifted from light to heavy-chemical industries. The ratio of heavy-chemical assets held by the top 10 Chaebols, relative to total manufacturing assets, soared from 70.6% in 1972, to 84.7% in 1979. The transformation of Daewoo was especially striking. Daewoo had no business involved in the manufacturing sector in 1972, but by 1979, 94.3% of its assets were from heavy-chemical industries. Table 3.2 also shows that Daewoo was not listed in the top 10 Chaebols at the beginning of the HCI-drive, but leapfrogged to fourth place by 1979. If Table 3.2 and Table 3.26 are examined together, it is readily apparent that those groups who underwent a dramatic transformation in their asset structure, most promoted their ranking in top ten list in Table 3.2 (Refer to the ratio of Heavy-chemical to total manufacturing assets between 1972 and 1979 for each Chaebol). This implies that those

big business groups who embraced HCI programs most enthusiastically reaped the most benefits, growing fastest among Chaebol.

Third, the Chaebol underwent extensive diversification of their business lines. At the beginning of the HCI-drive (1972), the average number of business lines of the ten largest Chaebols was 7.7. Except for three Chaebol groups (Samsung, Lucky and Hanjin), most of the top Chaebol diversified into only five to eight different business lines up until 1972. As shown in Table 3.27, most top business groups became involved in various target industries (steel, nonferrous metals, petrochemicals, general-type machinery, shipbuilding and electronics). For instance, Hyundai, Samsung, Daewoo, and Lucky-Goldstar (LG) debuted at least four different heavy-chemical industries during this short period. Korean big business group's diversification²⁷ during this period was both the response to the governmental incentive package and the entrepreneurial motivation to move on from decaying to growing industries. For instance, the government's use of past export performance as a criterion for the renewal of status as a "general trading

²⁷ There are various explanations of why Korean big business diversified into many different business lines throughout the dense industrialization. First, diversification is understood as a means of diffusing risk across different business lines, so that when one business line does not perform well, other lucrative business lines could save the entire company from sinking into bankruptcy. Especially in developing countries whose business environment is less predictable, business often relies upon diversification to diffuse uncertainty and risk. Second, businesses are likely to respond to economic stimuli packages structured by the developmental state, by engaging in diverse industrial programs laid-out by the government. Business endeavors to utilize the transformative programs in different phases of industrialization tend to end up with a large number of different business lines by embracing new target industries (expanding industries) and still carrying on the pre-existing industries. Third, businesses want to cut down some critical costs such R&D and advertisement expenses by sharing R&D outcomes and the brand name as collective goods among affiliated firms within a business group. Other collective goods which can be shared among member companies are managerial skills and valuable business experience (Kim Sang-keun 1995:72-88).

company,”²⁸ led Chaebol to actively seek mergers with and acquisitions of medium- and small-scale enterprises in broad lines of business, because the merger and acquisition of medium- and small-sized firms were quick and easy ways of inflating their export volume.²⁹ Chaebol learned over time that switching their core business lines into new expanding areas (in most cases, target industries) in different phases of industrialization through exploitation of preferential credit allocation was the only way to keep up with their competitors. After switching their core businesses, most big businesses continued their previous businesses to diffuse the high risk involved in their new investments in heavy-chemical industries. As a result, Chaebol expanded their affiliates tremendously during this period, but this expansion became somewhat stagnant after the HCI-drive. In short, the growing economic strength of the Chaebol (as indicated in the rising number of affiliates in big business groups, the ascending weight of Chaebol relative to the overall

²⁸ From 1975 on, the Korean government induced big business groups to establish “general trading companies” as a way to constantly promote exports. A “general trading company” license was given to entrepreneurs whose export volume was over one million dollars per year, whose exports were received by more than ten countries, and who exported more than seven items with a value of a half million dollars, as of 1975 (Cho Dong-sung 1986:21). “General trading companies,” which were mostly licensed to top Chaebol, were given an extensive range of benefits and other policy supports, including preferential credit allocation and exemptions from governmental regulations in the context of exports and imports. Because the license was issued on the basis of export volume carried out by individual trading companies, Chaebol competed neck and neck to obtain a larger volume of exports. Merger and acquisition of small-sized firms were often used to inflate export volume by individual Chaebols under overly heated competition. As a result of the fervent export drive during this period, the ratio of export volume carried out by 14 general trading companies soared from 12.4% in 1975 to 33.9% in 1979 (Cho Dong-sung 1986:52).

²⁹ For instance, between 1974 and 1979, the 30 largest Chaebols added 304 member companies, of which 152 were from new establishments, 173 from acquisitions, 13 from mergers, and 17 from joint investments with other corporations, whereas they sold 38 units during this period (Kim Hyo-keun 1986:78).

national economy, and the diversification of business lines) carried significant implications for the business-state nexus especially during the subsequent period. These implications will be explored in the following section.

THE BUSINESS-STATE NEXUS UNDER A LIMITED DEVELOPMENTAL STATE: BALANCED GROWTH WITH STABILITY AND “SLOUCHING TOWARD MARKET” (1980-1987)

The fourth period (1980-1987) shows that the state’s dominance over the nexus was no longer thorough and comprehensive, but rather, the nexus was transformed from a “principle-agent” relationship to a symbiotic one. Strategic interdependency began as a predominant formula on the basis of both parties’ mutual needs. To put it more specifically, the Korean state maintained its political edge over big business, while substantially losing its economic leverage due to the overgrown power of the Chaebol (Refer to Table 3.25 for the rising share of the Chaebol in the national economy). In the context of the internal structure of the state, this study discovered only a few changes in the policy coordination system (Refer to Table 2.8), the institutional characteristics of the recruitment system (Refer to Tables 2.17 and 2.19), the legislative-executive nexus (Refer to Table 2.14) and the institutional autonomy of developmental agencies (Tables 2.5, 2.6, and 2.7). The only change detected statistically in this study is that the reward system was deteriorating rapidly (Refer to Tables 2.20, 2.21, 2.22 and 2.23) and, as a result, the Korean government increasingly had difficulty in coaxing a quality labor force into public service. However, a rigorous inquiry into the internal structure of the state discloses that there were tangible changes in the institutional characteristics of developmental machinery. This study will explore those changes in detail later.

On the other hand, in the context of economic resources under the government and business and organizational characteristics of Chaebol corporations, several significant changes were detected. First, the degree of economic concentration (the Chaebol's share of the national economy) reached its peak in a few categories, deepening the state's structural dependency upon big business during Chun's rule. For instance, the economic concentration ratio in the hands of the top ten and top thirty Chaebols in terms of employment, sales, total assets, and added-value jumped to nearly their highest levels in early 1980s. Second, the highly diversified business lines turned out to be important sources for the Chaebol in the pursuit of political influence on the governing process. The Chaebol, with overarching power from their flagship industries to the media at the end of the HCI-drive, found themselves equipped with plentiful resources against the state. As shown in Table 3.6, the top ten Chaebols owned an average of 34.6 subsidiaries in 1980. And the top 30 Chaebols possessed an average of 15.4 subsidiaries in 1982 (Refer to Table 3.28). Third, businesses' ability to mobilize their business funds (internal savings) steadily increased, whereas their dependency upon external capital sources decreased (Refer to Table 3.10). For instance, the ratio of internal savings rose from 19.5% between 1970-74, to 30.0% between 1980-84. Additionally, in the context of external mobilization, business had increasingly become reliant upon direct capital mobilization from the stock market (which was under its control rather than under government control) rather than foreign and domestic bank borrowing (Refer to Table 3.11).

However, Korean Chaebol remained highly indebted, especially during the early 1980s. The high debt/equity ratio definitely made the Chaebol more vulnerable to the pressure of the government in the process of industrial restructuring during Chun's regime

(1980-1987). As shown in Table 3.29, the average debt/equity ratio of large corporations was 504.7% in 1980 and 451.1% in 1981, which was extremely high, as compared with their international competitors.³⁰ Another critical source remaining under the government's control was the large proportion of "policy loans," although their ability to attract business into the designated industries was substantially curtailed because of the narrowing interest gap between policy and general bank loans. As shown in Table 3.22, between 1980 and 1987, about 70% of total money lent was set aside as "policy loans" by the government, mostly owing to the financial need for industrial restructuring programs.

Owing to the above-mentioned changes across political and economic variables, the structural characteristics of the business-state nexus basically transformed from a principal-agent relationship into strategic interdependency. However, this period showed that, as long as the internal structure of the state remained close to Weberian bureaucracy and political leadership remained strongly committed to economic progress, an effective, goal-seeking collaboration between state and business could be manufactured under the chief-executive's leadership, regardless of the decline in governmental control over critical capital sources and the rising economic strength of big business. This finding becomes clearer when all the variables are compared between two different time periods, that is, 1980-1987 and 1988-1997. For instance, as Table 3.1-b shows, there was little change in the context of economic variables across these two time periods, but the essence of the business-state nexus became more collusive in character by the mid-1990s.

³⁰ For instance, the average debt/equity ratio for Taiwanese, Japanese and American firms was recorded as only 80-100%, 150-200%, and 120-150%, respectively, during the same period (BOK, *Analysis of Financial Statement*, various years).

(1) Restructuring the Policy Coordination System for “Balanced Growth with Stability” and Financial Liberalization

Chun Doo-hwan, who came to power through a military *coup d'etat* in 1980, demonstrated his power to the private sector by launching a political campaign against the Chaebol, as his predecessor had done about twenty years previously. With installation of the “Social Purification Committee,” the military junta carried out a “social purification movement” with the use of ultra-constitutional power, which aimed at uprooting “irrational and corrupt social customs and groups.” The Chun regime’s ruling ideology, which emphasized “balanced growth with stability” and “economic justice,” clearly departed from the previous regime’s, which was emphatically devoted to a “growth first” policy throughout the 1960s and 1970s. In fact, Chun’s championing of economic justice turned out to be political propaganda to make up for the lack of political legitimacy (Kim Suk-jun 1992:467–468). However, with the political need to demonstrate a clear-cut departure from the previous regime whose connections with big business were commonly perceived by the populace as corrupt collusion, especially during the HCI-drive, the Chun regime detached itself from the institutional linkage with big business. The Korean state’s break-off of its close ties with big business was a serious threat to the Chaebol who had grown into giants under the state’s patronage and guidance.³¹ Responding to this political threat, the Chaebol gave in to the military junta by voluntarily announcing the “Platform of

³¹ Right after the 12.12 military coup, the Military junta continually warned that Chaebol who did not live up to entrepreneurial ethics and inflicted damage on the public interests would be severely punished. There was also an attempt to imprison corrupt businessmen, although it was never carried out (Suh Se-jin, *Bourgeoisie and Class in Korea* 1991:142, Seoul: Nanam Publisher).

Entrepreneurial Ethics”³² at the “Entrepreneurs Rally for the Clean-up of Corrupt Business” in July 1980. In short, these types of political moves made by Chun’s military junta and big businesses set the pattern for business-state interactions during Chun’s rule (1980-1987).³³

There was a temporary cut-off in the institutional networks between state and business under the military junta. Military junta members, called the “National Preservation Committee” did not share a common social background with business elites. The Economic Standing Committee under the military junta recruited economic technocrats mostly from the EPB and delegated extensive authority to the technocrats (Kang Suk-yul 1994:20-22). The temporary cut-off of the networks of business-state and the military junta’s reliance upon EPB technocrats led to the rehabilitation of the EPB as the policy coordination center. As mentioned earlier, Park established the policy

³² The platform read as follows: 1) Businessmen will do their best to improve the balance of payments and restrain skyrocketing inflation with improvement of productivity and quality production. 2) Ownership and managerial authority must be separated to firmly establish managerial professionalism. 3) We will do our best to promote the well-being and real income of workers and to strengthen cooperative relationships with employees. 4) We will not engage in duplicate investments and other socially wasteful actions... This platform was endorsed by the government with the participation of the EPB head (*Dongah Daily Newspaper*, July 16, 1980).

³³ As for the business-state nexus during the early period of Chun’s rule, we have to remember that Chun’s military government forced big business to stop speculative investment in real estate and induced them into productive profit-seeking. In order to improve the financial structure of big business, the government pushed business groups that owed bank loans of ten billion won (for firms) or twenty billion won (for Chaebol) to report all land holdings to the banks and to sell land unrelated to the main business lines (Choi Byung-sun 1993:41). The annual increase rate of land prices in major cities skyrocketed between 1975 and 1979. The high growth rate of land prices implies that Chaebol were heavily engaged in speculative investments by purchasing large pieces of land under the excuse of plant locations in order to utilize the rampant inflation as a profit-seeking opportunity during this period. Between 1974 and 1979, the inflation rate of the GNP deflator remained between 16.2 and 31%, averaging 23.2%.

coordination center, that is, the Special Committee for the Promotion of Heavy-Chemical Industries, overriding the EPB to steer HCI programs. The chief-executive's direct and excessive intervention in strategic decision making via the "Special Committee for the Promotion of Heavy-Chemical Industries" inflicted serious damage on the institutional autonomy of the EPB during the HCI-drive (1972-1979). Chun's non-interventionist attitude toward economic decision-making and his elite-technocrat rearrangement centered around EPB elites greatly helped the EPB reclaim its policy leadership lost during the HCI-drive (Choi Byung-sun 1987; Kim Byung-kook 1987).

The rehabilitation of the EPB as the policy coordination center carried significant implications in the context of the business-state nexus. As mentioned earlier, MOCI (Ministry of Commerce and Industry) exercised significant power in carrying out HCI-programs outlined by CPHCI, using its strong connections with business. The enlargement of MOCI's role turned out to be problematic, because MOCI, unlike the EPB, had a strong tendency to patronize big business in the policy-making process. Due to the traditionally strong connection with business, the increasing influence of MOCI on the policy-making process resulted in the perversion of policy from its proper track of economic management, which was supposed to be governed by the EPB during the HCI-drive. In the late 1970s, there were serious conflicts among the EPB, MOCI and Chaebol because of their different approaches to skyrocketing inflation and debilitating HCI programs. But the Chun military government's negative attitudes toward big business made it difficult for MOCI to play a significant role any longer, leading, to some degree, to the EPB's recovery of the super ministry status lost during the HCI-drive (Choi Byung-sun 1990). The rehabilitation of the EPB as a policy coordination center made it possible

for the EPB to bring big business back on track of strategic collaboration in pursuit of common interests.

The institutional recuperation of the EPB's autonomous power was also attributable to the fact that the EPB, which had insisted on "balanced growth with stability" against MOCI and CPHCI from the late 1970s on, was recognized as a trustworthy institution by Chun's military government. Chun, who was personally uneducated on economics, unlike his predecessor, Park, was willing to delegate comprehensive authority to the EPB and backed it with his strong support (Lee Jang-kyu 1992). However, the rehabilitation of the EPB as a "super-ministry" was quite limited because the institutional resources held by the EPB had been shrinking since the late 1970s. The competence of the EPB's personnel was no longer dominant over other economic agencies and the EPB's control over the budget and foreign borrowing also lost its overpowering leverage to manufacture coordinated economic policies among the involved economic agencies, due to its declining significance.

Notwithstanding that the institutional resources under the EPB were greatly reduced in the 1980s, the authoritarian Chun's strong mandate to his principal economic secretaries (Kim Jae-ik and Sakong Il) and to the EPB was able to counterbalance the declining authority of the EPB. Elite technocrats from the EPB were appointed to critical policy bureaus of the MOF and MOCI with President Chun's strong backing. By doing so, the EPB's policy stance, which was focused on a "stabilization program," was imposed on other economic ministries without much resistance (Lee Jang-kyu 1992:157-169). President Chun deserves credit for the recovery of the economic policy coordination system, although the office of the principal economic secretary in the Blue House often

overpowered the EPB on critical issues. Without his consistent delivery of mandates to specific agents and agencies, economic policy coordination would not have been possible at that time. In other words, policy coordination was manufactured, mostly owing to Chun's authoritative engineering of economic agencies via his trusted technocrats. As mentioned in Chapter I, Chun also demonstrated his extraordinary determination to shield economic technocrats from the influence of party politics and the Chaebol, and his consistent stance for stabilization programs, up until the latter part of his rule (1986-1987) (Lee Jang-kyu 1992).

The "Deliberate Council of Industrial Policies" (DCIP)³⁴ was institutionalized as a new policy coordination system in August 1981. The institutional objective of the DCIP was to strengthen the screening process for equipment investment by the public and private sectors to prevent major investment projects from falling prey to ill-managed business, to promote technological and manpower development with a preferential tax system, and to re-energize the policy coordination system among economic agencies. The DCIP scrutinized the relevance, effectiveness, and soundness of various policies concerning the tariff system, preferential taxation, trade-related laws, distribution of developmental funds, investment licensing to private business, and governmental investment plans. This DCIP was also institutionally linked with the private sector via the

³⁴ The Council, which was chaired by the prime minister, was composed of ten heads of economic ministries, including the EPB, MOF, and MOCI. From March 1986, membership of this Council was expanded to include the Principal Secretary of the Presidential Economic Office and Director of Policy Coordination under the Prime Minister. In particular, the DCIP enhanced the government's ability to screen the adequacy of investment programs through the institutional augmentation of the Investment Screening Office under the EPB. Later on, the Investment Screening Office continued to be restructured to eliminate poor decisions on investment projects (EPB 1994:141).

“Civilian Council of Industrial Development” (CCID). The CCID was installed under the DCIP to share policy agenda, policy positions, and market information between the public and private sectors. The policy makers attempted to develop better defined and more plausible policy alternatives through direct interactions with private power holders, who were in charge of carrying out the policy blueprints (EPB 1994:141-142). But the pattern of interactions between the state and power holders in the private sector was not as intimate and dense as under President Park (1962-1979).

As demonstrated in previous periods, the patterns or types of the government’s policy coordination systems tended to structure the fashion of interactions between business and state. As mentioned earlier, the business-state networking was temporarily interrupted under the military junta (1979-1980). The institutional channels were eventually reinstalled, but the patterns of connectedness were quite distinct from those of preceding times, reflecting, to some extent, the government’s shift in its emphasis on indirect intervention. For instance, during early export-driven industrialization (1962-1971), the Monthly Meeting for the Promotion of Exports, in which President Park himself, economic technocrats in charge of transformative programs, and significant figures from the business community participated, was the formal institution via which business and state interacted with each other. During the HCI-drive (1972-1979), the CPHCI and FKI worked together closely, especially through MOCI under President Park’s explicit directives. But the formation of business-state interactions could not but change as the Korean state began to curtail its direct and selective interventionist roles with the economic liberalization programs. However, except for the temporary cut-off under the military junta, the dense, informal and formal networks were restored in time,

though in more aloof forms than during preceding periods.

There were several business-state networks during Chun's era. At the top of a hierarchical networking there was the "Business-State Meeting," which was an invitational meeting held at the Blue House on an irregular basis. In the meetings, the chief-executive explained the governmental intent of critical economic programs, and in exchange, listened to the views and concerns of the chairpersons of major Chaebol groups. Business groups usually brought issues to the Business-State Meeting which were not settled at lower level talks. However, during Chun's rule (1980-1987), the business-state interactions were carried out primarily in the form of conventions and seminars organized by the business community, private research institutes established by the Chaebol and public research institutes established by cabinet ministries. In short, the predominant pattern of business-state networks became more aloof, informal, and less intimate, as compared with the previous period during which the formal and direct networks were institutionalized. Qualities of the business-state nexus remained effective and productive in carrying out transformative programs as shown in the relative success of the "Structural Adjustment" program, attributed, to a large extent, to the political leadership (guaranteeing the institutional autonomy of the core developmental machinery), the coherent policy making regime, high indebtedness of big business groups, and the state's comprehensive control over capital resources.

(2) Industrial Restructuring with Financial Liberalization

(a) Epilogue of HCI-drive

Notwithstanding that President Park's HCI-drive (1972-1979) transformed the structure of the Korean economy into a more self-sufficient one with the substitution of previously imported items, such as steel & iron, petro-chemicals, and nonferrous metals, which are very critical to deepening industrialization, HCI programs began to present serious problems in the late 1970s. The economic cataclysm in 1979 was caused by a combination of several factors: First, the recession of the world economy, beginning with the second oil shock, cut down the Korean export volume. In the late 1970s, Korea had accumulated a negative trade balance, amounting to 1.85 billion dollars in 1978 and 4.2 billion in 1979 (BOK, *Yearbook of Economic Statistics*, March 1983). The deteriorating export environment in turn led to a serious debt repayment problem as the due dates of foreign borrowing approached, which were critical financial sources of HCI investments.

Second, the governmental incentive programs, which lowered capital expenses dramatically, led to excessive and duplicated investments in heavy-chemical industries, while neglecting light industries. The production capacity of target industries exceedingly surpassed the demands of the domestic market. According to the MOC report (*Plan for the Promotion of the Large-scale Machinery Industry*, April 1978), as of 1978, the volume of power generators manufactured was 10 times as much as the consumption capacity of the domestic market, steel: 4 times, petro-chemicals: 12 times, and automobiles: 4 times. This over-capacity of production under world economic recession in turn resulted in lowering the working ratio of heavy-chemical equipment. For instance, the working ratio of automobile plants plummeted from about 70% in 1979 to about 35%

in 1980. As a matter of fact, the overall working ratio of heavy-chemical equipment between 1975 and 1980 remained as low as in the 50s and 60s³⁵ (Kang Sung-nam 1992:200).

Other problems caused by the vehement HCI-drive included unbalanced growth between industries, subsequent high inflation and a budget crisis. For instance, between 1976 and 1979, 64.8% of total manufacturing investment flowed into heavy-chemical industries annually, while 35.2% was steered into light industries. An excessive drain of the governmental budget³⁶ and other financial resources into heavy-chemical industries eventually triggered high inflation. Thus, between 1974 and 1979, the average growth rate of consumer prices was 18.0%, soaring to 28.7% in 1980, and 21.3% in 1981 (EPB, *Korean Economic Indicators*, 1983).

Korean corporations' extreme reliance on external capital³⁷ in financing investment projects and their high debt-to-equity ratios doubled their financial distress whenever the Korean economy fell apart. As shown in Table 3.10, Korean corporations had mobilized a large share of investment funds from outside, rather than from internal savings (internal

³⁵ According to Kang Sung-nam's study (1992:200), the working ratio of heavy-chemical industries was 58.2% in 1975, 68.1% in 1976, 69.8% in 1977, 70.5% in 1978, 63.1% in 1979, and 56.3% in 1980, while the working ratio of light industries was 76.7% in 1975, 88.0% in 1976, 83.2% in 1977, 97.8% in 1978, 86.8% in 1979, and 72.9% in 1980. Thus, light industries had maintained a much higher working ratio of equipment than heavy-chemical industries. And light industries made a bigger contribution to export volume after controlling for the size of investments.

³⁶ For instance, about 51.9% of the governmental investments flowed into heavy-chemical industries in 1979.

³⁷ For instance, an average of 61.9% of finances in Japanese firms in 1977, and 70.9% in American firms, were mobilized through internal savings respectively, while, for Korean firms, only 23.9% of capital was from internal savings between 1975-79 (Kang Sung-nam 1992:203).

reserve, savings for depreciation, and appropriation expense). External mobilization (Refer to Table 3.11) accounted for 80.5% of total financing between 1970-1974 and about 75% between 1975 and 1979, whereas the rest was mobilized internally. A close look at external mobilization also discloses that Korea corporations heavily depended upon bank loans and foreign borrowing, which were not under their control. Issuance of valuable securities such as stocks and corporate bonds are more controllable by corporations, as compared with foreign borrowing and domestic borrowing from financial institutions. Table 3.11 shows that 75.2% of externally mobilized capital between 1970-74 and 68.4% between 1975-79 was from borrowing rather than issuance of valuable securities. Korean big business did not have difficulty borrowing foreign capital because there were plenty of Euro-dollars secured from the hiked oil prices during the early phase of the HCI-drive. But Korean corporations came under high financial distress as OPEC began to recall their loans in the late 1970s. Korean corporations' extraordinary reliance upon external capital made them highly vulnerable to a changing global economic environment.

Another financial vulnerability of Korean corporations lay in the excessive debt-to-equity ratios. As shown in Table 3.29, throughout the HCI-drive (1972-1979), the average debt/equity ratio in manufacturing rose constantly, peaking at 488% in 1980. Concerning the ten largest and fifty largest Chaebols, the debt/equity ratio was more serious and more damaging. As shown in Table 3.30, the average debt/equity ratio of the top ten Chaebols increased to 773.5% in 1980, and, for the top fifty Chaebols, to 524.4%. The higher debt/equity ratios of giant conglomerates, as compared with Small- and Medium-sized firms or overall manufacturing firms (394.9% for SMEs and 487.9% for

Manufacturing), were caused by the giant conglomerates' fervid investments in heavy-chemical industries. The excessive debt/equity ratio greatly raised the unit cost of production because of the high financial burden, resulting in lower profitability of enterprises. As a consequence, as shown in Table 3.30, most of the Chaebol would have been on the brink of bankruptcy were it not for a financial rescue by the government at the end of the HCI-drive.

(b) Setting Policy Targets: Industrial Restructuring: The lessons to policy makers from the troublesome end of the HCI-drive were clear: First, direct and discretionary intervention by the government in the allocation of financial resources was no longer effective, but only generated more daunting predicaments for both big business and the banks. The scale and complexity of the national economy had grown by the end of the HCI-drive, so that the distributional machinery under the "state enterprise-approach" no longer worked as proficiently as in the past. Especially the banks, which worked as a subordinate arm of the economic planning apparatus during early industrialization and distributed finances into target industries, could not be held accountable for bad loans. The government was ultimately responsible for ill-managed banks which basically delivered credit to the government-designated firms (Choi Pil-sun 1990:69-78; Kim Dong-won 1978). Thus, the government tried to increase reliance on the market mechanism. The second lesson learned was that "economic policy with paramount emphasis on growth" leads to destabilization, perpetrating high inflation and budget and trade balance deficits. Throughout Park's era (1961-1979), Korea pursued quick and quantitative economic growth with supportive programs for larger and quicker

investments. As a result, the problem turned out to be not a deficiency of investment, which is often the case for developing countries, but excessive and overdone investment ventures in strategic industries among rival Chaebol.³⁸ Thus, the “growth with inflation” strategy reached a breaking point at which a drastic policy turnaround had to be taken before the entire economy degenerated into greater cataclysm (Kim Suk-jun 1992:504-519). Chun’s government began to follow “balanced growth through stabilization” programs. Third, without restructuring the excessive and duplicated investments in heavy-chemical industries made by rival Chaebol groups, the government could not manage the two preceding problems. Especially industrial sectors (such as power generation, heavy construction equipment, heavy electrical equipment, electronic-switching systems, and diesel engines) were grossly over-done in terms of investments (Kim Suk-jun 1992:504-519; Choi Byung-sun 1993:4041). Thus, the reorganization of the Heavy-Chemical industries became the main task.

Accordingly, Chun’s government launched a policy paradigm shift to repair the above-mentioned economic predicament. Five major policy tasks arose: 1) financial liberalization, 2) economic stabilization, 3) industrial restructuring (reorganization of HCI), 4) market liberalization, and 5) regulatory policies over the Chaebol. The characteristics of the transformative programs Chun’s government had to carry out were startlingly distinct from preceding ones. Under the comprehensive developmental era (1961-1979), the government policy settings were largely geared to promote target

³⁸ The ratio of total fixed investment remained between 11.3% and 14.8% in the early 1960s, but since 1966 remained between 20.2% and 33.2%, averaging about 25% (BOK, *Yearbook of Korean Economic Statistics*, each year).

industries through the specific construction of incentive structures to induce businesses into substantial investments in strategic industries. From this point on (1980s), the heart of the transformative programs was not only promoting target industries but also the promotion of the market mechanism. Slouching toward market-led economy involved financial reform, deregulation of the domestic market and regulatory measures over big business (Moon Chung-in 1991).

Among these policy targets, this study will mainly focus on “industrial restructuring” because the strategic interactions of business-state in this area are more likely to disclose the traits of the business-state nexus and to be more empirically measurable as compared with other policy areas. In addition, this study wants to maintain consistency in the context of transformative programs with a narrow focus on the failure or success of industrial restructuring over time. The ultimate goal of industrial restructuring under Chun’s government (1980-1987) was to reorganize industries into more competitive forms with a strategic emphasis on advanced industries at a comparative advantage in the global market. Industrial restructuring proceeded in two steps: First, industrial restructuring was concerned with the disposal of ailing enterprises and the dissolution of excessive and duplicated investments in key heavy-chemical industries. The disposal of ailing enterprises was also a necessary measure to prevent financial markets from falling into chaos, because banks had accumulated non-performing loans, due to the poor performance of the borrowers. Accordingly, the Chun regime immediately launched the restructuring of the heavy-chemical industry. The second step in industrial restructuring involved the “rationalization of industrial structure” under which the economic planners classified which industries would become more market-prosperous in

the near future and which would not on the basis of strategic market analysis. Under this rationalization program, the government attempted to reorganize decaying industries by the reduction of production lines, regulation over enterprises entering into decaying industries, and the renovation of outdated equipment, while promoting promising industries with financial support (Lee Man-hee 1992:190-191).

(1) Disposal of ailing enterprises: The first critical area of industrial restructuring under Chun's rule was the disposal of ailing enterprises. Without reorganizing the overlapping investments in key industries, the overall industrial restructuring programs could not progress. The disposal process of ill-managed enterprises carried many important implications: First, the program heavily affected the survival of individual enterprises, due to the government's selective and directive intervention. Second, acquisition, merger and establishment of joint corporations were very likely to result in higher economic concentration in a handful of businesses. Third, the disposal process was also regarded as a tremendous opportunity for big businesses to grow faster, because of the massive financial infusion into troubled industries along with the postponing of loan repayment, transfer of lent money into investments by banks, and additional loan guarantees for foreign borrowing by the government (Shin Hee-keun 1994:42-43). Because of the stakes involved in the process of disposal of ailing enterprises, the interactions of business-state were intense and extremely tempering during the reorganization of heavy-chemical industries (1979-1980).

Three major investment reorganizations were begun from May 1979 through October 1980, and the overall program was completed by 1983. The first investment reorganization focused on power generators, diesel engines and heavy equipment. The

basic approach to the excessive investments in these business lines was to cut down the number of firms through merger, acquisition, or establishment of joint-companies, while regulating the entry of new investors in these areas (Refer to Table 3.31). But the first investment reorganization program (which began May 25, 1979) ended up with little fruit, due to severe interest conflicts among the involved parties and the disarray of the policy coordination system during Park's last years. As mentioned earlier, the policy coordination system lost its institutional capability to carry out industrial restructuring forcefully, due to conflicting policy positions on the restructuring process. And the Chaebol involved, which had grown into giants by the end of the HCI-drive, were unwilling to make concessions to the government's restructuring proposal. By doing so, the Chaebol eluded the government's transformative programs for the first time, reflecting the fact that the overgrown businesses had begun to constrain the policy choices of the state (Kang Sung-nam 1992:211-214).

The second investment reorganization program (which began on August 20, 1980) was steered by the military junta. Two business lines (power generators and automobiles), which were considered the most critical industries for future competition among big business groups, were forcefully restructured under the supervision of the "Emergency Committee for Safeguarding National Security." The original reorganization plan, concerning power generators, was as follows: Kunpo plant of Hyundai Yanghaeng (Hyundai International Inc.), Okpo Heavy Machinery (Daewoo Heavy), Heavy Machinery in Changwon Industrial Park (Hyundai Heavy), Samsung Heavy and Hyosung Heavy were supposed to merge under Daewoo Heavy. And the production lines of "power generators" and "heavy construction equipment" were to be arranged into a single system

(Refer to “power generator” in Table 3.31). However, regarding the “power generator” industry, the result of reorganization deviated greatly from the original blueprint. Daewoo Heavy, Hyundai Heavy and Hyundai Yanghaeng were forced to give up their shares and merged under the state-owned enterprise, Korea Heavy Machinery, instead of Daewoo Heavy. And other policy measures followed to make sure that no more excessive and duplicated investments in this industry occurred. Secondly, as for the automobile industry, Hyundai and Saehan automobile merged and pledged to specialize only in passenger cars, while Kia was to specialize in buses and trucks (KDI, *Report of Economic Stabilization (II)* 1981:1230-1204). The investment plans by other corporations in automobiles were also delayed or canceled by the government’s pressure and persuasion.

There were defiant actions from big business groups against the industrial reorganization plan. In particular, severe conflicts of interest between the Daewoo and Hyundai groups in the power generator and automobile industries were so intense that even the Emergency Committee for Safeguarding National Security (ECSNS) (which had sweeping power at that time) had a hard time in handling these two business groups. ECSNS used both political threats and financial incentives (Shin Hee-keun 1994:49-50) to control these groups. The Korean government’s control over capital sources and, unlike the policy coordination system which was falling apart during President Park’s last year of rule, the solidly united economic agencies behind the ECSNS helped it through. Although some other attempts to reorganize the automobile industry were not as successful as the above-mentioned cases, these two industries began to pull themselves out from the business slump. For instance, the operation ratio index of motor vehicle plants, which was down around 65% in the late 1970s, began rising in 1982, reaching 88.6% in 1985 (Refer

to *Major Statistics of Korean Economy*, published by National Statistical Office, each year).

The third investment reorganization program (which began on October 7, 1980) concerned “heavy machinery,” “electronic exchange switches,” “diesel engines,” and “copper metallic industries,” which were not included in the first two restructuring programs. As in the two previous cases, the basic approach to the overlapping investments and overcapacity in these industries was to rearrange the proliferation of enterprises into a smaller number by acquisition, merger, and joint-corporations and to require the selected enterprises to specialize in one or two items (Refer to Table 3.31). For instance, there were initially eight firms involved in heavy machinery, but, after reorganization, the number of firms had been reduced to four, mostly specializing in one or two items. The same approach was applied to other industries (Kang Sung-nam 1992:225-230). As a consequence of restructuring these industries, the operation ratio index of these industries bounced back towards full operation³⁹ after hitting bottom in the late 1970s.

(2) *Rationalization of Industries:* The so-called “rationalization of the industrial system” from the mid 1980s was implemented to transform the industrial structure to fit into the global market. First of all, in order to carry out the “rationalization of the industrial structure,” the government reformed “industrial support systems” by introduction of “industrial development laws” and “regulations on tax reduction and

³⁹ The operation ratio of the heavy-chemical industry remained as low as 56.3% in 1980, averaging 64.2% between 1975 and 1980, but the ratio began to rise steadily from 1981.

exemptions” in 1980. These two statutes clarified the direction of industrial restructuring as follows: 1) Stagnant businesses would receive special tax breaks in exchange for self-rescue efforts by the troubled enterprises. 2) Decaying industries must cutdown production lines, changing their business lines into more promising industries over the long run. 3) The government must promote more competitive and promising industries in the near future. And 4) small- and medium-sized firms and big businesses should specialize in main business lines, while abandoning other affiliated units (Government of Republic of Korea, *Official Report*, December 31, 1985 and January 8, 1986).

First, automobile, heavy equipment, diesel engines, electronics and ship building were selected as target industries whose prospective market was bright in the near future. Three essential means to improve the competitiveness of these industries were the banning of the entry of new enterprises into these areas, the massive infusion of finances, and tax exemptions. Second, synthetic metals and textiles were specified as non-competitive industries and no additional entry into these industries were permitted. A large amount of financial help was pumped into these areas to upgrade outdated equipment. The textile industry was transformed to be more capital intensive. Third, dying and processing industries and fertilizer industries were also specified as decaying industries, which must go through dramatic restructuring by a reduction of production lines and transfer of the outdated plants to developing countries (EPB, *Annual Economic White Paper* 1990:190-191).

As a result of the above-mentioned governmental efforts, a sharp rise in export volume was recorded for TV receivers, radios, passenger motor cars, ships and office machines since 1980 (Refer to Table 3.32). For instance, the export volume of passenger

cars, which was recorded as only 50 million US dollars worth in 1980, rose to 2748 million US dollars in 1987. On the other hand, Korean woven fabrics, footwear and apparel remained competitive export commodities throughout the 1980s, due to the successful renovation of production facilities and restructuring toward more capital-intensive industries. As shown in Table 3.32, there was a steady rise in the export volume of woven fabrics, footwear, and apparel throughout the 1980s.

Another significant part of industrial rationalization concerned the so-called “main-line business policy,” under which the government attempted to persuade big businesses to focus on two or three main business lines, instead of profuse diversification over unrelated industries. As mentioned in the previous section, during the HCI-drive (1972-1979), the largest Chaebols doubled the number of their affiliated firms and were involved in an average of 17.6 different business lines (Refer to Table 3.28). The over-heated competition among the Chaebol based on the belief that they were “too big to fail”⁴⁰ had driven them into an ardent diversification strategy, eventually resulting in an octopus-like corporation structure. On September 27, 1980, Chun announced the “Measures to Rationalize Corporate Structure,” the so-called 9.27 measures. Under these measures, Chun’s “Standing Committee for Emergency National Security Measures” (SCENSM) selected twenty-six Chaebols and forced them to revamp their group structures around

⁴⁰ The belief, that if the total amount of assets of a conglomerate was big enough and its bankruptcy would have a devastating blow on the overall economy, the government would rescue the ailing conglomerate with a massive infusion of public funds, had been fomented among big business groups over a long period. As this study shows, the Korean government provided tremendous financial relief to troubled firms in exchange for merger, acquisition and establishment of joint companies in key industries to be restructured during every economic recession.

specialized main businesses by casting off peripheral businesses and selling non-business related real estate. The SCENSM selected 135 firms from the total of 631 firms owned by the 26 Chaebols as the main line firms and ordered them to eliminate 166 firms by 1984 (Kim Seok-ki 1987:246-247).

The major policy means to induce big business into selected business lines were credit regulations under which a single borrower was permitted to use no more than 25% of total bank assets and, in addition, as of the 1980s, 35% of commercial bank credit must be allotted for small- and medium-sized firms (Lee Kee-young 1996:34-35). But, as for the main business lines selected by individual Chaebols, the government did not apply credit regulations to induce big business to focus on selected business lines. Under this program, the 30 largest Chaebols were obliged to choose three major businesses by themselves. The first selection of 51 main line businesses by the top 30 Chaebols, which constituted the overwhelming majority of selections, was coincident with the governmental intent to promote the manufacturing sector. But most of these selections were concentrated on a few businesses such as petro-chemicals, automobiles, and electronics. Thus, the overlapping selections among big businesses were the opposite of the original intent of this program, which was initiated as a solution to dissolve the excessive and duplicated investments in key industries.

It is not an easy task to measure the extent to which this main business line policy was successful under Chun's rule. However, it is clear that Chun's main business line policy substantially constrained the Chaebol's diversification drive and Chun was successful in regulating the Chaebol, notwithstanding the fact that the main line business policy was not as central to his policy focus as it was for his successors, Roh (1988-1992)

and Kim (1993-1997) (This matter will be discussed more extensively in a later section).

The third focus of “industrial rationalization” involved the repair of the economic imbalance between the over-grown big businesses and small- and medium-sized enterprises (SMS or SMEs). The emphasis on the heavy-chemical industries had led to the relative neglect of the small- and medium-sized firms that remained central to Korea’s export of light manufactures. Thus, SMEs were left very vulnerable to wage increases, fluctuating exchange rates, and the open market system without much policy support. The KDB and EPB insisted upon a policy refocus on SMEs as a critical part of the national economy. The KDB suggested that the government must not only protect the traditional fields of SME business, but also must emphatically promote SME firms with the support of finance, technology, and market information (KDI 1989:257). Under consideration of structural characteristics, market size, and other economic factors, SMEs were encouraged to collaborate with big business in a systematic manner. The EPB’s policy focus, regarding SMEs, was to develop a fair and complementary system between large firms and SME firms along specific industrial lines. According to the EPB and MOCI’s endeavor to construct a paired and complementary system, by 1988, 323 mother firms and 2060 subcontracted firms were organized in 43 different business lines, manufacturing 1199 items under a fair and complementary production system (The Central Council of Small- and Medium-sized Firms, *Report on Lining-up of SMS Firms under Complementary System* 1989:13-17).

The governmental endeavor to repair the imbalance between SMEs and large-sized enterprises began with the relatively larger infusion of finances into SMEs. The government imposed “credit regulations” over big business, while encouraging the

commercial banks to lend more capital to SMEs. To do so, from the 1980s, 35% of commercial banks' loans were to be allotted for SMEs. But because of the prevailing conventions among Korean banks, in which the lenders received collateral such as land and other real estate or a third party's debt guarantee as security when lending capital, the share of bank loans to SMEs did not increase as much as the policy program demanded, but, as shown in Table 3.33, after 1980, the SME firms' share did increase. About 88% of equipment funds in manufacturing during the HCI-drive (1974-1979) was allotted to the heavy-chemical industries, but this trend of credit allocation was halted in 1980 (Choi Pil-sun 1990:67). Although the share of the overall bank loans were not comparable with the equipment funds in the manufacturing sector, as shown in Table 3.33, SME firms' share relative to the large-sized enterprises rose steadily throughout the 1980s, owing to the governmental efforts.

As a consequence, the relative weight of SMS firms in the Korean economy was apparently recovering in the 1980s. As shown in Table 3.34, whereas the total sales of SMS firms remained at about 30% between 1970 and 1975, this number rose to 35.4% in 1985. The total value-added by SMS firms also recorded a sharp rise in the 1980s. Only in terms of export shares, SMS firms did not increase their piece of the pie, because the large heavy-chemical enterprises began to recuperate their exporting capability, using the industrial restructuring as their spring board. However, as demonstrated by the steady rise in the SMS firms' share of sales, value-added, and, later on, exports, in Table 3.34, Chun's program to promote SMS enterprises was the turning point from the policy exclusively oriented toward large-sized firms to a more balanced economic policy. This transformative program was not completely successful, but clearly set the wheels in

motion to balance the economy between SMS and large-sized enterprises. As shown in Table 3.34, the relative weight of SMEs in the national economy rose steadily throughout the 1990s too.

The overall success of the transformative program during Chun's regime was observed in the macroeconomic indicators. The GDP growth rate, which plummeted to negative 2.7% in 1980, averaged 9.1 annually between 1981 and 1987. The turnaround in the growth rate of the manufacturing sector was more dramatic, averaging 13.5% annually during the same period from a negative 1.6% growth rate in 1980. Along with this upward swing of the economy, the export growth rate, which was only 1.6% annually, also averaged 16.6% between 1982 and 1987, although it was stagnant compared to the 1970s. Thanks to the briskly growing economy during this period, the unemployment rate dropped from 4.8% in 1980 to 3.1% in 1987. More importantly, the annual inflation rate, which was recorded at 21.0% between 1978 and 1981, slowed to a mere 5.7% annually between 1982 and 1987. Chun's goal of price stabilization was obtained ahead of schedule (BOK, *Major Statistics of Korean Economy*, various years).

(3) The Government's Financial Control and "Industrial Structuring"

In order to understand how Korea pulled itself out of economic cataclysm at the end of the HCI-drive with the relatively successful "industrial structuring" under Chun (1980-1987), one had better take a close look at the government's control over financial resources during this period and how the government manufactured incentive structures to induce defiant big businesses into its reform programs. The governmental efforts to carry out transformative programs were slightly different from those of the preceding period.

The government tried to mobilize two mixed approaches: 1) an indirect and non-discretionary approach⁴¹ to the “rationalization of the industrial structure”; and 2) a direct and discretionary approach for the disposal of ailing enterprises and industrial restructuring in major industries.

Let us turn to the critical financial resources under governmental control and their use. First, despite the financial liberalization⁴² launched by the Chun government, a large portion of financial resources remained under government control. For instance, as shown in Table 3.22, the ratio of policy loans relative to total lent money did not shrink at all, rather it displayed an upward trend (between 1972 and 1979, the ratio of policy loans to total loans averaged 30.6%, whereas between 1980 and 1985 the ratio averaged 32.3%). If a broader definition of policy loans is used, about 70% of total money lent was still

⁴¹ For instance, the government paid a large sum of R&D expenditures to improve the competitiveness of industries which were promising in the near future. In fact, R&D expenditures from the government increased in a steady manner with an average growth rate of 33% between 1981 and 1986. The percentage of R&D expenditures relative to GNP jumped from an average of 0.69% between 1976 and 1981, to 1.02% in 1982, and 1.68% in 1986 (MOST, *Yearbook of MOST* 1981, 1987, 1990). In short, during this period (1980-1987), the Korean government combined a direct and indirect approach to induce businesses into the target industries on the basis of strategic market analysis.

⁴² The actual financial liberalization was carried out in three broad areas: 1) privatization of commercial banks, 2) entry deregulation and returning managerial authority to professional bankers, 3) freeing interest rates and reduction of administrative guidance over bank portfolios. The first move toward financial reform was to privatize the commercial banks. By doing so, the government attempted to let banks have owners who would pay attention to the efficiency of banking operations. And by returning managerial authority to professional bankers, the government expected that bankers would be more responsive to the rapidly changing market with the introduction of new financial goods to their consumers. Downsizing policy loans and freeing interest rates were inevitable measures to cut down excess demands for preferential bank loans. But these measures were carried out only to a limited extent, because of the long tradition of business-state linkage and political dilemma involved in financial liberalization (Choi Pil-sun, 1990).

under government control throughout Chun's rule (1980-1987). However, in the aftermath of the "freeing interest policy," the interest gap between "policy" and "general" loans dropped from 10% during the HCI-drive (1972-1979) to an average of 2.0% between 1980 and 1985. The shrinking interest gap implied that recipients of policy loans would not take advantage of policy loans as in the past. But compared with the interest rates of loans from the curb market, which adequately reflected the market price, receiving policy loans was still a huge privilege (Refer to Table 3.35). As a matter of fact, even after the privatization of commercial banks, administrative guidance over general bank loans persisted in informal manners (Kin Young-jin 1991). Additionally, the government maintained its control over the major decision-making on credit allocation through its authority to appoint top management.

The second critical factor which boosted state autonomy in the "industrial restructuring" process was the structure of financing for investments and corporation management. Korean corporations relied heavily upon external capital sources even during this period (1980-1987). As shown in Table 3.10, about 70% of investment and managerial funds were mobilized from outside corporations. According to Ahn Jong-gil's study (1995:58), American corporations mobilized over 70% of required business funds between 1952 and 1988 internally, utilizing internal savings, savings for depreciation and appropriation expense. In the case of Japanese corporations, a little over 50% of business funds came from their own savings. Additional information on the structure of capital mobilization by Korean corporations also assures us that Korean corporations remained very vulnerable financially. Table 3.11 reveals that more than 50% of required capital was still coming from financial institutions, while direct financing (the issuance of valuable

securities such as stocks and corporate bonds) accounted for only 34.8-42.2% of external mobilization. In particular, giant conglomerates began to tap the curb market as the economy slid into a deep slump in the late 1970s, leading to a rise of borrowing from the curb market (the share of the curb market relative to total borrowing rose to 7.5% between 1979 and 1983 and 6.2% between 1984 and 1988). In short, Korean corporations' heavy reliance upon external resources, especially borrowing from financial institutions which were still under government control, made it possible for the government to have the upper hand in the process of "industrial restructuring." Thus, the Chaebol were more attentive to the governmental reform directives during this period.

Another financial weakness of Korean corporations was rooted in their high indebtedness. As Haggard, Maxfield, and Schneider (1998) point out, Korean Chaebol were not be as powerful as they looked on the surface, because they were highly indebted to the state-controlled banks. The disposal process of ailing enterprises was carried out between 1979 and 1983, when the average debt-to-equity ratio in manufacturing reached an apex, as shown in Table 3.29. By 1980, the debt-to-equity ratio reached 488%, dropped to 451.5% in 1981, 385.8% in 1982, and continued to slide down until 1989. The ratios of the top ten Chaebols reveal that big business groups were worse than the overall manufacturing sector in terms of the debt-to-equity ratio. As Table 3.30 demonstrates, the average debt-to-equity ratio of the top ten Chaebols was 773.5% in 1980, which was much higher than that of small- and medium-sized firms. For instance, the most indebted business group, Sunkyung, had accumulated a debt which was more than 21 times as much as its own equity-capital in 1980. When giant conglomerates carried this amount of debt, governmental measures, like halting new financial infusions

into these conglomerates, immediately led to insolvency. Therefore, there was a high likelihood that giant conglomerates would listen to policy makers and follow their administrative directives.

Another empirical indicator, that is, the ratio of equity capital to total assets, signifying the capital soundness of corporations, shows that Korean corporations were fragile. As shown in Table 3.36, in the period of 1980-1987, when the “industrial restructuring” was carried out, the ratio of equity-to-total assets in the overall manufacturing sector and in big business was as low as 17.0% in 1980 and 17.6% in 1986. In contrast with Korean corporations, Taiwanese and American corporations were over 40% in terms of the equity-to-total assets ratio, while Japanese firms were slightly better than Korean firms. Comparison of the Korean corporations’ equity-to-total assets with Taiwan, a developing country, confirms that Korean corporations were extremely susceptible to the external economic environment. For instance, highly indebted corporations would not suffer financial distress during a booming economy, as long as their performance was good enough to repay their debts, but these corporations would have difficulty in making ends meet during economic downturn because of the rising financial burden. In short, the debt-ridden Korean corporations remained susceptible to governmental pressure in the process of “industrial restructuring,” especially due to the fact that the critical programs, “the reorganization of ailing enterprises,” were carried out during a sluggish economy.

(4) Full-fledged Chaebol and Their Growth

Unlike the preceding periods during which capital quickly accumulated under the state's patronage and guidance, this period demonstrated that the Korean state was no longer willing to support big business groups with profuse preferential credit allocations. Only in the cases where the state had to help troubled firms with massive financial injections, as in the disposal of ailing enterprises, did the state voluntarily favor the Chaebol. Otherwise, the state showed quite an ambivalent orientation toward the Chaebol. The equivocal attitude of the Korean state toward big business originated from the fact that big businesses had grown too big to be market-accommodating, but also too big to be ignored. On one hand, there were the "market threatening" aspects of big business, that is, high general economic concentration in the hands of big business, monopolization of the market by big business, and economic imbalance between small- and medium-sized and large-sized enterprises. As for the state, which still wanted to play a positive role by securing an effective market, this aspect of big business was understood as needing correction, so the state took some regulatory action over the Chaebol. On the other hand, Chun's political regime, whose survival largely depended upon the economic performance of big business, could not but collaborate with them by granting their requests (Kim Eun-mi 1997:167-212). Accordingly, the state's policy preference concerning big business groups remained somewhere between regulation and collaboration during this period (1980-1987).

During Chun's rule, the growth of the Chaebol was characterized as follows: First of all, the Chaebol became stabilized in terms of ranking. As shown in Table 3.2, during the era of the comprehensive developmental state (1960-1979), numerous new comers

(underlined) appeared in the list of the top ten. Only one new comer each was observed in 1987 and 1997, implying that the scale and maturity of the Chaebol were large enough that they would not fade away. Second, the growth of the Chaebol slowed down substantially, due to regulatory policy over the Chaebol, and policy emphasis on “balanced growth” between the small- and medium-sized and the large-sized enterprises, and on “growth with stability.” As a result, there were intelligible indications that the growth of the Chaebol had become stagnant. For instance, the ratio of “sales” by the top thirty Chaebols, which grew rapidly in the late 1970s, has held steady at around 40% since 1981 (Refer to Table 3.25).⁴³ In addition, from 1981 on, other economic concentration ratios (in the hands of the top 30 Chaebols) in terms of “assets” and “added-value” have remained unchanged, although different indicators bear slightly different features.

Another significant change which occurred under Chun’s regime, in the context of Chaebol growth, was the reduction in the number of affiliated units under each business group. As shown in Table 3.6, the average number of subsidiaries in the top ten Chaebols grew from 5.2 in 1961, to 34.6 in 1980. Under Park’s “fervent growth drive” between 1961-1979, the number of subsidiaries increased almost sevenfold from the beginning of state-led industrialization. But Chun’s industrial restructuring programs led to a much smaller number of units under the top ten Chaebols. For instance, the average unit number dove from 34.6 in 1980 to 22.5 in 1983. But this number began to rise again, reaching

⁴³ Although the weight of the Chaebol to the national economy did not rise substantially, the Chaebol realized impressive growth in terms of their absolute sales and assets. According to Kim Seok-ki (1987), the growth rate of the nine largest Chaebols was 34.5% in terms of sales between 1979 and 1985, while the average growth rate of the real GNP was 5.4%.

24.1 by 1987 as Chun loosened up during the last year of his reign (Refer to Table 3.6).

More importantly, Chun's "main-line business policy" substantially curtailed the diversification drive by the Chaebol. As shown in Table 3.28, each business group was only involved in an average of 7.7 different business lines in 1970, but this number went up to 17.6 by the end of the HCI-drive (1979). But under Chun (1980-1987), the average number of industries under the 30 largest Chaebols shrank, dropping to 13.9 by 1988. In short, Chun's "rationalization of industrial structure" heavily affected the pattern of Chaebol growth. No longer were rapacious diversification and expansion of units encouraged by the government. Rather, they were discouraged.

CONCLUSION

The historic comparative analysis over the four different periods in this chapter demonstrates several significant theoretical implications in the context of economic development. First, an intimate and direct business-state linkage can be operated as an institutional device to drive dense industrialization. Korea, as a late-late developer, took a discretionary approach in the distribution of scarce resources (credit, subsidies, tax breaks, foreign borrowing), relying upon the "quasi-internal organization of business-state" rather than the market mechanism during the developmental era (1961-1979). Even in the subsequent period (1980-1987), industrial restructuring and rationalization were carried out mainly through the business-state conduit, although Korea slouched toward market much more, compared with the preceding period. We observed the consecutive successes of economic transformative programs under Park (1961-1979) and Chun (1980-1987) and, as a result, stellar economic growth during these periods, except for two economic

downturns (1969-1970, 1979-1980). The Korean case clearly contradicts the neoclassical notion that the state's discretionary intervention in the market creates huge rent and inevitably invites private business into rent-seeking collusion with the state. In contrast with the neoclassical presumption, the business-state nexus remained a growth-oriented collaboration under the Korean state's entrepreneurship. Thus, my study inquired into what sorts of forces made it possible for the business-state connectedness to stay on the right track of collaboration.

Second, this study discovered that there was a wider range of variables that determine the nature of the business-state nexus than previous studies contended. Previous developmental literature has supported the belief that the nature of the business-state nexus is properly answered by a close examination of the state's institutional resources. Broadly speaking, statist pointed to a certain type of state, that is, the "developmental state," as the only force which could prevent the business-state relationship from deteriorating into a rent-seeking collusion. The top-down approach in developmental literature, which focuses solely on the internal structure of the state in its effort to interpret the business-state nexus, has limited explanatory power. In the developmental era of South Korea, 1960-1980, during which the state lopsidedly dominated the business-state linkage by controlling the overwhelming majority of capital resources, a close look at the internal structure of the state discloses almost all aspects of business-state interactions (the first several sections in this chapter are devoted to support this notion). But, at the end of the developmental era, this inquiry into the business-state nexus must involve a wide scope of variables beyond the internal structure of the state.

During the "comprehensive developmental state" (1960-1979), the Korean state,

as entrepreneur, directed and guided its agents in the private sector by tightly controlling the flow of capital into targeted industries, while its private partners remained inconsequential in terms of the amount of their capital. Accordingly, the structural characteristics of private business as explanatory variables in defining the business-state interactions were overshadowed by the overwhelming state power. But during the limited developmental state (1980-1987), no longer was the Korean state able to wield almighty power over its private partners which had grown into giants. Big business started to claim its equal partner status with the state through the use of its sheer capital size. But, curiously enough, powerholders in the private sector remained defenseless against the state's demand for industrial readjustment during economic downturn (1979-1981). The high indebtedness virtually destroyed the prowess of big business. As shown in Graph 3.8, most firms were struggling with high debt/equity ratios, in particular, during the early 1980s. Thus, despite the overgrown power of the Chaebol, the Korean state enjoyed extensive autonomy from the private powerholders during economic reform programs (1980-1985) and was able to lead its private partners into goal-oriented collaboration. This chapter contends that the organizational characteristics (size, financing structure [sources of corporate funds], degree of diversification, and financial vulnerability) of big business have emerged as critical variables in defining the strategic interactions between business and state around transformative programs during the "limited developmental state" period (1980-1987). From this point on, any serious attempt to explain economic development on the basis of the business-state nexus must begin with simultaneous attention to both the state and its private partners. The structural characteristics of both sides are likely to determine the essential aspects of business-state interactions and their

effects on economic development.

Third, this study shows that the internal dynamics and patterns of the business-state relationship have been changing over time. A specific kind of institutional linkage of business-state has been associated with a specific type of transformative program. For instance, the HCI-drive (1972-1979) required more intimate, narrow, direct and selective ties with private partners, owing to the high risk and uncertainty involved in this transformative program, as compared with the export-drive (1963-1971). Through the construction of a quasi-internal organization, the Korean state tried to dispel any doubts held by its private partners over the credibility of the HCI program. On the other hand, during the export-drive in the early 1960s, the business-state linkage was more open and less intimate and less direct mostly due to the structural traits of the export-drive program. In short, there is no one type of institutional linkage between business and state which is transferrable to other developing countries. But the lesson for other late-late developers is how the Korean state and business built up mutual reciprocity, trust, and cooperation along with strategic interactions. Government elites attempted to threaten and persuade their private partners to remain in reciprocal agreement on developmental programs. Not only did monitoring, disciplining and punishing help, but also mutual reciprocity helped the business-state nexus stay on the developmental track. When mutual reciprocity and trust existed it was much easier for the Korean state to determine who were the more credible and productive agents in the process of business licensing and credit distribution. On the other side, private businesses did not have to be overly concerned about the short-term return on investments, due to the fact that the rewards of pursuing the government-designated programs and the government's commitment to those programs were ample

and reliable. In the 1960s and 1970s, mutual reciprocity greatly reduced the cost of monitoring and disciplining for the government and the cost of transactions for businesses. In a word, although the patterns of institutional linkage between state and business have been in a transforming mode, the Korean state was successful in leading its private partners into goal-oriented collaboration under mutual trust, cooperation, and reciprocity.

Fourth, this study discovered that two variables, “political leadership” and the “policy-making regime,” stand out in their explanatory power over the changing nature of the business-state nexus. No matter what sort of forces were behind the chief-executive’s commitment to economic progress, the chief-executive’s championing of industrial progress was a critical factor in determining the nature of the business-state nexus. The construction of a coalition of developmental elites began only with the chief-executive’s pledge to development. As laid-out in “political leadership” in Chapter II, the political aspects of the state (or political elites) define and regulate the overall aspects of the internal structure of the state and, thereby, the structural characteristics of the business-state nexus vary most with political leadership. Whether or not the “policy-making regime” worked as a positive force in inducing private business into the designated industrial targets ultimately depended upon political leadership. For instance, the institutional autonomy of the “policy-making regime” (policy coordination system and core developmental agencies), which was a critical source for keeping the business-state relationship one of development-oriented collaboration, was under the chief-executive’s control. The chief-executive who determined to guarantee the institutional autonomy of the core developmental agencies turned out to be an indispensable element in carrying out developmental programs.

On the other hand, I found out that it is quite difficult to directly associate the recruitment and reward system with the changing patterns and nature of the business-state nexus. Only during Park's revolutionary restructuring of the bureaucratic system in 1960-1963, did the recruitment and reward system clearly demonstrate explanatory power about the nature of the business-state nexus. The problem is that these two variables did not vary much during the comprehensive and limited developmental state (1960-1987), resulting in a loss of explanatory power over the changing business-state nexus. In my comparative historic analysis, the utility of these variables was quite limited at least during the time periods this chapter covered. However, these variables are expected to have more explanatory power in cross-country studies. This study also discovered that the state's control of resources does not necessarily guarantee the state's dominance over the business-state nexus or the state's autonomy from the particular interests of powerful social groups. For instance, during the Rhee regime (1948-1958), the Korean state controlled the lion's share of capital resources, but, without the provisions of a coherent Weberian bureaucracy, the political leadership's strong commitment to economic progress, and a cohesive policy-making regime, most capital resources ended up in the hands of the rent-seekers. In short, state control over capital resources is, to some extent, a necessary but not a sufficient condition for state dominance over private powerholders. State autonomy is more embedded in a certain type of state structure than in the extent to which a state controls capital resources.

Table 3.1-a
Changes in Business-state Nexus Across Different Time Periods (1948-1998)

	major components	detailed components	1948-1960	1961-1971	1972-1979
Political Quality	Regime Type	Authoritarian/Democracy	semi-demo/semi-authoritarianism	Quasi-democracy	Bureaucratic-authoritarian
	Internal structure of state	Recruitment System	poor	very strong	very strong
		Reward system	poor	very strong	very strong
		Policy making regime (policy coordination system)	very poor	very strong	very strong
Economic Quality	Structural Dependence	Political leadership (institutional autonomy of economic agencies)	very poor	very strong	very strong
		Economic power of big business	negligible	very moderate	moderate
		degree of governmental control over capital sources	strong	strong	strong
	Who controls capital sources	financial vulnerability of business (debt/equity ratio)	moderate	moderate	strong
		Business's Financing ability	very dependent on state	very dependent on state	very dependent on state

(Table 3.1a Continued on next page)

(Table 3.1a Continued)

Overall Nexus		1) Political Characteristics 2) Economic Characteristics	rent-seeking coalition (Collusive, symbiotic relationship)	export-collaboration (collaboration with state dominance)	HCI-collaboration (closer collaboration with state dominance)
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Reference: Rankings: very poor, poor, moderate, strong, very strong

Table 3.1-b
Changes in Business-state Nexus Across Different Time Periods (1948-1998)

	major components	detailed components	1972-1979	1980-1987	1988-1997
Political Quality	Regime Type	Authoritarian/Democracy	Bureaucratic-authoritarian	Bureaucratic-authoritarian	procedural-democracy
	Institutional Arrangement	Recruitment System	very strong	very strong	very strong
		Reward system	very strong	moderate	poor
		Policy making regime (policy coordination system)	very strong	strong	poor
Economic Quality	Structural Dependence	Political leadership	very strong	strong	poor
		Economic power of big business	moderate	strong	strong

(Table 3.1b Continued on next page)

(Table 3.1b Continued)

	who controls capital sources	degree of governmental control over capital sources	large	moderate/strong	moderate
		financial vulnerability of business (debt/equity ratio)	strong	strong	strong
		business financing ability	high dependence on state	high dependence	moderate dependence
Overall Nexus		1) Political Characteristics	HCI-collaboration (closer collaboration with state dominance)	Symbiosis relationship with state's political dominance but economic dependence	Symbiosis relationship with state's political and economic dependence
		2) Economic Characteristics			

Reference: Rankings: very poor, poor, moderate, strong, very strong.

Table 3.2
Changes in the Ten Largest Chaebol on the Basis of Sales, 1960-1997

1960	1965	1972	1979	1987	1997
1. Samsung	Samsung	Samsung	Hyundai	Hyundai	Hyundai
2. Samho	Lucky	Lucky	Lucky	Samsung	Samsung
3. Gaepung	<u>Ssangyong</u>	Hanjin	Samsung	Lucky-Goldstar	Lucky-Goldstar
4. Daehan	Panbon	Shinjin	Daewoo	Daewoo	Daewoo
5. Lucky	Sambo	Ssangyong	Hyosung	Sunkyung	Sunkyung
6. Dongyang	<u>Samyang</u>	Hyundai	<u>Kukche</u>	Ssangyong	Ssangyong
7. Keukdong	<u>Tongyang</u>	Taehan	Hanjin	Korea Explosive	Hanjin
8. Hanguk Glass	<u>Taehan</u>	<u>Korea Explosive</u>	Ssangyong	Hanjin	<u>Kia</u>
9. Doklip	<u>Kaepoong</u>	Keukdong	Korea Explosive	Hyosung	Korea Exp.
10. Taechang	<u>Hwashin</u>	<u>Daenong</u>	<u>Sunkyung</u>	<u>Lotte</u>	Lotte

Source: Data from 1960 until 1987 is from Cho Tong-song (1991:211). 1997 data is from *The Report of Fair Trade Practice*, published from FTC, 1997.

Reference: The ten largest Chaebol in 1997 are based on their total assets.

Underlining indicates that Chaebol first entered the top 10 in that year.

Table 3.3
Opportunity Cost of Capital (1946-1960)

year	Nominal Interest rate for bank loans	Inflation rate of consumer price	Real Interest rate for bank loans	Average Earning rate of corporations (a)
1946	11.0	530.7	-519.7	
1947	11.0	91.4	-80.4	
1948	12.8	29.9	-17.1	
1949	12.8	56.7	-43.9	
1950	9.9	186.7	-176.8	
1951	18.3	212.7	-194.4	
1952	18.3	102.3	-84.0	
1953	18.3	21.4	-10.1	
1954	18.3	81.2	-62.9	9-18
1955	18.3	31.4	-13.1	9-18
1956	18.3	16.3	2.0	9-18
1957	18.3	-6.5	24.8	9-18
1958	17.9	2.6	15.3	9-18
1959	17.5	10.7	6.8	9-18
1960	17.5	15.1	2.3	9-18

Source: Bank of Korea, *Yearbook of Economic Statistics*, each year. (a) is from Sakong and Jones (1981:138).

Table 3.4
Foreign Exchange Market Distortions, 1955-1965

(Unit: price per dollar by won)

	official exchange rate (a)	premium (b)	tariffs and tax (c)	dollar price for buyers (d)=(a+b+c)	distorted rate (e)= (d/a)
1955	31.3	48.1	5.9	85.3	2.72
1956	50.0	52.9	7.0	109.9	2.20
1957	50.0	58.9	9.4	118.3	2.37
1958	50.0	64.0	20.3	134.3	2.69
1959	50.0	84.7	47.8	182.5	3.65
1960	63.8	83.9	52.0	199.7	3.13
1961	127.5	-	30.8	222.5	1.74
1962	130.0	-	28.8	245.2	1.89
1963	130.0	39.8	21.0	268.0	2.06
1964	214.3	39.7	36.8	290.8	1.36
1965	266.5	0.0	41.0	307.5	1.15

Source: Sakong and Jones (1981: 120). (b) indicates the surplus profit in dollars that importers would gain through the use of the official exchange rate.

Table 3.5
The Weight of Korea Development Bank Relative to Total Bank Loans

(unit: 10 million won, %)

year	Korea Development Bank			Overall Financial Institutions			Weight of Korea Development banks		
	facility fund (A)	managerial fund (B)	total [C]	facility fund (D)	managerial fund (E)	total (F)	A/D (facility)	B/E (management)	C/F (total)
1954	608	128	736	944	2,055	2,999	64.4	6.2	24.5
1955	2,438	313	2,751	2,889	3,659	6,548	84.4	8.6	42.0
1956	4,625	767	5,392	5,332	7,301	12,633	86.7	10.5	42.7
1957	7,849	1,360	9,209	8,493	11,644	20,137	92.4	11.7	45.7
1958	9,082	1,461	10,543	12,571	13,677	26,428	71.2	10.7	39.9
1959	12,337	1,796	14,133	17,133	15,159	32,292	71.9	11.9	43.8
1960	13,433	2,419	15,852	19,391	20,776	40,167	69.2	11.7	39.5

Source: Korea Development Bank, *30 years of KDB*, 1984, p 71.

Table 3.6
Changes in Top Ten Chaebols between 1961 and 1993

Chaebols 1961	# units	Major Industries involved	Chaebols 1972	# units	Major Industries involved
1. Samsung	13	import, food, textile, bank	1. Samsung	16	food, oil refinery, electronics
2. Samho	7	import, textile, bank	2. Lucky	18	chem., elec'y, electronics, oil-refin
3. Gaepung	9	import, cement, bank	3. Hanjin	8	transportation, airlines
4. Daehan	5	import, food, textile	4. Shinjin	8	automobiles, machinery
5. Lucky	4	import, chemical, consumer goods	5. Ssangyong	6	cement
6. Dongyang	4	cement, food	6. Hyundai	6	construction, automobile
7. Keukdong	4	import, sea transportation	7. Taehan	5	transportation
8. Hanguk	2	import, glass	8. Korea Explo.	7	chemical, oil refinery
9. Doklip	2	food	9. Keukdong	8	shipbuilding, sea transportation
10. Taechang	2	import, textile	10. Daenong	8	textile, grain-importer
Average	5.2			9.0	

(Table 3.6 Continued on next page)

Table 3.6 Continued

Chaebols 1980	# units	Chaebols 1983	# units	Chaebols 1987	units	Chaebols 1991	units	Chaebols 1993	#
1. Hyundai	60	1. Hyundai	35	1. Samsung	34	1. Samsung	52	1. Samsung	50
2. Lucky	53	2. Samsung	31	2. Hyundai	40	2. Hyundai	43	2. Hyundai	48
3. Samsung	39	3. LG	42	3. LG	50	3. LG	59	3. LG	54
4. Sunkyung	28	4. Sunkyung	14	4. Daewoo	26	4. Daewoo	22	4. Daewoo	24
5. Daewoo	48	5. Daewoo	27	5. Sunkyung	13	5. Sunkyung	31	5. Sunkyung	33
6. Ssangyong	20	6. Kukche	18	6. Ssangyong	18	6. Ssangyong	22	6. Ssangyong	23
7. Hyosung	39	7. Korea Explo	16	7. Hanjin	14	7. Kia	10	7. Hanjin	21
8. Kukche	29	8. Hanjin	12	8. Hyosung	18	8. Hanjin	23	8. Kia	13
9. Hanjin	19	9. Hyosung	16	9. Korea Explo	20	9. Lotte	32	9. Lotte	31
10. Daelim	11	10. Ssangyong	14	10. Shindonga	8	10. Korea Expl	27	10. Korea Expl	29
Average	34.6		22.5		24.1		32.1		32.6

Sources: 1961,72: Kim Seok-ki (1987: 57-76) and Cho Dong-sung (1990:173)

1980: Tong'a Ilbo, January 1, 1981

1983: Han'guk Ilbo, June 16, 1984

1987-93: Kyong'yong Nungnyul Yonguso (1988, '92, '95)

Table 3.7
Foreign Capital Inflow: 1966 to 1972

(In million dollars, %)

	1962-65		1966	1967	1968	1969	1970	1971	1972	1966-72	
	Amount	Share								Amount	Share
Public Loans	63	7.1	73	106	70	139	115	303	324	1,130	26.4
Commercial Loans	71	8.0	110	124	268	410	367	345	326	1,950	45.6
Bank Loans	--	--	--	--	40	30	25	90	20	205	4.8
FDI	13	1.5	14	11	19	13	66	43	61	227	5.3
Sub-total	147	16.6	197	241	397	592	572	781	731	3,512	82.2
US & UN Aid	739	83.4	103	97	106	107	83	51	5	552	13.0
Claim Fund	--	--	30	30	34	31	25	31	27	211	4.8
Total Foreign Capital	886	100.0	330	368	537	730	680	863	763	4,275	100.0

Sources: MOF, EPB, BOK

Table 3.8
Cost of Foreign Capital

	(Unit: percent)		
	1966-70	1971-75	1976-80
Domestic lending rate	24.4	17.0	18.0
(Curb Market Interest Rate)	54.2	40.1	41.3
Foreign Interest Rate	6.4	7.9	11.5
Foreign Inflation Rate	4.7	8.3	6.0
(GNP Deflator)			
Exchange rate depreciation	5.1	7.8	5.5
GDP deflator, Korea	14.6	19.8	20.7
Real Foreign Exchange Rate	1.7	-0.4	5.5
Interest rate differential			
between home and foreign market	12.9	1.3	1.0
Real private cost of borrowing abroad	-3.1	-4.1	-3.7

Source: Woo Jung-eun (1991: 104)

Table 3.9
Interest Rates on Various Loans

Year	Inflation rate in whole sale (a)	Interest rate for bank deposits (b)	Interest rate for bank loans [c]	Earning rate of corporation (d)	Interest rate for policy loan (export) (Real interest rate) (e)	Interest rate for Curb Market (f)	Real interest rate for bank loans (g)	Real interest rate for policy loans for export (h)
1961	13.2	15.0	13.87	9-18	13.87	-	0.67	0.67
1962	9.4	15.0	13.87	9-26	9.13	-	4.47	-0.27
1963	20.6	15.0	13.87	9-26	9.13	52.4	-6.73	-11.47
1964	35.1	15.0	14.0	9-26	8.0	61.4	-20.1	-27.1
1965	9.9	30.0	24.0	9-26	6.5	58.8	14.1	-3.4
1966	8.6	30.0	24.0	9-26	6.5	58.7	15.4	-2.1
1967	6.5	30.0	24.0	16-38	6.0	56.4	17.5	-0.5
1968	8.1	25.2	26.0	16-38	6.0	55.9	17.9	-2.1
1969	6.9	22.8	24.0	16-38	6.0	51.2	17.1	-0.9
1970	9.4	22.8	24.0	16-38	6.0	50.8	14.6	-3.4
1971	8.6	21.3	22.0	16-38	6.0	46.3	13.4	-2.6

Source: Bank of Korea, *Yearbook of Economic Statistics and Monetary and Financial Statistics*, each year

Table 3.10
Sources of Corporate Funds in the Manufacturing Sector

(Unit: percent)

	1962-66	1967-71	1970-74	1975	1976	1977	1978	1979	1980
Internal Savings	16.5	15.4	19.5	17.9	22.6	31.8	25.1	25.2	22.4
External Borrowing	83.5	86.5	80.5	82.1	77.4	68.2	72.4	74.8	77.6
total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

	1980-1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Internal Savings	30.0	39.2	41.5	37.1	56.0	46.4	31.3	33.6	42.1	57.4	45.5	47.4	37.5	23.6
External Borrowing	70.0	60.8	58.5	62.9	44.0	53.6	68.7	66.4	57.9	42.6	54.5	52.6	62.5	76.4
total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank of Korea, *Analysis of Financial Statements*, each year.

Reference: Internal mobilization includes internal savings, savings for depreciation, and appropriation expenses. External Mobilization includes bank loans, government lending, stock issuance, corporation bond issuance, borrowing from curb market, borrowing from foreign lenders, loans from investment companies, merchant banks, and insurance companies.

Table 3.11

Structure of Capital Mobilization from External Funds (Share Rate)											(Unit: percent)
	63-65	66-71	70-74	75-79	80-84	85-87	88-91	92-94	95	96	97
Borrowing from financial institutions	48.4	41.8	51.4	48.6	51.0	56.8	36.7	37.9	31.8	31.3	37.9
Banks	33.5	32.8	36.7	30.8	24.4	34.7	18.7	16.5	14.9	15.7	12.9
Non-bank financial institutions	15.0	9.0	14.7	17.8	26.6	22.2	18.0	21.3	17.0	15.6	24.3
(Insurance)			0.2	1.3	4.6	4.0			2.7	3.3	2.5
(Short-term financial Co.) ^a			2.2	3.8	6.0	2.2			6.6	6.2	3.8
(Etc.)			12.2	12.6	16.0	15.9			7.7	6.1	17.9
Valuable securities issuance (direct finance)	27.6	14.3	24.8	31.6	42.2	41.3	47.5	44.2	48.1	47.0	37.1
(Stocks)	21.4	11.8	22.0	22.5	21.5	23.9	23.3	15.7	14.4	11.3	7.7
(Corporate bonds)			0.8	2.5	6.3	3.2	18.2	13.9	15.3	16.9	22.9
(Etc.) ^b	6.2	3.4	2.0	4.9	12.7	13.1	5.7	11.4	15.2	17.8	4.6
Etc.	8.5	7.8					9.9	15.3	11.7	11.5	18.9
Foreign borrowing	15.4	36.2	23.8	19.8	6.8	1.9	5.9	2.5	8.4	10.2	6.1
Total			100	100	100	100	100	100	100	100	100

Sources: 1963-1971: BOK, Annual Report

1970-1987: Choi Pil-sun (1990:112)

1988-1993: Bank of Korea (1994), *Understanding Capital Circulation Account*1994-1996: Bank of Korea (1997), *Monthly Survey Statistics*1997: Bank of Korea (1997), *Capital Circulation Account*Reference: ^a : includes loans from trust banks and investment companies.^b : includes issuance of government bonds and corporate bills.

Table 3.12

Loans and discounts of the Korea Development Bank, by Industry: 1961-1971 (Unit: percent)

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971
Manufacturing	52.1	47.4	44.3	44.9	50.7	50.8	48.6	48.9	43.8	47.6	44.1
textile (wearing apparel & leather)	10.1	8.9	7.2	8.7	10.5	12.0	10.7	8.5	9.9	8.0	6.4
Chemical & plastic products (mostly fertilizer)	16.0	14.2	13.1	11.0	10.6	11.5	12.2	14.0	8.1	8.9	9.2
metal, machinery & equipment	12.0	9.5	9.7	10.5	11.4	13.1	12.0	12.2	12.4	17.6	17.1
others	14.0	14.8	14.3	14.7	18.2	14.2	13.7	14.2	13.4	11.1	11.4
Agriculture, forestry & fishing	1.2	1.4	1.0	0.8	0	1.1	1.2	1.0	0	0.1	0.3
Mining & quarry	7.2	5.8	6.3	5.4	4.7	4.2	5.8	6.8	5.9	6.1	6.8
Construction	10.2	8.6	8.1	7.4	6.6	7.9	0.1	0.7	10.1	8.3	7.3
Electricity, gas & water	25.7	31.1	33.9	34.9	30.2	28.5	32.0	28.1	28.7	29.2	29.9
Others (transport, com, financing, business service trade, restaurants & hotel, and others)	3.6	5.7	6.4	6.6	7.8	7.5	12.3	14.5	11.5	8.7	11.6
Total	100	100	100	100	100	100	100	100	100	100	100

Source: The data was created using *Monthly Economic Statistics*, published by BOK.

Table 3.13

Loans and Discounts of Deposit Money Banks, by Industry: 1961-1971

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971
	(Unit: percent)										
Manufacturing	29.4	35.0	34.8	34.2	40.9	44.9	46.6	44.9	45.1	45.8	47.6
textile (wearing apparel & leather)	7.8	9.6	9.3	9.3	11.3	12.1	11.5	11.3	11.1	11.1	11.5
chemical & plastic products (mostly fertilizer)	2.4	3.1	3.3	3.3	3.9	4.5	6.3	5.3	7.0	10.5	8.0
metal, machinery & equipment	2.7	3.9	4.5	4.3	5.5	6.5	6.8	7.5	8.0	10.2	10.8
others	16.5	18.4	17.7	17.3	20.2	21.8	22.0	20.8	19.0	14.7	17.3
Agriculture, forestry & fishing	51.9	41.0	39.3	40.9	31.0	25.9	17.1	14.1	13.1	12.0	11.9
Mining & quarry	1.1	1.6	1.7	1.5	1.6	1.8	2.5	2.7	2.0	1.7	2.4
Construction	1.6	1.8	2.2	2.2	2.2	2.2	2.8	4.6	7.1	7.4	9.4
Others (electric., gas & water, transport, communication, financing, business service etc.)	16.0	20.6	22.0	21.2	24.3	25.2	31.0	33.7	32.7	33.1	28.7
Total	100	100	100	100	100	100	100	100	100	100	100

Source: The data was created using *Monthly Economic Statistics*, published by BOK.

Table 3.14
Exports and Korean Economy in the Early Phase of Development (1954-1976)

year	export (unit: million dollars)	export growth rate (unit: percent)	manufactured exports as percent of total export (unit: percent)	proportion of exports to GNP (unit: percent)	proportion of foreign trade (exports plus imports) to GNP
1954	24	-	-	-	8.8 (1955)
1955	18	-33.3	-	-	
1956	25	38.9	-	-	
1957	22	-13.6	-	-	
1958	16	-37.5	14.6	-	9.0 (1958-1960)
1959	20	25.0	10.8	-	
1960	33	65.0	12.5	-	
1961	41	24.7	13.9	6.3	21.2
1962	55	34.0	17.5	6.0	22.6
1963	87	58.4	44.5	5.4	21.2
1964	119	37.2	48.4	6.7	20.2
1965	175	47.0	60.8	9.5	25.4
1966	250	42.9	61.4	11.9 *7.9(1962-66)	32.2 *24.3(62-66)
1967	320	27.9	67.2	13.6	36.0
1968	455	42.2	74.3	14.7	40.6
1969	622	36.7	77.0	15.4	41.4
1970	835	34.2	80.0	14.9	38.9
1971	1068	27.8	82.1	16.1 *14.9(1967-71)	42.6 *39.9(67-71)
1972	1624	52.1	84.0	20.5	46.1
1973	3225	98.6	84.3	29.7	63.2
1974	4460	38.3	84.9	28.1	68.2
1975	5081	13.9	81.6	28.0	66.2
1976	7715	51.8	87.7	31.2 *27.5(1972-75)	65.6 *61.9(72-76)

Source: EPB, BOK, *Monthly Statistical Review*, *Monthly Economic Statistics*, each year.

Table 3.15
Exports by Principal Commodities
(Unit: Million US dollars)

	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
food and live animals	9	22	18	26	18.2	24.3	29.2	37.3	40.3	48.0	41.4	66.8
raw silk (not woven)	2.8	3.9	4.7	5.7	6.8	11.6	14.9	18.0	23.8	35.8	39.3	53.9
metalliferous ores	9.6	7.9	10.5	13.2	15.2	18.8	20.1	23.0	32.3	27.6	16.4	16.3
fertilizers (manufactured)	-	-	-	-	-	-	1.6	1.9	6.2	6.3	7.5	11.6
plywood	1.2	2.3	6.3	11.4	18.0	29.9	36.4	65.6	79.1	91.7	124.3	153.6
textile (woven)	0.9	1.8	4.3	11.1	25.2	31.5	42.3	52.5	60.0	78.6	130.0	167.1
cement	-	-	-	-	0.8	0.3	0.2	0.2	3.3	4.4	10.6	12.7
iron or steel plates	-	0.5	8.3	2.1	10.2	7.1	0.9	0.8	3.6	7.5	20.1	68.1
electrical machinery	-	-	-	-	1.9	5.1	7.3	18.9	36.7	43.9	68.5	125.2
apparel	-	-	-	-	18.9	28.7	38.4	91.6	122.1	160.5	226.9	305.4
footwear	-	-	-	-	4.2	5.5	8.1	11.0	10.5	17.3	37.4	55.4
total of above	23.5	38.4	52.1	69.5	119.4	162.8	199.4	320.8	417.9	521.6	722.4	1036
other products	17.4	16.4	34.7	49.6	55.7	87.5	120.8	134.6	204.6	313.6	345.6	588
total exports	40.9	54.8	86.8	119.1	175.1	250.3	320.2	455.4	622.5	835.2	1,068	1,624

Source: BOK, *Monthly Economic Statistics*, each year.

Table 3.16
Goal and Achievements of the Fifth Five-Year Economic Plan

	Unit	3rd Republic				4th Republic				5th Republic	
		1st (1962-66)		2nd (1967-72)		3rd (1972-76)		4th (1977-1981)		5th (1982-86)	
		1962									
		Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual	Plan	Actual
GNP	US\$100 million at 1980 price	126.7	137.6	233.1	309	416	490	669	643	933	971
	US\$100 mil at current price	(23)	(37)		(94)		(287)		(662)		(940)
GNP growth rate	percent	2.2	7.1	7.0	9.6	8.6	9.7	9.2	5.8	75	8.6
per capita GNP	dollars at 1980 price	395	471	719	941	1211	1367	1723	1669	2229	2334
	dollars at current price	(87)	(125)		(285)		(800)		(1719)		(2268)
industrial structure	percent	100	100	100	100	100	100	100	100	100	100
primary		37.0	34.8	34.0	26.8	22.4	23.5	18.5	15.8	12.2	12.8
secondary		16.4	26.1	26.8	22.2	27.9	28.4	40.9	30.7	31.0	30.1
social service		46.6	39.1	39.2	51.0	49.7	48.1	40.6	53.5	56.9	57.1

(Table 3.16 Continued on next page)

Table 3.16 Continued

Ratio of gross investment domestic saving ratio	percent	12.8	22.7	21.6	19.9	25.1	24.9	25.6	26.0	30.3	29.5	29.5
		3.2	13.0	11.8	14.4	14.6	21.5	23.9	23.9	20.5	21.7	32.5
Current account balance	100 million dollars											
commodity export		0.6	2.5	1.0	1	9	4	3	12	47	4	45
commodity import		0.5	1.4	2.5	6	11	35	78	202	207	357	336
		3.9	4.9	6.8	9	22	28	84	189	243	351	293
employment growth	percent	---	4.7	3.2	3.6	3.6	2.9	4.5	3.2	2.3	2.5	1.9
unemployment rate		8.2	14.8	7.1	5.0	4.5	4.0	3.9	3.8	4.5	3.8	3.8

Source: EPB, *Major Statistics of Korean Economy*, various years.

Table 3.17
Distribution of Policy Loans to HCI Programs

(Unit: percent)

Year	HCI/National Investment Fund	HCI/KDB Policy Loans
1974	54.9	25.3
1975	41.9	26.0
1976	52.1	31.0
1977	58.9	34.8
1978	61.4	34.9
1979	64.9	38.3
1980	60.8	41.5
Average during the whole period	59.6	36.6

Source: Kim Ju-ho, 1995:242.

Reference: For example, in 1974, 54.9% of all NIF went to HCI.

Table 3.18
Priority Rationing of Finance to Five Strategic Industries by Korea Development Bank in Each Period (Unit: Million won, %)

(1954-1961)								
	Electricity	Agriculture-Fishery	Petrochemicals	Construction	Textile	Etc	total	
Lending Size (Ratio)	5,761 (21.1)	3,536 (13.0)	3,528 (12.9)	2,700 (9.9)	2,325 (8.5)	9,475 (34.7)	27,325 (100.0)	
(1962-1971)								
	Electricity & gas	Metal-Machinery	Textile-Clothing	Mining	Petrochemical	Etc	total	
Lending Size (Ratio)	53,333 (23.7)	33,106 (14.7)	20,684 (9.2)	17,519 (7.8)	17,518 (7.8)	82,947 (36.8)	225,113 (100.0)	
(1972-1979)								
	Electricity & gas	Metal-Machinery	Transportatn & Commnctn	Primary-Metal	Petrochem	Etc	total	
Lending Size (Ratio)	610,696 (23.0)	445,097 (16.7)	383,764 (14.4)	332,974 (12.5)	252,926 (9.5)	638,046 (24.0)	2,663,503 (100.0)	
(1980-1989)								
	Transportatn & Commnctn	Metal-Machinery	Petrochemicals	Primary-Metal	Electricity & gas	Etc	total	
Lending Size (Ratio)	50,183 (24.6)	42,454 (20.8)	23,835 (11.7)	21,901 (10.8)	18,104 (8.9)	47,196 (23.2)	203,673 (100.0)	

Source: KDB, *Forty Years of KDB*, 1994: 309-320.

Table 3.19
Foreign Capital Inflow during HCI-Drive (1972-1979)

	(in million dollars, %)											
	1966-1972		1972	1973	1974	1975	1976	1977	1978	1979	1972-1979	
	amount	share									amount	share
Public loan	1,130	26.4	324	403	385	477	713	636	817	1,089	4,844	30.0
Commercial loan	1,950	45.6	326	461	603	801	839	1,241	1,913	1,578	7,762	48.1
Bank loans	205	4.8	20	49	218	200	131	300	328	1,522	2,768	17.1
FDI	227	5.3	61	6.5	163	62	85	102	101	195	775.5	4.8
Total	3,512	82.2	731	1,104	1,369	1,540	1,768	2,279	3,159	4,313	16,149.5	100.0
Interest rate for P.L. ^a				4.4	5.6	6.5	7.1	6.7	7.8			
Interest rate for C.L. ^b				9.3	9.2	10.1	11.8	13.0	12.0			

Source: KDB & MOF, 30 years of Foreign Borrowing, 1993: 621-629 and 184 (for nominal interest rates)

Reference: ^a indicate 'nominal interest rate for Public loans; ^b indicates 'nominal interest rate for Commercial loans.

Table 3.20

Distribution of Commercial Loans from Foreign Lenders (Arrival amount as standard)

(unit: million dollars, %)											
	1966-1972		1973	1974	1975	1976	1977	1978	1979	1973-1979	
	amount	share								amount	share
Primary Industry	76	3.9	13	27	10	21	10	6	58	145	2.0
Manufacturing	1,051	53.9	202	428	586	630	893	1,305	1,051	5,095	68.0
Light industry	426	22.0	87	359	140	211	172	239	268	1,476	19.7
Heavy industry	615	31.3	78	150	447	402	719	1,066	774	3,636	48.6
Misc.	10	0.6	55	148	-	-	2	-	9	214	3.0
Infrastructure & service	823	42.1	241	148	205	192	339	602	522	2,249	30.0
Total	1,950	100.0	461	603	801	839	1,241	1,913	1,578	7,489	100.0

Source: KDB & MOF, 30 Years of Foreign Borrowing, 1993: 170, 223.

Table 3.21

Interest Rates of Various Loans during Heavy-Chemical Industrialization-Drive (1972-1979) (Unit: %)

Year	Interest rates for various loans						Policy Loans			
	Inflation rate of GNP deflator	Interest rate for Bank deposits	Interest rate for general bank loans	Earning rate of corporate bond	Interest rate for Curb market	Real interest rate for policy loans ^A	Interest rate for Export Loans	Interest rate for equipment investmnt	Interest rate for National Investmnt fund	
1971	13.5	21.3	22.0	16-38	40.1	-	6.0			
1972	11.5	12.6	15.5	16-38	42.5	-	6.0			
1973	13.7	12.6	15.5	21.8	33.3	-3.7	7.0	10.0	10.0	
1974	31.0	15.0	15.5	21.0	40.6	-1.7	9.0	12.0	12.0	
1975	25.7	15.0	19.0	20.1	41.3	-19.0	9.0	12.0	12.0	
1976	22.5	16.2	18.0	20.4	40.5	-22.7	8.0	13.0	14.0	
1977	16.2	14.4	19.0	20.1	38.1	-3.2	8.0	13.0	14.0	
1978	23.5	18.6	19.0	21.1	41.2	-8.5	9.0	15.0	16.0	
1979	20.2	18.6	19.0	26.7	42.4	-5.2	9.0	15.0	16.0	
Average	19.8	16.0	18.1	21.6	40.0	-9.1	7.9	12.9	13.4	

Source: BOK, National Accounts, each year; Office of Statistics, *Major Economic Indicators*, each year.

Reference: A: 'Real Interest rate for policy loans' is calculated by subtracting the interest rate for export loans from the inflation rate of GNP deflator.

Table 3.22
Policy Loans and Various Interest Rates

Year		Policy loans				Ratio of loans		
	Total Money Lent (M)	Total Policy Loans (P)	BOK redis-count (%)	Govt. budget (%)	NIF (%)	P/M (%)	int. gap (A) (%)	General loans/M (%)
1967	1770	571	18	14	--	32 (53.1)*	18.0	68
1968	3069	812	15	11	--	26 (48.0)*	20.0	74
1969	5294	1196	13	10	--	23 (44.0)*	18.0	77
1970	7068	1803	17	9	--	26 (43.9)*	18.0	74
1971	9005	2118	16	8	--	24 (49.0)*	16.0	76
1972	11784	2943	18	7	--	25 (51.0)*	9.5	75
1973	15875	4270	20	7	--	27 (48.3)*	8.5	73
1974	24278	8345	28	5	1	34 (50.8)*	6.5	66
1975	29056	9879	27	5	2	34 (52.9)*	10.0	66
1976	37249	10731	21	4	3	29 (56.9)*	10.0	71
1977	47090	13350	19	5	4	28 (65.1)*	11.0	72
1978	66090	20083	21	5	4	30 (65.1)*	10.0	70
1979	89778	28359	24	4	4	32 (64.7)*	10.0	68
1980	122044	36242	22	4	3	30 (68.2)*	5.0	70
1981	159550	49328	23	4	3	31 (68.1)*	2.0	69
1982	202258	61163	23	4	3	30 (62.1)*	2.0	70
1983	241503	77051	24	5	3	32 (67.9)*	0.0	68
1984	279789	98598	27	5	3	35 (72.0)*	1.5	65
1985	338103	121894	29	5	3	36 (73.5)*	1.5	64
1986	390986	130993	26	5	3	34 (73.9)*	1.5	66
1987	430958	139898	25	5	2	32 (74.4)*	1.5	68

(Table 3.22 Continued on next page)

(Table 3.22 Continued)

1988	488054	132685	20	5	2	27	3.0	73
1989	625478	144886	16	5	2	23	2.5	77
1990	740286	163755	16	5	1	22	2.5	78
1991	894156	191558	15	5	1	21	2.5	79
1992	1027970	233701	17	5	1	23	2.5	77
1993	1151374	235339	14	6	0.5	20	2.5	80
1994	1358503	228100	10	6	0.3	17	2.5	83
1995	1524777	231441	8	7	0.2	15	2.5	85
1996	1771841	205726	4	7	0.1	12	1.0	88
1997	2004011	290510	7	8	0.06	14	5.32	86

Source: BOK, *The Yearbook of Economic Statistics, National Accounts, Monthly Survey Statistics*, each year.

Reference: The numbers under * indicate the ratio of policy loans relative to total money lent when a broad definition of policy loans was applied. Previous studies have used this broad definition of policy loans. This study uses both broad and narrow definitions of policy loans, because data based on the narrow definition is available across the different time periods covered by this study.

Interest gap (A) was calculated using the interest rate of general bank loans and the interest rate of policy loans for export promotion.

NIF=National Investment Fund

Table 3.23
Progress of Heavy-Chemical Industrialization in the 1970s
(Unit: percent)

	Structure of Manufacturing		Structure of Export-Goods		
	Heavy-Chemical	Light-Industry	Heavy-Chemical	Light-Industry	Primary Industry
1970	37.8	62.2	12.8	69.7	17.5
1973	39.4	60.6	23.8	63.4	12.8
1974	48.1	51.9	32.5	54.1	13.4
1975	45.3	54.7	25.1	57.4	17.5
1976	46.5	53.5	29.8	57.9	12.3
1977	48.7	51.3	32.8	52.7	14.5
1978	49.9	50.1	35.1	53.6	11.3
1979	52.1	47.9	38.6	50.3	11.1
1980	50.5	49.5	41.6	48.4	10.0

Source: KDB & MOF, *30 Years of Foreign Borrowing*, 1993: 140-141, 195, 199.

Table 3.24
Growth of Big Business Groups in Terms of Total Value-added in the 1970s
(Unit: billion won, %)

# of Chaebols	1973	1978	Average annual growth (%)
top 5	269.85 (3.5)	1,006.64 (8.1)	30.1
top 20	549.95 (7.1)	1,739.39 (14.0)	25.9
top 46	759.96 (9.8)	2,122.20 (17.1)	22.8
GDP	7,729.21	12,400.62	9.0

Source: Sakong, Il (1980, p.5).

Reference: # in parenthesis indicates 'annual growth rate' each year.

Table 3.25
Share of Thirty Largest Chaebols in Mining and Manufacturing: 1977-1997
(unit: percent)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
employment	20.5	22.2	24.5	22.4	20.8	18.6	17.9	18.1	17.6	17.2	17.6	17.4
sales	32.0	34.1	35.2	36.0	39.7	40.7	39.9	40.3	40.2	37.7	36.8	36.0
fixed assets	-	-	-	-	36.7	37.2	37.1	40.3	39.6	39.1	37.9	35.3
value added	29.1	-	-	-	30.8	33.2	32.4	34.4	34.0	33.2	32.6	31.0

	1989	1990	1991	1992	1993	1994	1995
employment	16.6	16.0	17.7	17.5	16.6	17.7	18.0
sales	35.2	35.0	38.2	39.7	38.1	39.6	40.7
fixed assets	35.3	32.2	45.3	44.5	42.6	45.0	44.0
value added	30.0	30.0	35.4	35.9	33.5	36.9	40.2

Source: FTC, *Whitepaper of Fair Trade Practices*, each year.

Table 3.26

Changes in the Ratio of HCI to Total Assets Before and After HCI Drive

(Unit: billion won)

	Hyun-dai	Lucky	Sam-sung	Dae-woo	Hyo-sung	Kuk-che	Han-jin	Ssang-yong	Korea-Ex	Sun-kyung	total
'72											
(A) Manu.	25	89	74	0	21	7	0	61	65	22	364
(B) HCI	25	79	28	0	4	4	0	61	56	0	257
B/A (%)	100.0	88.8	37.8	-	19.0	57.1	-	100	86.2	0.0	70.6
'79											
(A) Manu.	1,005	1,088	763	631	458	291	0	527	359	141	5,263
(B) HCI	1,005	1,088	440	595	218	225	0	527	336	26	4,460
B/A (%)	100.0	100.0	57.7	94.3	47.6	77.3	-	93.6	93.6	18.4	84.7

Source: Kim, Seok-ki (1987:187)

Reference: (A) (Manufacturing) indicates total assets of each group invested in manufacturing sector.

(B) indicates total assets of each group invested in heavy-chemical industry

Table 3.27
Investment Plan and Business Participation During HCI-Drive: 1972-1979

Industry	Plan	Business Participation
Steel	* Pohang Steel Expansion * Second Steel establishment * Special steel facilities establishment	* Pohang Steel expansion (8.5 million tons) * Second Steel (Pohang and Kwangyang man) * Korea Special Steel (now, Sami Special Steel) * Daehan Junggee (now, Kia Special Steel, 1986)
Nonferrous metals	* Onsan industrial park	* Korea Zinc, Onsan copper-refinery (now, LG metal, 82) * Daehan Aluminum
Machinery	* Changwon industrial park * Automobile industry as Exporting items	* Hyundai: Hyundai heavy-metals * Daewoo: (Korea Machinery -> Daewoo heavy-metals) * Hyosung: (Hanyoung Inc. -> Hyosung heavy-metals) * Samsung: (Daesung Inc. -> Ssangyong heavy-metals) * Ssangyong: Jinil Inc. -> Ssangyong Heavy-metals) * Kia: Asian Automobile * Daewoo: Daewoo Automobile with GM
Shipbuilding	* Gugedo Shipbuilding Industrial Park	* Hyundai: Hyundai Meepo shipbuilding (now, Hyundai Heavy-Metals) * Daewoo: Daewoo Shipbuilding (now, Daewoo Heavy-Metals) * Samsung: Samsung Shipbuilding (now, Samsung Heavy-metals)

(Table 3.27 Continued on next page)

(Table 3.27 Continued)

Electronics	* Export Industrialization	* Samsung: Samsung Electronics and Samsung Corning (Korea Semiconductor-> Samsung Electronics) (Korea Telecommunication -> Samsung Electronics) * LG: Goldstar Electronics (Dawhan Semiconductor-> LG Information and Communication) * Daewoo: Daewoo Electronics (Take-over Daehan Electronics, 1983)
Chemicals	* Yochon Industrial Park * Oil-refinery Establishment	* Honam Etelien (now, Daerim Inc.) * Honam Petrochemicals-Chemical (now, Lotte Chemical) * Kumho: Kumho Chemical (now, Kumho-Shell Chemical) * LG: LG Petrochemicals-Chemical * Samsung: Samsung petrochemicals-Chemical * Kolong: Koolong Chemical * Namhae Chemical (SOE) * Ssangyong: Ssangyong Oil-Refinery

Source: Kim Ju-ho, 1995:244

Table 3.28
The Number of Subsidiaries of the 30 Largest Chaebols Over Time

	1970	1979	1982	1988	1989	1990	1992	1993	1994	1995	1996	1997	1998	1999
# of subsidiaries	126	429	402	498	514	538	608	604	616	623	669	819	804	686
average # per Chaebol	4.2	14.3	13.4	16.6	17.1	17.9	20.3	20.1	20.5	20.8	22.3	27.3	26.8	22.9
# of industries involved	7.7	17.6	15.4	13.9	14.0	11.8	17.9	18.3	19.1	18.5	18.8	19.8	19.97	19.17

Source: Cho, Dong-sung (1996:34), FTC, *Whitepaper of Fair Trade Practices*, each year.

Kim, Seok-ki (1987:171)

Table 3.29
Average Debt/Equity Ratio in Manufacturing, 1961-1997
(Unit: percent)

Year	Manufacturing	Large enterprise	Small/medium	Year	Manufacturing	Large enterprise	Small/medium
1961	136	-	-	1981	451.5	451.1	453.2
1962	154	-	-	1982	385.8	377.6	433.0
1963	92	-	-	1983	360.3	360.6	254.2
1964	101	-	-	1984	342.7	339.5	249.2
1965	94	-	-	1985	348.4	344.7	223.1
1966	118	-	-	1986	350.9	355.7	230.2
1967	151	-	34.2	1987	340.1	333.1	232.3
1968	201	-	-	1988	296.0	283.9	228.4
1969	270	-	-	1989	254.0	239.9	240.7
1970	328	331.8	78.6	1990	285.5	274.5	243.8
1971	328	-	-	1991	306.7	288.1	262.1
1972	313	-	-	1992	318.7	302.5	288.1
1973	272	-	-	1993	294.9	273.5	255.2
1974	316	-	-	1994	302.5	282.9	264.7
1975	339	351.3	185.9	1995	286.8	268.3	284.9
1976	365	-	272.2	1996	317.1	301.6	296.1
1977	367	-	358.8	1997	396.3	390.0	399.5
1978	367	-	388.1	1998	303.0	520.1	406.3
1979	377	377.5	374.3	1999	264.0		
1980	488	504.7	394.9				

Source: Bank of Korea, *Financial Statement Analysis*, National Federation of Small/Medium Enterprise, Report on Small/Medium Enterprise, various years.

Table 3.30

Debt-to-Equity Ratios of the Top Ten Korean Chaebol (ranked by sales, excluding financial industry)

	1980	D/E	1984	D/E	1987	D/E	1991	D/E	1998	D/E	(Unit: percent)
Top 10 Chaebols		773.5		504.8		483.0		408.0		608.3	
1. Hyundai		366.3	Samsung	447.5	Hyundai	452.1	Hyundai	398.2	Hyundai	580.5	
2. Lucky		555.2	Hyundai	340.7	Samsung	483.4	Samsung	335.9	Samsung	370.4	
3. Samsung		615.0	LG	456.2	LG	384.9	LG	356.5	Daewoo	471.8	
4. Sunkyung		2,161.5	Daewoo	442.8	Daewoo	407.4	Daewoo	356.7	LG	512.3	
5. Daewoo		397.2	Sunkyung	485.6	Sunkyung	349.6	Sunkyung	306.7	Sunkyung	455.7	
6. Ssangyong		510.7	Ssangyong	433.8	Ssangyong	389.0	Ssangyong	224.7	Hanjin	916.5	
7. Hyosung		861.1	K-Explosive	320.3	Hyosung	297.0	Kia	340.7	Ssangyong	399.7	
8. Kukche		690.7	Kukche	914.5	Hanjin	1,777.0	Hanjin	1,262.1	K-Explosive	1064.3	
9. Hanjin		1,251.8	Hanjin	422.1	K-Explosive	202.4	Lotte	174.3	Kumho	951.0	
10. Daelim		325.4	Hyosung	784.1	Lotte	87.2	K-Explosive	324.2	Donga	361.1	
Top 50 Chaebols		524.4		462.1		410.6		368.9		521.5 (top 30)	
SMEs		394.9		366.0		375.0		415.5		406.3 (1996)	
Manufacturing Co.		487.9		342.7		340.1		309.2		396.3 (1997)	

D/E: Debt-to-equity ratio

Source: 1980-1991: Lee, Yeon-ho (1997), p. 70; 1998: Choi, Seung-roh (1998), p. 39 and KDB (1996), *Business Financial Statement Analysis*.

Table 3.31
Investment Readjustment in Major Heavy & Chemical Industries (1979-1980)

Industries	Before readjustment (as of May 1979)	As of Oct. 1980	After Oct. 1980
Power Generator	Hyundai International Inc. Hyundai Heavy Daewoo Heavy Samsung Heavy Hyosung Heavy	*Daewoo	merged into a single firm (Korea Heavy Machinery) which was a state-run enterprise
Automobile	Hyundai Motors Daewoo Motors Kia Motors Dong-A Motors Sahan Motors	*Hyundai & Sahan to be merged and specialize in passenger cars *Kia to specialize in truck and bus	*Daewoo and Hyundai as producers of passenger cars *Kia in truck and bus
Heavy Electrical Machinery	Hyosung Heavy Ssangyoung Heavy Machinery Hyundai Heavy Electrical Co. Kolon Electrical Co.	*Hyosung Heavy	*Hyosung Heavy
Electronic Central Switch	Korea Electronic Telecom Dongyang Precision Goldstar Telecom Daehan Communication	*Samsung Goldstar	*Samsung Goldstar *each specialized in different type of switches
Diesel Engine	Ssangyong Heavy Machinery Daewoo Heavy Hyundai Engine	*Hyundai Ssangyong	*Hyundai & Ssangyong oligopoly system
Nonferrous Metals	Korea Metals Onsan Copper Metals	*Korea Metals	*Korea Metals

Source: The above table is reorganized with reference to Kim Seok-ki (1987:271) and Shin Hee-keun (1993:46-48).

Table 3. 32

Exports by Principal Commodities (Top Ten Items)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
	1973-1987							(Unit: Million US dollars)							
plywood	273.2	163.4	206.4	333.1	319.1	346.1	-	-	-	-	-	-	-	-	-
woven fabrics	404.1	448.8	610.5	880.8	955.3	1408	1451	1778	1980	1812	1974	2126	2106	2698	3383
cement	19.6	48.9	68.9	109.9	155.0	142.3	114	234	339	332	204	111	96	131	157
iron or steel plates	130	233	74	158	166	298	447	557	564	570	640	1060	893	988	1289
power generator	3	3	2	15	20	24	56	92	115	121	121	184	240	211	412
office machines	33	41	44	58	58	70	88	89	95	121	235	439	588	992	1599
TV receivers	-	-	-	-	100	230	301	420	501	380	553	707	591	811	1200
Radio	-	-	-	-	126	182	282	287	346	297	386	544	500	710	1200
passenger motor cars	-	-	-	-	13	42	54	50	70	49	87	174	518	1343	2748
ships	-	-	-	-	526	801	515	618	1411	2832	3735	4684	5040	1815	1138
apparel	433	523	1075	1318	2070	2595	2856	2950	3868	3774	3707	4500	4500	5483	7537
footwear	106	180	191	399	488	686	729	874	1024	1154	1235	1352	1534	2059	2756
total of above	1402	1641	2272	3272	4996	6824	6893	7949	10313	11442	12877	15881	16606	17240	23419
other products	1823	2819	2809	4443	5050	5886	8162	9556	10941	10411	11568	13364	13677	17474	23862
total exports	3225	4460	5081	7715	10046	12710	15055	17505	21254	21853	24445	29245	30283	34715	47281

Source: BOK, *Monthly Economic Statistics*, each year.

Table 3.33
Structure of Bank Credit according to Borrowers

(Unit: percent)

	1972	1974	1976	1978	1980	1982	1984
Manufacturing	45.4	45.2	40.9	39.2	38.5	32.5	28.1
Large-sized enterprise	45.7	45.6	41.3	39.6	39.2	32.2	27.8
SMS enterprise	27.2	24.4	34.9	37.0	33.7	33.8	30.4
(SMS-Large enterprise)	-18.4	-21.1	-6.3	-2.6	-5.4	1.6	2.5
Heavy-chemical	49.2	41.2	41.5	41.6	39.6	32.8	27.7
Light industry	42.3	49.0	40.3	35.9	37.1	32.1	28.9
(Light - Heavy Industry)	-6.9	7.7	-1.2	-5.6	-2.5	-0.6	1.2

Source: BOK (Bank Supervisory Commission), *Statistics of Bank Management*, each year.

Table 3.34
The Relative Weight of Small- and Medium-Sized Enterprises as Compared with Big Business
(unit: percent)

	1963	1966	1970	1975	1980	1981	1982	1983	1984	1985	1987	1991	1996
SME proportion (A)	98.5	98.3	97.0	96.2	96.6	96.9	97.3	97.4	97.5	97.5	97.6	98.5	99.1
# of employment	62.4	58.4	48.1	45.2	49.4	50.7	53.5	54.5	54.7	55.9	53.7	63.5	68.2
total sales	-	-	30.2	30.8	32.1	32.4	34.3	34.7	34.7	35.4	38.0	45.7	46.7
value-added	49.7	41.4	28.0	31.3	35.1	34.7	36.1	37.2	36.4	37.7	39.4	45.8	47.2
export	18.6	27.8	32.2	34.5	32.1	31.0	22.3	20.2	25.5	27.8	37.7	39.9	42.8

Source: Central Council of SMEs Association, *Statistics of SMEs*, each year. (KOTRA: export statistics).

Reference: the above numbers indicate the ratio of SMES relative to the overall economy in each category except for (A).

(A) indicates the proportion of SMEs among the total number of firms in the manufacturing sector.

Table 3.35
Variety of Attractions for Promotion of Saving (1980-87)

Year	Inflation rate of GNP deflator	Interest rate for bank deposits	Interest rate for bank loans	Earning rate of corporate bonds	Composite index of stock prices	Annual %age increase of land price in major cities	Interest rate for Curb market	Interest rate for export policy loan	Interest rate for machinery policy loan	Interest rate for National Investment fund	Annual %age growth of M2
1980	24.3	19.5	20	30.1	108.8	17.0	44.94	15.0	20.0	22.0	26.9
1981	17.3	16.2	17	24.4	126.3	7.1	35.25	15.0	11.0	16.5	25.0
1982	6.8	8	10	17.3	122	5.6	33.12	12.0	10.0	10.0	27.0
1983	5.6	8	10	14.2	127.7	31.7	25.77	10.0	10.0	10.0	15.2
1984	5.4	10	11.5	14.2	131.9	21.6	24.84	10.0	10-11.5	10-11.5	7.7
1985	4.7	10	11.5	14.2	138.9	7.8	24.00	10.0	10-11.5	10-11.5	15.6
1986	4.8	10	11.5	12.8	227.9	6.4	23.10	10.0	10-11.5	10-11.5	18.4
1987	6.9	10	11.5	12.6	417.6	13.9	22.90	10.0	10-11.5	10-11.5	19.1

Sources: Bank of Korea, *National Accounts*, each year; Office of Statistics, *Major Economic Indicators*, each year.

Table 3.36
The Ratio of Equity Capital to Total Assets Across Different Countries

(Unit: %)

	Korea		Japan	Taiwan	United States
	Manufacturing	Big Business			
1980	17.0	n/a	20.6	n/a	49.6
1986	22.3	17.6	27.1	n/a	44.0
1987	22.7	23.1	28.2	47.5	42.9
1988	25.3	26.0	29.1	48.0	42.0
1989	28.2	29.4	30.3	52.4	40.5
1990	25.9	26.7	30.6	54.5	40.2
1991	24.6	19.8 (top 30 Chaebol)	31.2	50.5	40.4
1992	23.9	19.9 (top 30)	31.6	51.8	37.3
1993	25.3	19.0 (top 30)	32.0	53.2	36.4
1994	24.8	20.1 (top 30)	32.3	53.4	37.5
1995	23.97	19.9 (top 30)	32.6	53.85	38.5
1997	20.2	20.5 (top 30)			
1998	24.8	16.1 (top 30)			

Source: Bank of Korea, *Analysis of Financial Statement*, each year.

Reference: According to *Whitepaper of Fair Trade Practices* (published by FTC), the Ratio of Equity Capital (top 30 Chaebols) was:

19.9 in 1992

22.2 in 1993

21.9 in 1994

22.3 in 1995

20.6 in 1996

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**DRIVING ENGINE OR RENT-SEEKING SUPER-CARTEL?
THE BUSINESS-STATE NEXUS
AND ECONOMIC TRANSFORMATION
IN SOUTH KOREA:
1960-1999**

VOLUME II

By

Soo Chan Jang

A DISSERTATION

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CHAPTER IV

THE PARADOX OF MARKET DEEPENING UNDER DEMOCRATIC REGIMES (1987-1997)

This chapter concerns the dilemma of dual transformations: political liberalization and market-oriented economic reform. The 'limited developmental state' during Chun's rule (1980-1987) was a transitional period during which Korea struggled to restructure from a state-led to a market-based economy. But, contrarily, the Korean state's effort to repair the legacy of the HCI program (1973-1979) got watered down to a highly interventionist one. Compelled to address the excessive investments in heavy-chemical industries and the unbalanced industrial structure which was overwhelmingly in favor of large conglomerates, the Korean state kept up its role as credit and business licensing distributor during Chun's rule. Thus, real market-oriented reform was retarded. In fact, there was policy juggling between a state-led and a market-oriented economy during Chun's rule, owing to two contradictory missions: 1) long-term market-oriented reform; and 2) the imminent need to correct the fallout from previous HCI programs.

From the late 1980s on, market-oriented reform could no longer be postponed, due to the fact that the scale and complexity of the Korean economy almost exhausted the benefits of sector-specific intervention. There was an increasing informational asymmetry between private agents and the public principal as the Korean economy became larger and more complex, with the result that the intimate and direct business-state tie as the distributional institution of business licensing and bank credit became an ineffective tool which could not accommodate the rapidly changing economic environment. In other

words, the negative effects of the interventionist state became greater than the beneficial effects, owing to the moral hazard problem in the business-state relationship. “Who is accountable for what” became largely unanswerable as the asymmetry in information between credit distributor and recipients increased. Accordingly, the market deepening program was, in part, internally driven by economic technocrats who had become increasingly aware that the interventionist state was no longer a viable device to manage economic affairs.

Economic globalization also worked as an external force which drove Korea into marketization. Globalization means homogeneity and uniformity. For instance, the international capital herd demands countries to install market institutions which are characterized by “openness,” “predictability,” and “transparency,” and rewards those countries with stock and bond investments. Like other developing countries, Korea had been under pressure to remove the old fashioned practices (crony capitalist activities) in the 1990s. For instance, international capital called for transparency and openness of financial statements by Korean corporations and for a higher standard in the supervisory and disciplinary role of the Korean state.

As Korea evolved into a major trade competitor with the leading economies under the highly intertwined world economy, the United States, in particular, attempted to level the playing field through its request for the abolishment of state subsidies and other acts of favoritism towards domestic business. Certainly, the leading economies wanted to wean Korea from its catch-up economy status, so that Korean conglomerates would conduct their international business under the same rules as other global competitors. The more globalization in production and financial markets, the more the Korean state was

constrained in its interventionist policy. When Korea joined the OECD in 1996, sector-specific promotion policy had become almost impossible. Under the globalized economy, market rules regulate and steer the performance of economic actors. Accordingly, Korea increasingly attempted to embrace globalization wholeheartedly by restructuring the leading conglomerates. The Korean state felt an urgent need to enhance the competitiveness of its domestic business. Thus, its endeavor to embrace globalization involved reforming the structural base (such as the real-name financial transactions and real-name real estate transactions) and corporate structure. For instance, the Korean state foresaw the concentration of managerial, technical and capital resources into the core business lines of the Korean Chaebol as strategically viable, while regarding the diversification drive as a dead-end strategy.

Democratization also accelerated market-oriented reform. The business community, which had become more autonomous since 1987, following political liberalization, raised its voice for “deregulation.” In particular, the FKI (the lobbyist arm of the Korean Chaebol) openly demanded that the state must retreat to a minimalist role by limiting itself to the role of supervisor or referee of market institutions and supplier of infrastructure. On the other front of civil society, labor and the middle class, which gained organizational strength¹ under a liberal political climate, demanded “economic democracy.” Under rampant strikes in the work place and watershed demonstrations in the main streets of cities, the Korean state was compelled to abolish the old institutional

¹ During the early phase of democratic transition, union density increased from 15.5% in 1986 to 23.3% in 1989, adding 5208 new unions and 0.9 million workers in new membership.

shell which gave the Chaebol great advantages. For instance, the “Composite Financial Income Taxation,” “Real Name Financial Transaction System,” and “Real Name Real Estate Transaction System” was a response by the popularly-elected president to appease the voters, who raised these issues. Thus, empowerment of civil society, following political opening, drove the state toward market deepening in two different ways. The business community, dominated by the Chaebol, pushed through “deregulation” from state, whereas labor and the middle class put political pressure on the Korean state to “regulate” the Chaebol with new institutional provisions and corporate restructuring. Thus, the Korean state’s market deepening program was characterized by the juggling of policy emphases between what two different social groups demanded. The democratic regime swung back and forth, like a pendulum, siding itself with the interests of the Chaebol or the labor-middle class, according to the political climate. When the grass-roots movement peaked, as in the early phase of political opening or during an economic boom, or when a national election came around, the political regime shifted gears toward economic justice and distribution and regulatory policy over the Chaebol. Whenever the economy plunged or the grass-roots movement was in disarray, the political regime caved in to the demands of the Chaebol for a “growth-first policy,” abandoning the regulatory and supervisory role of the state over Chaebol.

In short, the market deepening programs were primarily driven by the internal and external forces discussed above. Globalization and democratization were the external forces propelling the political regime toward market deepening, while the increasing malfunction of the interventionist state was the internal dynamic pushing toward market-oriented reform.

However, the democratic regime faced a daunting predicament from the very beginning of the market deepening program, mainly due to the fact that the Korean state, which once wielded unbounded power over civil society, became much more limited in its power over the Chaebol, the primary target of the market deepening program. Previous studies (e.g.: Haggard & Kaufman, 1995) tended to portray the dual transformations in Korea as a seamless model of transition. Spotlighting “Chaebol reform,” this study discloses the turbulent path of economic transformation under Roh Tae-woo (1988-1992) and Kim Young-sam (1993-1997). From the mid-1980s on,² the Korean government pursued “market deepening programs” through a comprehensive redesign of institutions. The Korean state attempted to institutionalize a robust market system, so that all contestants in the game were subject to the same impersonal rules, which ensure that winning and losing depend purely on competitive prowess. The market deepening program involved three broad areas: First, the democratic government attempted to set the institutional foundations through the introduction of the “Real Name Financial Transaction System (RNFTS)³,” the “Real Name Real Estate Transaction System

² The regulatory and reform policies over the Chaebol began with the introduction of the Fair Trade Act enacted in 1980 under Chun Doo-hwan. But, as reflected by the lack of any subsequent revision of the Act during Chun’s reign (1980-1987), Chaebol reform was not the central policy focus until 1987, when the Fair Trade Act was overhauled entirely. From 1987 on, the Korean state’s primary concern was how to transform the Chaebol system to be subject to market rules and, in turn, to be competitive in a rapidly changing global market.

³ The introduction of RNFTS was advocated by the democratic government for the following reasons: 1) The supervisory agency would be better able to monitor and discipline for improper financial transactions under the RNFTS than the pseudo-name system, and, by doing so, the government could improve the transparency and open rules of the financial market, eventually leading to fair competition among financial traders; 2) The RNFTS would also set the institutional foundations for further liberalization of interest rates and the financial market through the enhancement of market rules; 3) The

(RNRETS),” the “Act for the Concept of the Land as Public Goods (ACLPG)⁴,” and the “Composite Financial Income Taxation (CFIT).” In particular, the Real Name Financial Transaction System was considered an indispensable step for further liberalization of the financial market. The conduct of capital transactions under pseudo-names tended to

RNFTS would enhance the fairness of the tax system. The government would become better able to detect financial property and income which was not disclosed under the pseudo-name system. It would become easier for the tax bureau to track the sources for taxes which were highly evasive under the pseudo-name system, such as value-added, income, inheritance, and gifts. In particular, if the RNFTS was institutionalized with CFIT at the same time, the efficiency of government tax collection would be dramatically improved; 4) The RNFTS would reduce corruption. In particular, it would curtail the flow of political slush funds among business and politicians by attaching name-tags to political donations; 5) The RNFTS would curtail or dismantle the dual financial market system which was divided into “curb market” and “formal market.” The proportion of the “underground economy” relative to GNP was estimated at 20-30% in Korea (1987), 8.4-12.9% in the United States (1976-1981), 11.3-12.2% in Japan (1976-1980), and 20.9-24.9% in Taiwan (Refer to MOEF, *The Task and Accomplishments of the “Real Name Financial Transaction System,”* 1996:103-117).

⁴ In South Korea, whose population density is among the highest in the world, the demand for land and other real estate exceeded the supply. As a consequence, the annual growth rate of land prices was extremely high throughout the 1970s and 1980s (Refer to Table A.2). Riding on land price hikes, landowners raked in windfall profits, for instance, amounting about 69 trillion won just in 1988. The lion’s share of that windfall flew into the pockets of a tiny number of the wealthiest people, due to the high land ownership concentration. According to the report by the “committee on the concept of the land as public goods,” only 28.1% of Seoul residents owned a piece of land. The top 5% of the wealthiest people nationwide owned 65.2% of the total private land, as of February 1989 (Dong-Ah Yearbook, 1990:109). The overheated real estate market created the following problems: 1) Business, in particular, the Chaebol, became highly inclined toward speculative investments in land, neglecting equipment investments in the manufacturing sector; 2) The hyper real estate market also tended to widen the income gap between the haves and have-nots; 3) As a result, popular discontent rose, resulting in further political instability during democratic transition. In order to deal with these problems, the government attempted to institutionalize RNRETS (this system was introduced in July 1995) and ACLPG (in October 1989). Under these systems, land could not be utilized as a means to inflate an individual’s property. The government was given legitimate authority to regulate the property rights of individual citizens concerning land. The authority involved restricting land possession, land transactions, taxation on windfall profit from land price hikes, and constraining business from speculative investment in land and real estate.

foment speculative investment, corruption, tax evasion, and illegal inheritance of wealth (MOEF, 1996). In addition, the breakdown of the “dual” market system (which consisted of the “underground economy” and “formal economy”) was a critical step towards incorporating all economic activities into one single market, thereby putting all economic actors under a competitive market force. However, the Chaebols, who were by far the largest beneficiaries of the existing system, appeared to be the major target of the structural reform program. There was increasing popular pressure on the Roh and Kim regimes for the government to prevent ‘the propertied class’ from snowballing their capital with speculative investments in real estate under the pseudo-name financial transaction system. In particular, popular discontent with the Chaebol rose to the level where the incumbent president was compelled to act upon structural reform, especially when land and apartment prices mounted to unbearable levels for the grass-roots in 1988-1990. In short, the rising call of the populace for reform was the primary driving force behind the market deepening program at the structural level. But when, to what extent, and how these institutional provisions would be introduced depended upon the dynamics of democratic politics.

The second critical feature of the market deepening program involved restructuring the Chaebol system. Chaebols, which once worked well as agents of developmental programs, turned into stumbling blocks in the way of the market deepening process. The Chaebol system, which was characterized by “high ownership concentration,” “corporate governance controlled by an single owner-chair,” and “overly diversified business lines,” had become unsuitable for the increasingly globalized market. Rather, the Chaebol transformed into bullies to venture firms and small/medium-sized

firms, wielding their monopolistic market status in Korea. Illegal, unfair transactions and financial subsidies among Chaebol-affiliated firms virtually crippled the market rules of fair competition among domestic enterprises, so that it became almost impossible for the venture firms and small/medium-sized firms to be competitive. Additionally, the entangled financial transactions among Chaebol-affiliated firms prevented ailing affiliates from exiting from the market, draining money-surplus flagship firms. In turn, the Chaebol flagship firms lost their edge against their global competitors. Therefore, making the Chaebol subject to fair, transparent, and rational rules of the market became an imperative task to be carried out in a timely manner. Figure 4.1 (drawn by the Fair Trade Commission (FTC) in 1994) illustrates how the democratic government perceived the Chaebol system as the cause of economic inefficiency and a market-harming entity. Restructuring the Chaebol system involved not only intensifying the state's supervisory and regulatory role over the Chaebol but also expanding the state's capacity to oversee the financial market. But the democratic government's endeavor to improve its supervisory role often encountered the adversarial wave of 'neoliberalism' and the stubborn resistance of the Chaebol.

The last locus of market deepening reform concerned "deregulation" of the intrusive state. The state-led economy, which was loaded with various business licensing, trade and financial market regulations, had to remove its interventionist hands to adopt a new brand of economy, that is, a market economy. More specifically, "deregulation" included the simplification or abolishment of an overly bureaucratic licensing system, liberalization for the private transaction of foreign exchange, and the opening of domestic marketing channels to foreign investors. But, in the pursuit of deregulation and structural

reform, the Roh (1988-1992) and Kim (1993-1997) governments encountered the dilemma that “economic liberalization without strings” leads to a distorted market under which the Chaebol are disproportionately favored, leaving the country as a whole less well off than it would have been otherwise. In other words, “deregulation” had to proceed alongside reinforcement of the state’s supervisory role, even though that sounded contradictory. In particular, the very fact that the Chaebol dominated the Korean market certainly complicated the path of the market deepening program. For example, the holdup in the liberalization of financial markets, of which the core reform agenda was outright privatization, was rooted in the very fact that the outright privatization of commercial banks would have ended up with them in the hands of the Chaebol. In turn, the Chaebol, owing to their ownership structure, were likely to turn banks into private cash boxes. In short, the main target of market deepening programs was inevitably aimed at Chaebol reform.

Successful Chaebol reform depended upon the extent to which the Korean state was able to remain autonomous from the particular interests of powerful social groups and how speedily the state installed the institutional provisions for market disciplining over major economic actors. As manifested as the economic crisis at the end of 1997, the market deepening program, whose core agenda was corporate (Chaebol) restructuring, ended up in failure. The brief explanation for the failure is that the Korean state had fallen under the influential power of the Chaebol and became inept in regulating, much less, restructuring the Chaebol system. But, explaining **how** it happened involves the exploration of a wide range of variables on both the state and Chaebol sides. Thus, this chapter will inquire into business-state interactions through a close look at the following

questions: 1) To what extent and how did democratization exhaust the institutional sources of the developmental state or help improve the institutional capacity of the Korean state? 2) Which factors allowed the Chaebol to exploit its capital control as an instrument of power over the policy-making process, as compared with the previous period during which the Chaebol's capital size did not become a valuable power source? 3) Which variables concerning the organizational characteristics of the Chaebol were responsible for the fact that the Korean state increasingly became a captive of the Chaebol? And 4) What are the origins of the "policy inconsistency" and "ideological juggling" which characterized this period (1988-1997), and to what extent is "ideological juggling" associated with the poor performance of the market deepening program?

DEMOCRATIZATION AND ITS EFFECTS ON THE BUSINESS-STATE NEXUS

This section concerns democratization and its effects on the institutional aspects of the business-state nexus. A large part of Chapter II was spent explaining the consequential effects of the democratic transition on the internal structure of the state, based on extensive data. Thus, this section will describe the critical features of the business-state nexus which were different from the previous period. Several significant traits appeared in the business-state nexus during the Roh and Kim regimes: 1) The state-business relationship swung back and forth between intimate collaboration and harsh friction, depending upon the democratic government's ideological emphasis between "economic growth" and "economic justice," and "neoliberalism" and "neo-institutionalism;" 2) Politicization of elite connectedness between state and business; 3) Escalating corruption and rent-seeking; and 4) As a consequence of the preceding traits,

the policy choices by the Korean state were increasingly swayed by the Chaebol.

Democratization called for a paradigm shift in the template of the dominant economic ideology. Prior to political liberalization, economic management had been dominated by developmentalist pragmatism (Jones and Sakong 1980), although the distributional issues evolved into an undeniable agenda item in the discourse of policy-making around the end of authoritarian rule. As Graph 2.1 shows, President Chun began to pay more attention to economic justice than his predecessor Park, but the issues of “economic growth” and “stability” received more than twice as much attention as “economic justice” from the chief-executive. In contrast with Chun, Roh split his policy attention equally between economic growth and justice, as did Kim (1993-1997). Although the chief-executives’ policy priorities toward “economic democracy” were not linearly associated with tighter regulatory policies over the Chaebol, it is obvious that the Chaebol came under harsh attack by the Korean state during periods in which the chief-executive placed his emphasis on “economic justice.” In summary, whenever the democratic regime stressed “economic justice” over “economic growth,” restructuring the Chaebol system became the policy priority of the state, rather than “promotional policies of Chaebol,” such as tax breaks and special subsidies for exports.

Another interesting observation was that both the Roh and Kim governments vacillated widely between “economic growth” and “economic justice,” creating confusion for both big business and the grass-roots (Graph 2.1). During economic downturn, the democratic regime sided itself with the Chaebol by carrying out growth-promoting policies. But during times when popular discontent with the Chaebol rose, the democratic regime showed a strong tendency to regulate the Chaebol. The following section will

explore in detail the dynamics of the politics behind the democratic regime's strategic shift between these two policy goals.

The consequential effects of "policy inconsistency" on the market deepening program were devastating. First, low policy credibility made it almost impossible for the democratic regime to entice the Chaebol into corporate restructuring programs. Responding to the state's fickle position, big business often made use of foot-dragging as their main strategy. No longer were the governmental programs trustworthy to the eyes of the Chaebol, crippling the government's ability to persuade big business to join the market deepening program through the use of threats or incentive packages. Second, policy disorientation disturbed the traditional long-term based investment practice of Korean business. Big business, which was risk-averse without the government's long-term policy commitment, turned to speculative investments, as it did during Roh's early rule (1988-1990), or halted its investments until the government discarded its anti-Chaebol policy, as in the case of the early Kim Young-sam administration (1993-1994). As Table 4.14 shows, the equipment investment ratio under Roh and Kim not only fluctuated wildly but also remained much lower than during the previous period. More importantly, overlapping and excessive investment in several industries marked this period, mainly owing to the lack of governmental guidance and leadership over the private sector. Third, "policy juggling" went along with the frequent reshuffling of the economic team (heads of EPB, MOF, MOCI, and chief economic advisor; Refer to Table 2.6) and the frequent reshuffling in turn led to big business' dominance in the business-state relationship, because the temporary occupants in the core economic agencies, that is, the economic technocrats, were unwilling to engage in perilous disputes with the long term

powerholders in the private sector. The short tenure made it almost impossible for the economic ministers to commit to the often protracted battle against the Chaebol regarding the market deepening program.

There was also confusion and disorientation over the market deepening programs on the part of the state, compared with the previous period. As mentioned earlier in this chapter, the market deepening program involved seemingly contradictory measures such as “deregulation” (liberalization of the financial and capital market, deregulation of market entry and the business licensing process, etc.), expanding the regulatory and supervisory role of the state over the financial market and Chaebol, and structural reform. However, the Chaebol, riding the worldwide high wave of “neoliberalism,” attempted to push through “outright deregulation” without administrative strings. Through the use of research institutes, including CFE and KERI (which were established by the FKI), Hyundai, Daewoo, and Samsung Economic Research Institutes, the Chaebol campaigned for the *laissez-faire* approach, fomenting the belief that the “Chaebol problem” could be resolved only through the “invisible hand” of the market (Hong Deuk-yul, 1997). That is, if the problem were thrown into the “invisible hands of the market,” the most effective market structure would eventually evolve in Korea. As a matter of fact, this kind of *laissez-faire* approach, advocated by the Chaebol, gradually took hold in the discourse of the economic elites. In particular, during the last years of Kim’s rule (1994-1997) when “globalization” became the predominant credo, the myth of the market prevailed over the inner circle of the policy-making regime (Lee Yeon-ho 1998).

On the other end of the business-state nexus, the democratic government oscillated between neoliberalism and neo-institutionalism for its political convenience. Korean

career bureaucrats, to a large extent, have traditionally followed ideological pragmatism to get things done. Thus, their attitude toward Chaebol reform appeared to be a mixture of various schools of thought. But participatory politics forced presidents to select an economic team whose economic ideology fit the political climate across different time periods. In particular, selecting economists from academic circles added an ideological dimension to economic management, while appointing career politicians inevitably led to the politicization of policy-making during democratic rule (For economic elite assignment during this period, refer to Table 2.5). On the other hand, unlike during authoritarian rule, each economic agency showed a divergent policy proclivity, depending upon the economic agenda to be dealt with or upon each agency's constituents. For instance, regarding the core business line policy, MOCI insisted that each Chaebol must single out its main business line to improve its competitiveness in the global market. But MOEF, KDI and FTC were convinced that improving industrial competitiveness must be carried out by the "invisible hand of the market." Accordingly, Samsung's entry into the already overcrowded automobile industry should not be barred by administrative regulations but by the market. Another example involved the issue of the "Real Name Financial Transaction System (RNFTS)." The FTC urged the institutional introduction of an immediate and comprehensive RNFTS early on, whereas MOCI opposed the early introduction of an RNFTS.

In summary, there was turmoil in the government in the context of economic ideas and practices. On the other hand, the Chaebol continued to insist on deregulation. The continual ideological bickering in the business-state relationship eventually resulted in victory for the Chaebol during the last years of Kim's rule (1994-1997). This meant that

deregulation, in particular in the financial and capital markets, proceeded deeply without the strengthening of the regulatory and supervisory role of the state over the Chaebol.

The chief-executives whose primary concern was electoral survival, were compelled to compensate their loyal electorates with more elite assignments into the core power apparatus in return for electing them into the presidential office. This study examined the elite structure of business and state. In the big business elite circle, Youngnam elites (Presidents Park, Chun, Roh and Kim Young-sam came from this region) occupied about 35-40% of the top managerial positions across different regimes and there were no meaningful changes across different political regimes. In the state elite circle, a close look at the core economic bureaus of economic ministries, financial institutions, and financial supervisory agencies revealed that, in the first place, the ratio of the incumbent president's proteges (elites whose birthplaces were identical to the incumbent president's) sharply increased in the core economic bureaus⁵ under Roh's and Kim Young-sam's reigns. Over 50% of directors in core bureaus came from Youngnam Province during the Roh regime (1988-92) and over 65% during the Kim regime (1993-97) (*Hankyeorae 21 Century*, 9/28/1995; *Monthly Chosun*, May 1993; *Weekly MaeKyong*, 1/18/1995; *Monthly Joongang*, February 1990). Second, concerning financial institutions, this study examined the birthplaces of the top managers of six major commercial banks and five state-owned banks. The government-run banks did not show a significant increase in the percentage of the incumbent president's proteges during

⁵ The core economic bureaus can be listed as follows: 1) Directors of "Budgeting," "Financial Policy," and "Taxation Bureaus" in EPB; 2) Director of "Financial Management Bureau" in MOF; 3) Director of "Commerce Bureau" in MOCI.

comparable periods. (Over 30% of the cases during the Park regime were missing, so those periods were excluded.) At any rate, the ratio of Youngnam elites fluctuated between 28.2% under the Chun regime and 31.7% under the Kim Young-sam regime (Refer to Table 4.10). Regarding the six major commercial banks, there was a steady increase in the ratio of Youngnam bankers from Chun's reign to Roh's and Kim's reign. As Table 4.11 demonstrates, the ratio of Youngnam bankers rose from 22.3% during Chun's reign to 27.6% during Kim's reign. Under Kim Dae-jung, whose birthplace was Honam Province, the ratio of Youngnam elites dropped to 24.2 percent. Third, in the context of financial supervisory institutions (Bank of Korea, Banking Supervisory Authority, Insurance Supervisory Board, Security Supervisory Board, Monetary Policy Committee), there was a sharp increase in the ratio of Youngnam elites across different regimes. Only 33.9% of elites were from Youngnam Province between 1961 and 1973, but this ratio rose to 37.1% between 1974 and 1979, 52.5% between 1980 and 1987, 54.6% between 1988 and 1992, and 61.4% between 1993 and 1997. This ratio plummeted to a mere 27.3% under Kim Dae-jung (1998-present). It can readily be assumed that the sharp rise in the incumbent president's proteges in financial supervisory institutions, along with personal interlocking among Youngnam elites across private and public sectors, led to a high potential for collusion.

The effects of the increasing number of the incumbent president's proteges in the core bureaus of economic agencies, major commercial banks and financial supervisory institutions included the following : 1) It undermined the bureaucratic cohesiveness among middle-level managers. Politicization of mid-level managers had an inimical effect on the collective goals of career bureaucrats. The collective goal of improving the

national wealth was slowly but steadily dissipated as career civil servants became preoccupied with individual or group interests. Thus, the rivalry of cabinet ministries often turned into a stumbling block to reform programs, as shown in the issue of “Independence of the Central Bank” (Refer to “financial reform” in Chapter V). 2) Being aware that under factionist politics political connections were more crucial to their career advancement than was their technical competency, economic technocrats began to make decisions based heavily on political considerations. 3) With the close connectedness of business and the state, which was filled with Youngnam elites, the potential for rent-seeking collusion sharply increased, considering that personal connections weighed more than institutional rules in human interactions in South Korea. 4) In particular, the filling of core financial institutions and financial supervisory agencies with the incumbent presidents’ proteges made it impossible for bankers to detect whether or not a business diverted bank loans from profit-seeking projects to non-profit-seeking investments, for example, real estate speculation. This change in the economic elite structure is strongly associated with the following feature of the business-state nexus under the democratic regime: “corruption.”

Graft was practiced not only during the post-developmental state, but throughout the developmental era. Most previous studies (e.g, Kim Young-rae 1997) emphasized that the close business-state linkage could not have avoided rampant corruption. Preferential credit allocation and business licensing were traded for political funds by the chief-executive. In contrast with the old notion that all political regimes were equally involved in graft, a recent study by Dave Kang (1999) presents quite a different picture. The hierarchical organization of the business-state relationship during the developmental

era kept corruption from boiling out of control, but once the power balance between business and state tilted in favor of the Chaebol, rampant rent-seeking evolved. Determining the pattern and level of corruption is critical to understanding changes in the business-state nexus.

There have been distinct patterns in the collection and distribution of political funds across political regimes. In the 1960s, political funds from business groups were mobilized via three different conduits, that is, the Presidential office, the KCIA (Korean Central Intelligence Agency), and power elites of the ruling party. Businesses were obliged to kick back a certain percentage of bank credit and foreign loans as political donations during this period. But in the early 1970s and under the Yushin regime (1972-1979), Park monopolized the paths of political funds exclusively under his own hand, so that the middlemen (party elites and powerholders within the ruling circle) were eliminated. Businesses did not have to pay bribes in return for access to the president. Big businesses offered large political donations to the chief-executive twice or three times per year, like a quasi-tax, but were not compensated directly for their monetary offerings. Rather they were paid off by Park's preferential economic management toward big business in general from the early 1970s on. The so-called "ruling fund" (*tongchijakum*) of the chief-executive was a critical source of operating expenses for the ruling party and career politicians (Park Jong-yul 1989:289; Han Seung-jo 1991:87; Woo Jong-chang 1995:43-46; Dave Kang 1999:31). On the other hand, graft by politicians was tightly controlled across parties.

Chun Doo-hwan (1980-1987) followed his predecessor's practice of political fund raising by collecting huge sums of quasi-taxes from big businesses. The amount offered by

big businesses was determined by the size of the conglomerates without an exchange of favoritism for individual donors,⁶ although the likelihood that businesses and the state exchanged benefits with each other cannot be dismissed. The operating expenditures of the ruling party and campaign funds for congressional candidates, by and large, came from the pocket of President Chun (Cho Shinjae, 1992:126-127; *Monthly Chosun*, March 1996).

The political consequences of the monopolization of political funds under the chief-executive were as follows: First, Park and Chun were largely successful in protecting career politicians from the influence of big business and, more importantly, in shielding economic technocrats from the rent-seeking of big businesses, although not completely successful (Han Seung-jo, 1991). Second, with the monopolistic use of political funds, the chief-executive was able to place career politicians under tight control and maintain executive dominance over the legislature. Third, big businesses did not have to seek out individual politicians and agents for its business lobbying, but instead made deals with the chief-executive. But the deals were carried out in the context of the president's super-dominance over the Chaebol, so that graft did not inflict damage on the state's ability to "pick winners" in business licensing and the credit allocation process.

But under the Roh administration (1988-1992), the pattern of political fund

⁶ During the first half of Chun's reign (1980-1984), there was little collusive trade between power elites and big businesses in the context of credit allocation and business licensing. But from 1985 on, the Chun regime began to deviate from the track of constructive collaboration into the politicization of licensing and credit allocation under mounting political pressure. By the end of his regime, the business-state nexus had largely turned into a conduit to be used for big business' rent-seeking. In particular, Chun mobilized a huge sum of political funds to support his hand-picked presidential candidate, Roh Tae-woo, during his last year (*Monthly Chosun*, March 1992).

mobilization and distribution diverged from that of his predecessors. The role of the Blue House (presidential residence) in the collection and distribution of political funds diminished (although Roh collected a huge sum of slush funds from big business), so that individual career politicians began to approach business circles to solicit campaign funds (Han Seung-jo 1991:87; Kim Sung-woo 1991). In addition, democratization returned various aspects of constitutional authority to the legislature, so that big businesses could hardly avoid lobbying individual representatives who were involved in the economic policy-making process. For instance, the revival of the congress' authority to audit the executive branch and national affairs provided career politicians with ample opportunity to accept bribes (*Newspeople*, 10/24/1996). The new practices in political fund raising escalated the already rising lobbyist power of big business and, as a result, the economic policy-making process increasingly came under the influence of big business. The second characteristic of political funds under Roh was that public projects and privatization of state-owned enterprises were increasingly traded in compensation for large donations from big businesses. Under Kim Young-sam (1993-1997), who, right after his inauguration, promised not to collect any political money from big businesses, the political leverage of big businesses continued to rise, owing to the new rent-seeking patterns in which more rank-and-file bureaucrats and career politicians were involved.

Along with changes in the patterns of political fund mobilization and distribution, the amount of political funds has been on the rise throughout the late 1980s and 1990s. There is no empirical data available to gauge the amount of political funds collected over

time, but the mounting slush funds (the so-called *Beejakum*⁷) of firms after democratization reflect some aspect of deepening political corruption. This study tried to approximate the size of the slush funds by looking into the entertainment expenses (*Jeopdaebee*) of enterprises, which constituted the lion's share of *Beejakum*. As shown in Table 4.13, the absolute size of slush funds (entertainment expenses) soared, inflating from 418.7 billion won in 1987 to 1.3669 trillion won in 1994, although the ratio of the slush funds relative to total sales has remained steady. But considering that the ratio of slush funds relative to total sales would be likely to decrease as total sales increased, the steadiness of the ratio of slush funds means that Korean firms have intensified their lobbying during this period. The data on all corporate bodies between 1995 and 1997 convincingly show that the slush funds of Korean firms in both absolute and relative terms have been rising during this period. By 1997 when Korea slid into the IMF bailout program, the slush funds amounted to 3.5 trillion won (3.9 billion dollars), or 0.31% of total income for the average body corporate. The increasing slush funds reflect the fact that firms have become more extensively engaged in lobbying career politicians and thus rent-seeking has grown into a regular pattern in the policy-making process.⁸

⁷ *Beejakum*, most of which is used to lobby politicians and governmental officials by the head of a conglomerate, is mobilized through the use of various sources, including budgeted entertainment expenses, speculative investments, stock market manipulation, phony financial statements, tax evasion and so forth. Among these various sources, reception expenses constituted a large part of the slush funds (Park Dae-ho, 1991).

⁸ Table 2.24 shows that in 1991, Korea was ranked as the 27th least corrupt country among the 47 most industrialized countries. As compared with its competitors, Singapore and Taiwan, Korea is reported as a much more corrupt country by the IMD. However, this survey data had a short time horizon and did not demonstrate the trend of deepening corruption over a long period. The interesting fact is that in the year 1997, when the Korean economy plunged into the currency crisis, the corruption index was the worst.

Another critical change in the pattern of corruption is that the government began to directly swap credit allocation and business licensing for monetary bribes. For instance, the Hanbo Group made a huge presidential campaign donation in exchange for preferential credit, just before going bankrupt⁹ (*Hankyeorae* 1/21/1999; *Joongang Daily* 2/4/1999). Kia and Dongah groups¹⁰ were also accused of receiving preferential credit under the Kim Young-sam administration in return for huge donations to the presidential campaign. In addition, the two most significant areas of business licensing, that is, new auto-makers and mobile phone service providers, were selected based on political considerations. Licensing Samsung Motor in an already overly crowded automobile industry was a classic case in which business licensing turned into a political source to promote the regime's political interests. President Kim Young-sam's son, Hyun-chul, was also accused of peddling influence when the government selected mobile phone service providers in 1996 (*Joongang Daily* 1/23/1999; *Korea Herald* 2/5/1999). It goes without saying that the rampant corruption twisted the track of the "market deepening program" during this period.

⁹ The former chairman of the Hanbo Group, Chung Tai-soo, recklessly spread around his slush funds and received preferential credit during Roh's reign. He had amassed more than 700 billion won in slush funds under the Kim Young-sam government. Chung admitted to funding Kim Young-sam's presidential election campaign in 1992 (*Korea Herald* 2/4/1999). The Korea Development Bank poured 23 million dollars into the Hanbo group in February 1993, 48 million dollars in June 1993, and 48 million dollars in September 1993, even though Hanbo was already teetering due to its extremely high debt/equity ratio (*Joongang Daily* 2/5/1999). Hanbo went insolvent in early 1997 before the currency crisis.

¹⁰ Dongah Construction Group, which was staggering financially, was given 1.1 trillion won in bank credit under a workout program after Kim Young-sam was sworn into presidential office in 1993. But the Dongah group, which amassed a high debt/equity ratio during Kim's reign, went bankrupt before the foreign currency crisis in 1997 (*Newsmaker* 9/7/1998).

Under the Roh Tae-woo and Kim Young-sam governments (1988-1997), the business-state nexus derailed from the track of goal-oriented collaboration and the state increasingly became a captive of the Chaebol. The transformation in the business-state nexus had its origin in changes in the internal structure of the state rather than in an economic power shift. As shown in Table 3.1-b, between the two periods, 1980-1987 and 1988-1997, there was relatively little change in the “economic quality” of the business-state nexus. In particular, the share of the Chaebol in the national economy (economic power of big business) remained unchanged (refer to Graph 3.6). “Structural dependency theorists,” such as Kim Eun-mee (1997), contend that the structural transformation in the business-state nexus stems from the rising economic strength of big business. According to these left-leaning scholars, the state’s structural dependency on capital inevitably led to the political scheme in which the state became captured by capital. But as shown in Graph 3.6, the economic power of big business reached an apex by the early 1980s and remained almost unchanged throughout the 1980s and 90s, but the nexus was perverted into a collusive form in the early 1990s. Accordingly, the degeneration of the nexus to a collusion during this period must be attributed to the following changes in the internal structure of the state: 1) the rising rivalry among economic agencies; 2) dislocation of the policy-making regime; 3) disarray of the bureaucratic system; 4) decentralization of the economic policy-making process; and 5) politicization of economic agencies (Refer to Chapter II).

Democratization changed the dynamics of politics and subsequently the internal structure of the developmental state. Electoral politics altered the chief-executives’ primary concerns and policy priorities (Refer to Graphs 2.1 and 2.2), owing to their

changing survival strategies. Facing more open contests for political power through electoral support, the chief-executives put aside the traditional cause of economic development, and focused on electoral politics and day-to-day political quarrels. Getting elected to a public post and serving as an elected official in Korea required a large amount of cash. Politicians were tempted to seek support from big business to finance their election campaigns and offices, corporations being the only financial source available. Corporations, in return, got valuable help from politicians in landing government projects and securing bank loans. Big business, which was the primary source of political funds, was able to increase its political leverage over policy makers. Presidents who got elected with corporate financial support could hardly be expected to be autonomous from the collective and particular interests of big business in the course of policy making.

THE OVERALL STRATEGIC INTERACTIONS OF BUSINESS-STATE OVER MARKET DEEPENING

This section is designed to demonstrate that the state incrementally became captured by the Chaebol during 1988-1997. As shown in subsequent detailed interactions of business and the state, convincing evidence exists that the state's structural dependency on capital restricted the policy choices of the Roh and Kim administrations. This section will describe the path of interactions among state and business in the context of the macroeconomic environment during the period of democratic transition and thereby explore why the Korean state failed to carry out a market deepening program including Chaebol reform. The period of 1987-1997 can be divided into three distinctive business cycles, the first period being between early 1987 and early 1989, the second period

between late 1989 and 1992, and the third, 1993-1997.

(1) First Period: 1987-1989

Roh Tae-woo, who was sworn into presidential office through the first popular election in 15 years, sought to undertake political and economic reform during the first business cycle. Reflecting the intensity of the democratic movement and widespread collective action, Roh spent most of his inaugural speech stressing economic justice and distribution, economic stability rather than growth, democratic values, and reunification (Refer to Graphs 2.1 and 2.2). The main features of Roh's economic reform program included four main sections: 1) the introduction of a wide range of social welfare programs¹¹ (e.g, building two million houses); 2) the introduction of anti-Chaebol measures; 3) market liberalization;¹² and 4) deregulation.

The first two measures were driven by Roh's attempt to quiet the outburst of pent-up discontent during the democratic transition. The latter two were prompted by the private sector's demands and the internal logic of economic development. As for the anti-Chaebol measures, which are the central focus of this study, Roh's government put limits on bank loans to large business groups (March 1988). Other programs, such as "counter-

¹¹ The welfare programs introduced by Roh in his early reign can be listed as follows: 1) building two million houses to supply the middle class with lower priced housing; 2) universal health insurance coverage; 3) introduction of a national pension system; and 4) introduction of the minimum wage act.

¹² The policy measures taken by the Roh government concerning market liberalization were the liberalization measure for the private transaction of foreign exchange (March 1988), step wise promotion measures for the internationalization of the capital market (December 1988), exchange rate determination at the market-average rate system, and improvement of the system of foreign-exchange concentration under the central bank's control (March 1990).

measures on real-estate speculation” (August 1988) and the “Act for the Concept of Land as Public Goods (ACLPG),” (October 1989) resulted in relative success. On the other hand, the Roh government attempted to introduce the Real Name Financial Transaction System (RNFTS), but failed.

It is quite interesting to look into why these two critical reform programs, ACLPG and RNFTS, ended up with such divergent results. Early on, the Roh government organized special committees for the introduction of the ACLPG and RNFTS (composed of career bureaucrats, economists, and other specialists), responding to popular demand for economic justice and fairness during democratic transition. The ACLPG system was more directly associated with the middle class’ concerns, due to the skyrocketing price of real estate. For instance, the annual growth rate of land prices was 13.9% in 1987, 29.8% in 1988, and 30.5% in 1989 (refer to Table A.2 in the appendix). These soaring land prices fueled the on-going eruption of pent-up discontent in the midst of democratic transition. The special committee for the ACLPG system reported to the public that those enterprises whose investments were concentrated solely in real estate during 1974-1987, increased their assets by 10 fold, while enterprises which concentrated entirely in equipment investment increased only 3.3 fold during the same period. The report said that the top five percent of the wealthiest people owned 65.2% of total private land. It goes without saying that the report of the special committee further fed popular anger against the Chaebol and the political regime. President Roh, who became aware that his regime survival could be in jeopardy if he failed to pacify the middle class’ discontent, took action against land speculation. In December 1989, the ACLPG system was institutionalized by the National Assembly with the introduction of the Act of Ownership Restriction on Land,

the Legislation of Taxation on Land Profit, and the Legislation of Taxation on Excessive Land Ownership (Lee Chang-kyu, 1995: 195-206). Even the Chaebol's vehement challenge could not stop the Roh regime from moving forward with the ACLPG legislation, because the dynamics of regime survival politics curtailed the influential power of the Chaebol on the issue. For instance, the ruling party (LDP), which lobbied against the ACLPG in the early phase of debate, reversed its position once the members realized that continual opposition to the ACLPG would lead to a serious political blow through the loss of popular support. In the end, the chief executive followed through on his original plan to institutionalize the ACLPG.

However, regarding the RNFTS, the political dynamics evolved differently from the case of the ACLPG. Cho Sun (head of EPB) and his economic cabinet members (Mun Hee-kap and Lee Kyu-seung), who took over the core economic agencies in December 1988, pointed to the RNFTS as an indispensable institution for "financial market liberalization" and "economic democratization." In particular, Mun Hee-kap, as principal economic advisor for President Roh, was determined to lead the institutionalization of the RNFTS by the establishment of the Special Unit for RNFTS (Lee Chang-kyu, 134-140). In addition, the Special Deliberation Committee for Financial Market Development, which was composed of economists, career technocrats, and specialists, strongly recommended that the government proceed with the RNFTS, because the RNFTS was seen as the institutional foundation for the liberalization of interest rates and the financial market (Refer to the earlier discussion to understand why the RNFTS was indispensable for financial market liberalization).

But the issue of the RNFTS did not receive political attention from the middle

class, due to the fact that pseudo-name transactions did not **directly** damage their standard of living, although the middle class and grass-roots were at a structural disadvantage under the existing system. Therefore, the debate over the RNFTS issue was limited to the circle of elites, not giving the populace much opportunity to get involved. On the other hand, the Chaebol quickly defied the government's bid to institutionalize the RNFTS, being afraid of the effects of the RNFTS, such as disclosing covert financial transactions among business and politicians, higher taxation on their financial income, and higher inheritance and gift taxation. The Chaebol singlehandedly persuaded career politicians, who were conscious of the effects of the RNFTS on political slush funds, to block the RNFTS legislation. Finally Roh, who did not have much political incentive to push the RNFTS against the challenge of the Chaebol and the propertied class in general, abandoned the reform cause. Subsequently, Roh replaced the neo-institutionalist-dominant economic cabinet with a growth-oriented one, who were backed by the Chaebol. On April 4, 1990, the new head of the EPB announced that the government no longer pursued the institutionalization of the RNFTS.

These two cases demonstrate that if the dynamics of popular politics allowed the democratic regime to stay on the right track, the reform program was pushed through successfully despite the opposition of the Chaebol. But when there was no political incentive for the democratic regime to press the reform agenda, the reforms usually fell prey to big business. The defeat of the RNFTS under Roh's rule epitomizes the way the policy-making regime was swayed by political calculation rather than economic rationality. Roh's early rule was characterized by the fact that surging popular movement counterbalanced the influential power of the Chaebol in the economic policy-making

process. State managers were forced to incorporate popular demands into their policy making.

During the early phase of democratic transition, the economy recorded a remarkable performance for three consecutive years, starting in 1986, even in the midst of high political uncertainty, thanks not only to price stability following the structural adjustment policies implemented in the early 1980s, but also to the favorable world economic environment characterized by the so-called “three lows,” namely, low oil prices, low international interest rates and the low value of the U.S. dollar in terms of the Japanese yen. Real GDP increased at a rate of around 11.5% per annum. The current account of the balance of payments, long saddled with a chronic deficit, moved into a surplus in 1986 and stayed positive until 1990 (Refer to the first column in Table 4.14). Aided by this outstanding economic performance, business, especially large-sized firms, allowed a steep wage increase in the face of rampant wildcat strikes, while the state relinquished the use of coercive force in industrial relations. Between 1987 and 1989, annual real wages increased at a rate of around 9.7%, whereas the annual nominal wage increase surpassed the productivity growth rate for the first time ever.

(2) Second Period: 1989-1992

In 1989, economic growth slowed abruptly. Exports turned sluggish owing to wage hikes and external factors, such as the disappearance of the favorable “three lows,” and the rapid catch-up growth of other Asian late-starters, such as China. It appeared that the government had few alternatives but to rehabilitate the Chaebol as trade performance deteriorated. The Roh government found it needed the Chaebol to pull the country out of

economic lethargy. In February 1990, Roh replaced his economic cabinet with a new brand (neoclassicals), with Lee Seung-yun (head of EPB), Kim Jong-in (chief presidential economic advisor) and Jeong Young-yi (head of MOF), who stressed economic growth vis-a-vis stability. The new economic team declared that the government would not restrain Chaebol growth but would try to promote small and medium-sized industries so that the imbalance could be redressed. The more conservative economic team reversed the policy emphasis from “economic stability” to “economic growth,” discarded the plan to adopt the “real name financial transaction system” and revised the act for the concept of land as public goods (April 3rd measures for economic recovery). The major reasons for discarding anti-Chaebol measures were the economic slowdown and Korea’s dependence on the export prowess of the Chaebol (Robert E. Bedeski 1994:87; Park Hyung-Shin 1995:152-158; Im Hyun-Jin 1993:373, 390).

The governmental backpedaling showed that the Korean state’s policy choices were constrained by the Chaebol’s control over investments. But it must also be kept in mind that the state’s structural dependency on capital (capital mobility) became salient only when the coherent corporation within the policy-making regime crumbled under democratic rule. The dislocation of the bureaucratic system, rising cabinet ministerial rivalry, and the frequent reshuffling of the economic cabinet under Roh Tae-woo allowed the Chaebol to wield their investment decisions as political leverage against the state. Lee Chang-kyu (1996) and others gave detailed accounts of frequent bickering among the cabinet ministries over the reform agenda. In comparing the influence of the Chaebol over policy-making between the Chun and Roh regimes, we see that the Chaebol during Chun’s rule (1980-1987), although already having obtained a level of economic prowess equal to

that of the Roh period (1988-1992), were rarely successful in changing the policy path set by the government. In short, the capital prowess of the Chaebol operated only in the context of institutional settings which are an integral part of the business-state nexus.

The Roh government, which remanufactured a broad political coalition by merging with two other conservative parties in 1989 ("Grand Conservative Coalition"), reasserted itself as the manager of industrial relations at the request of business and revived wage guidelines, which had been deserted during the early phase of the transition. The government issued some beneficiary measures for the Chaebol to boost the depressed economy. Roh brought labor back under control and restrained the skyrocketing wages following the rampant strikes. These measures aimed at the recovery of international competitiveness for Korean firms by cutting down factor costs. The government began to crack down on militant trade unions, which were mostly members of the Korean Trade Union Congress (KTUC). More than 270 unionists were imprisoned each year during this period, 1989-1992 (*The Report of Human Rights*, 1989-1990). Along with the governmental crackdown on labor activism, the attempt to adopt a more progressive labor law was discarded. These retrogressive measures were mostly attributable to its reliance on political coalitions with the Chaebol and the collusive relationship between state and business elites (Kim Dong-Choon 1995; Roh Joong-Kee 1995; Lim Young-il 1997).

From 1990 to 1992, the economy grew strongly again at a rate of above 9% per annum, stoked by brisk domestic demand. But this economic boom was supported by surplus capital which originated from excessive export success between 1986 and 1988 and was led by construction and non-manufacturing sectors, whereas exports were largely stagnant as demonstrated by the continual negative balance of payments (Refer to Table

4.14). In addition, another aspect of unhealthy economic growth was the fact that a large part of the surplus capital retained by the Chaebol flowed into speculative investments in the real estate market, bond market and tertiary industries under the high uncertainty of the international market. Confronted with the growing disequilibrium, inflation and mounting discontent with the speculative behavior of the Chaebol among the population, the Roh government announced various policy measures against the Chaebol, such as the presidential decree of May 8, 1990, forcing 49 Chaebols to sell their non-business-related real estate, and the reform of inheritance laws (December, 1990). In addition, the Fair Trade Commission (FTC) was enlarged and strengthened as an independent agency and reorganized as a ministerial-level commission in 1990 to intensify regulatory policies over Chaebols. Under the revised Fair Trade Act in 1990, the government included financial and insurance subsidiaries of Chaebol under the “prohibition on cross-unit investments” within Chaebol and introduced a surcharge to be imposed on affiliated firms which digressed from the prohibition on cross-unit investment. The FTC also began to more aggressively enforce sanctions against Chaebol who breached the fair trade practices.

The Chaebol did not use the large surpluses amassed during the “three lows” era (1986-1989) for facility investments or revamping their industrial structures, but instead spent most of their surpluses on real estate speculation. The Chaebol’s drive for speculative investments propelled the annual increase of land prices in major cities in 1989 and 1990. Responding to economic need and popular discontent against the Chaebol, the Roh government took the so-called 5.8 measure¹³ in which the Chaebol were forced to sell

¹³ The major content of the “5.8 measure” was that, first, the government upgraded standards for non-business real estate and the Chaebol were forced to sell off their real

off their non-business real estate. Roh's anti-Chaebol measures concerning real estate speculation were contradictory to other pro-Chaebol policies during this period. His anti-Chaebol moves stemmed from political considerations when the majority of the populace withdrew their political support for his regime. Thus, Roh was compelled to show that his regime was not just for the Chaebol. Roh himself closely supervised this policy process using his economic staff, instead of the economic ministries.

However, the Chaebol did not acquiesce to the directives of the government, but attempted to soften the government's stand on the criteria for non-business real estate by insinuating that stiffened measures against speculative investments would diminish the Chaebol's appetite for investment and, in turn, would eventually lead to an economic slump (Refer to FKI's policy recommendation, 6/8/1990). In response to the Chaebol's resistance, rather than yielding to their threats, the government escalated its pressure on the Chaebol with the warning that, if the Chaebol did not live up to the government's demands, the government would suspend its bank loans to the Chaebol and subsequently the National Taxation Office would launch investigations into tax evasions committed by the Chaebol. Yielding to the mounting pressure from the government, the Chaebol announced their intentions to sell off their non-business real estate in May 1990.

However, there was no clear winner in the financial outcome of interactions between business-state over the real estate speculation issue. The government eventually softened its stand, and in return, the Chaebol volunteered to sell those pieces of real estate which

estate. Second, the government prohibited Chaebol from purchasing non-business real estate from that point on. Third, Chaebol were no longer allowed to obtain bank loans using real estate as collateral. Fourth, Chaebol were not permitted to purchase in the names of high ranking executives (Shin Hee-keun 1993:82-83).

were large but not valuable. However, some Chaebol were quite determined not to relinquish their real estate even under government pressure simply because their continual holding of that real estate would benefit them financially over the long run, even considering the costs of not yielding to the government's pressure (Shin Hee-keun 1993:88-97). As a result of the government's efforts, land prices took a nose-dive starting in 1991, as shown in Appendix Table A.2. The Chaebol gave up about 10% of their land. This case illustrates one aspect of business-state interactions, that the Korean state could still manage its anti-Chaebol measures when the political dynamics kept the chief-executive on track with the reform program. In other words, as long as the chief-executive was determined to carry out the reform target, owing to popular pressure, and mobilize the institutional resources in a unified pattern, the Korean state was still capable of controlling the Chaebol at a relatively effective level. In contrast, anti-Chaebol measures in real estate speculation and other anti-Chaebol measures, such as the "prohibition of cross-debt guarantees" and "restrictions on inter-unit investments," were fruitless (business-state interactions will be described in detail in a later section). The newly revised (December 1990) inheritance and gift taxation system, which was introduced to reduce high ownership concentration, did not make much difference from the previous system either, basically owing to the government's weak resolution to implement it thoroughly.

The third round of business-state interactions began with Roh's appointment of a new economic cabinet (Choi Kak-kyu, Lee Young-man, and Kim Jong-in, February 1991-February 1993), who thought that economic recession stemmed from the lack of investment in social infrastructure, R&D, and automation of assembly lines. Thus, the

fourth economic cabinet under Roh Tae-woo manufactured incentive packages to induce the Chaebol to invest in major prospective industries. With the introduction of the “core business line policy,” the government asked the Chaebol to single out their core business lines and concentrate on those (Jo Seung-yul 1996:202-203). The seventh five-year economic plan (1992-1995), under the slogan of “new industrial policy,” aimed at resolution of the Chaebol’s fleet-like control structure. A prohibition of inter-unit investments and cross-debt guarantees was instituted as a means to dissolve the Chaebol’s control system which was maintainable via inter-company share holdings (for detailed interactions with regards to this issue, refer to section five of this chapter). Reacting to anti-Chaebol measures, the Chaebol challenged the state’s reform policies. Jung Ju-Young, who was then chair of the Hyundai group, declared himself a presidential candidate (October 1991) and formed the United People’s Party (February 1992) in his effort to grasp political hegemony. The FKI also began to speak against the state, saying that the failing economy was largely attributable to the interventionist policy of the government, not to the Chaebol (FKI 1991:224, 379-382). “A Policy Proposal to the New Government,” announced by the FKI in October 1992, suggested that the government should limit itself to minimalist functions, allow for the free activities of entrepreneurial forces to affect the Korean economy, and contribute to improving national competitiveness by enlarging its investment in infrastructure. It was the first time ever for the FKI to publicize its position in this way in its 31-year history (*Kukmin Daily*, 7/15/1992).

(3) Third Period : 1993-1994, 1995-1997

The third cycle of the economy (1993-1997) began with the inauguration of President Kim Young-sam in February 1993. On taking office, Kim implemented a short-term stimulation package termed the “Hundred-day Plan for the New Economy,” in line with the “Five-year Plan for the New Economy” (April 16, 1993). The initial “Five-year Plan for the New Economy” included not only a short-term stimulation package but also the first civilian government’s enthusiastic plan to guide the Chaebol reform and liberalization programs. According to this plan, the government constructed stricter regulations for the entrance of the Chaebol into the banking and media business, and took various measures to induce the Chaebol to specialize in main line businesses, to break up the overly concentrated ownership structure, and to limit cross debt guarantees among affiliated firms. Other reform agenda items were as follows: 1) tax reform; 2) the introduction of Real Name Financial Transaction System; and 3) Combined Financial Statements. To protest against Kim’s efforts to strengthen the regulations and under the clouded policy orientation, the Chaebol drastically reduced their equipment investment and, as a result, overall equipment investment contracted 1.1% in 1992, and 0.1% in 1993, from an average growth of 15.2% in the three previous years (1989-1991) (Refer to Table 4.14), leading to a brief economic sag in the first half of 1993. The Chaebol withheld investment decisions until it became clear what the new government intended to do with the Chaebol and industrial policy (*Choongang Daily*, 3/09/1993). Aware that nothing much could be done with the staggering economy without collaboration from the Chaebol, Kim invited individual owner-chairs to his residence one by one. At the end of these meetings, which took about two months, Kim viewed the Chaebol not as a reform target

but as a collaborator in his reform program (*Korea Kyungje Shinmun*, 10/25/1993). The Chaebol were convinced to go along with Kim's industrial plan. Policy uncertainty was cleared away and anti-Chaebol measures were modified. The Chaebol's new investment decisions were followed, leading to hyper growth of equipment investment in the next year (*Hankook Daily* 7/05/1993). In fact, the equipment investment growth ratio turned around from negative 0.1% in 1993 to positive 23.6% in 1994. Kim's government announced the revised Five-year Plan for the New Economy (July 2, 1993) under which the regulations for the Chaebol were greatly modified or even abolished. At the request of the Chaebol, the Five-year Plan listed greater investment for infrastructure and a more comprehensive plan for the privatization of state-owned enterprises.

Kim Young-sam announced the RNFTS act in June 1993, for the purpose of fair currency transactions and reducing political bribery among bureaucrats, politicians and business elites. The RNFTS was introduced in the form of a presidential emergency order rather than going through the regular law-making process under anticipation of a strong challenge from the propertied class. As a matter of fact, the FKI, the lobbyist arm of the Chaebol, endorsed Kim's move toward the RNFTS by making it clear that the FKI did not oppose the gradual institutionalization of the RNFTS in its "Policy Proposal to the New Government" (*Korea Kyungje Shinmun*, 09/22/1992). However, the Chaebol immediately demanded that the government take recompensive measures, so that the RNFTS would not drag the economy into a slump. At the request of the Chaebol, the government softened its stand on the process of transferring unnamed capital to its real name. The two policy measures which were the critical supportive institutions for the effective work of the RNFTS, that is, the Composite Financial Income Taxation (CFIT) and the Real Name

Real Estate Transaction System (RNRETS), were not institutionalized. The RNRETS finally came to life in 1995, but the policy-makers' attempt to institute the CFIT have been frustrated time and again. As of December 1999, the CFIT was not institutionalized.

As a result of the combination of a short-term stimulation package and the revival of equipment investment by big business, the economy was back on a recovery track by late 1993 and showed a full-scale expansion in 1994 and 1995. GDP growth rose to 5.8% in 1993, 8.4% in 1994 and 8.7% in 1995. But a close examination reveals that the overall economy was not healthy. The overwhelming majority of equipment investments were done in very limited industries, and only by big businesses who could secure the "privilege loans," while the majority of small- and medium-sized firms, specializing in footwear, clothing, and leather products, went bankrupt, and only limited export goods, including semi-conductors, computers, steel and chemical products, were capable of maintaining competitiveness in the international market. Thus, the imbalance in growth between the Chaebol and small- and medium-sized firms arose as a serious structural flaw in the Korean economy. Since 1993, the number of SMEs which went bankrupt has risen sharply. In addition, the overlapping investments in automobiles, power generation, oil refining, railroad vehicles, ship engines and aerospace drained the Chaebol's capital resources under low profitability (Park Hyung-Shin 1995:158-170).

In late 1993, the Kim Young-sam government began to abandon or soften anti-Chaebol measures under the high wave of neoliberalism in Korea. The FKI was given the authority to select a mobile phone service provider (December 1993) under the assumption that private businesses knew best what was in their interest. The privatization of state-owned enterprises was announced by the government as a means of economic

liberalization (December 1993), and the government also softened the regulations on bank loans to Chaebol groups (January 1994) (Hong Duk-yul 1996:230-137). The government's hands-off approach to economic management reached an apex with the demolition of the EPB in December 1994, which had been symbolic of the sector-specific promotional policies during the developmental era. The EPB and MOF merged into a super economic ministry with a brand new name, that is, the MOEF (Ministry of Economy and Finance). Other policy measures which were initiated under neoliberalism included: 1) abolishment of regulations on bank loans to Chaebol (April 1995); 2) liberalization of the foreign exchange system; and 3) liberalization measures for the enhancement of foreign direct investment. Regardless of the fact that these "deregulations" should go hand in hand with the strengthening of the state's supervisory and disciplining role in the financial market, the hyper neoliberalism at that time did not permit the government to orchestrate the market deepening with a comprehensive approach. The institutionalization of "central bank independency," the "establishment of the combined financial supervisory agency," and the strengthening of the Fair Trade Commission were protracted time and again, often due to the swirling rivalry of the economic agencies. Kim's government also virtually relinquished its "core business line policy" which was the most critical part of the Chaebol regulatory policy and was designed to enhance the competitiveness of Chaebol's flagship firms in the global market. In particular, licensing the entry of Samsung Group into the automobile industry in December 1994, signaled that the government was no longer serious about the pursuit of the core business line policy. In addition, the government lost its grounds to prohibit other business groups from entering into various industries. It goes without saying that the watershed of other business groups entering into power

generators, aerospace industry, steel industry, and oil refinery came after the Samsung licensing, leading to excessive and duplicated investments in these industrial sectors. In April 1995, the government announced the abolishment of licensing regulations for the top ten Chaebol, which had remained as the last administrative string in terms of business licensing (*Maeil Kyungje Shinmun*, 4/07/1995).

In early 1996, Kim's government turned from its previous anti-Chaebol policy, which had centered on regulating business diversification and high economic concentration. As a matter of fact, the regulatory policies appear to have misfired, as demonstrated in the rising number of Chaebol-affiliated firms and increasing diversification (Refer to Table 3.28 & Graph 3.5), and the mounting share of the national economy attributable to the Chaebol during Kim's early rule (Refer to Table 3.25 & Graph 3.6). The locus of the so-called "new anti-Chaebol" measures moved toward the corporate governance system and ownership structure. The Kim government began to see the corporate governance system, which was monopolized by the despotic owner-chairs, as more problematic than the "expansionist drive" (*Hankook Daily*, 5/06/1996). Thus, while abolishing regulations on bank credit, real estate purchase, and entry of Chaebol into financial industries, the government attempted to enhance the transparency, democracy and openness of corporate management. The new anti-Chaebol policy involved: 1) rehabilitation of the general meeting of shareholders, and of the functions of the director and outside auditor; 2) strengthening the rights of minor shareholders; 3) introduction of the combined financial statements among affiliated firms; 4) strengthening taxation on inheritance; 5) restricting internal financial transactions among affiliates; and 6) reduction or abolishment of cross debt-guarantees among subsidiaries (*Hankook Daily*, 5/06/1996).

As the economy began to slow down (Refer to GDP growth rate and manufacturing growth rate in Table 4.14), the Kim administration retreated from its original plan. For instance, the economic cabinet decided to desert its plans to impose the combined financial statements on the Chaebol, to introduce the institution of outside auditor, and to strengthen the minor shareholder's rights, saying that the combined financial statement was too heavy a burden on the already staggering businesses (*Maeil Kyungje Shinmun*, 10/14/1996). Concerning the cross-debt guarantee issue, the government retreated from an absolute prohibition on any debt guarantees to a policy under which the Chaebol reduced their debt guarantees to 100 percent of total assets (Ibid, 10/23/1996). In addition, the government's plan to strengthen the Fair Trade Law was greatly modified. This retreat from the initial plan implied that the recuperation of the national economy had priority over regulating the Chaebol (*Seoul Shinmun*, 10/23/199; *Maeil Kyungje Shinmun*, 10/19/1996). Imposing any regulations over big business was perceived as harming the national economy. Furthermore, from late 1996, the Kim administration began to push "deregulation" to rekindle the sluggish economy. The government abolished the credit basket system on the top ten Chaebol, the licensing system for the purchase of real estate, regulations on the entry of Chaebol into the financial industry, and regulations on foreign borrowing (*Maeil Kyungje Shinmun*, 12/03/1996). In particular, deregulation of the entry of Chaebol into the financial industry led to the rampant establishment of NBFIs by big business. The Chaebol, unfettered from regulations on foreign borrowing, also rushed out to foreign creditors, resulting in the rapid increase in foreign debt during Kim's last years.

In summary, the interactions of business-state were basically characterized by the

following: 1) The democratic regime's efforts to strengthen its regulatory measures over big business could hardly survive during economic recession, due to its structural dependency. The political regime was compelled to turn to big business for economic recovery, because big business was the only actor who could rejuvenate the sagging economy. Under the political climate in which regime survival was largely reliant upon the Chaebol's economic performance, the democratic regime was constrained in its policy choices with respect to strengthening market discipline and supervisory roles. 2) On the other hand, the democratic regime could more readily remain in its reform track when the national economy was in an upswing, when popular politics got into the policy-making process, or right after a newly elected president came to power. In particular, high popular participation in politics tended to check the influential power of the Chaebol upon the policy-making process, as demonstrated in the case of anti-land speculation measures against Chaebol. In short, the detailed interactions of business-state in this section show that the state's structural dependency upon big capital became more salient when the national economy went down and big business was not checked by participatory politics of the middle class and the grass-roots.

CHAEBOL AS AN OBSTACLE TO MARKET DEEPENING

Big business groups have been referred to as stubborn obstacles to overcome in transforming the state-led economy to a market-led economy in South Korea. The Chaebol are the manifestation of overlapping economic concentration in four different categories: 'aggregate economic concentration', 'market concentration', 'ownership concentration', and 'conglomerate concentration'. Unlike the advanced industrial

countries where “market concentration” has been the principle concern in the context of an adequate operation of market, in Korea, the Chaebol system presents itself as the core problem with these four overlapping powers in the marketization process. This study on “Chaebol as the problem” focuses narrowly on why the primary characteristics of the Chaebol and their dominance in the Korean economy are harmful to an adequate performance of the market and thereby stand in the way of marketization.

This question will be addressed by taking a close look at four different kinds of economic concentrations.

(1) Aggregate Economic Concentration (General Economic Concentration)

Aggregate economic concentration notes the degree to which the economy of the nation is controlled by the big business groups. More precisely, the degree of aggregate economic concentration can be empirically measured by what percentage of total sales, assets, employment and added-value,¹⁴ for instance, in broad industrial sectors such as manufacturing, is accounted for by the top business groups.

¹⁴ Aggregate economic concentration is usually measured by total assets, sales, employment and added-value. Total assets is often used to measure the composite economic power of conglomerates on the basis of the notion that total assets reflect the stocked economic power over the long run. Total sales indicate the outcome of business activities during a certain period of time. Total sales is easy to measure and is an empirical index which is proven in the market. That is why it is often used to measure the degree of aggregate economic concentration. Employment size also reflects a firm’s power of productivity. Unlike assets and sales whose value is greatly influenced by currency fluctuation, employment usually remains steady, so that it reflects the structural aspects of economic concentration. Value-added is able to grasp the contribution made by both labor and capital and be comparable across different industries. But it is not often accessible to researchers (Hwang Inhak 1997).

The aggregate economic concentration data (Refer to Table 3.25) clearly illustrates that the Chaebol controlled the lion's share of the national economy. The top 30 Chaebols accounted for 36% of sales by the end of the HCI-drive (1980). In terms of assets and added-value, the top 30 Chaebols accounted for 36.7% and 30.8% respectively (1981). According to Table 3.25, the aggregate economic concentration reached a pinnacle by 1982 and has remained at almost the same level since then in every single category. For instance, the top 30 Chaebols accounted for about 40.7% of total sales in 1982, and throughout the 1980s and 1990s the percentage stayed between 35.0 and 40.7%. In short, the aggregate economic concentration ratio (as well as the ratio of export volume by the GTCs¹⁵), undoubtedly ascertains that there is an extensive structural dependency of the Korean economy upon the Chaebol.

The high aggregate economic concentration in Korea by itself does not seem to be a serious problem. Assuming that capital increases as industrialization deepens, the rise in capital concentration in Korea seems to be on the right trajectory for capitalist development. The economy of scale, attained by the Chaebol, had been and might continue to be conducive to improving competitiveness in the global market. In addition, comparison with major OECD countries, including the United States, Japan, Germany and

¹⁵ Another way to measure the relative weight of the Chaebol to the whole economy, the ratio of export/import volume by the General Trading Companies (GTCs) to total export volume, also shows the same trend. In export-led economies in which over 60% of GNP is created via exports/imports, the high weight of GTCs to total export volume implies that the livelihood of the Korean economy, to a large extent, varies with the performance of GTCs, which are special agents for the export/imports of the Chaebol. Table 4.1 shows that, since 1975 when GTCs were licensed to promote exports by the Park regime, more than 40% of exporting has been conducted by 7 GTCs, except for the early period (1975-1979). Especially during recent years, GTCs carried out about 45% of the total export volume.

Great Britain, also tells us that Korean aggregate economic concentration is average or lower than average in terms of various standards (Hwang, In-hak, 1997). For instance, among the above-mentioned countries, Korea ranked last in terms of employment concentration, fourth in sales, and second in assets (Ibid. 129-135). The recent *OECD Economic Surveys 1997-1998* (1998) informs us that

“the share of the 100 largest firms in Korea is comparable to the 48% in the United States and 40% in Germany, though higher than the 27% in Japan. This reflects the fact that individual Korean companies are not large by international standards. In terms of sales, Hyundai Motors, the biggest Korean car manufacturer, is only about 7% as large as General Motors, while Samsung Electronics is 14% the size of Matsushita in Japan” (OECD, 1998:92).

Thus, aggregate economic concentration alone does not cause serious problems with market rules.

But, when aggregate concentration overlaps with other types of economic concentration, it compounds the issues of the Chaebol in the market deepening process. As shown in Figure 4.1, general economic concentration, ownership concentration, and conglomerate concentration were interconnected, resulting in low economic effectiveness. Thus, the analysis of the overall effects of aggregate economic concentration must be taken up in context with the other types of economic concentration: ownership and corporate concentration.

(2) Ownership Concentration (Structure of Ownership and Control)

Ownership concentration denotes the extent to which the stock shares of conglomerates are held in the hands of the founder or founding family. But under the Chaebol's odd ownership structure, intercompany share holdings provide almost the

identical effect as the owner-chair having his own share holdings. Thus, the intensity of ownership concentration is usually measured by three different kinds of share holdings: share holding 1) by an owner-chair; 2) by his family; and 3) by member companies. As Table 4.3 shows, Korean Chaebol show highly concentrated ownership. The average internal holding rate by the 30 largest Chaebols remained way above 40% in the 1980s and 1990s. The top five Chaebols displayed an even higher rate of internal ownership than the top thirty Chaebols.

This high ownership structure permits the complete unification of ownership and control in the hands of the founding-family. Founding-family members collectively hold a dominant number of shares of stock, and the founder, a relative, or a trusted subordinate is in charge of managerial control. In advanced industries, ownership of large corporations is typically divorced from control, with the former in the hands of diversified shareholders and the latter in the hands of professional managers. In contrast with industrialized countries, not only is ownership in Korea confined to a single family, but control is also generally concentrated in a single person. This single person is likely to be a chairman or president who typically established a single enterprise and brought it to prosperity along with dense industrialization (Kim Dong-woon, 1999).

What sort of ownership structure grants an individual such over-arching power to control a Chaebol group in Korea? The easy way to control managerial power is to hold a majority share of each unit of a Chaebol. But it is nearly impossible for one individual or family to use this method, owing to the large amount of capital required for a business group. Hence, Korean Chaebol have utilized intercompany share holding as a method to secure control over affiliated firms. Intercompany share holding takes many different

forms, such as direct mutual holding of stocks between two units ($A \longleftrightarrow B$), circular holding among more than two units ($A \rightarrow B \rightarrow C \rightarrow A$),¹⁶ and radial holding between parent and satellite units ($A \rightarrow B$, $A \rightarrow C$, $A \rightarrow D$, $A \rightarrow E$). The actual picture of cross-ownership among affiliated firms is much more complicated than the simplified forms of internal holdings explained here (Refer to Kang Myung Hun 1996; Jo Dong-sung 1990).

As shown in Table 4.3, in the top 30 Chaebols, the owner-chairs and their families have held about 10% of the total stock of their companies throughout the 1990s. In addition, various types of cross-ownership among member companies tremendously boosted the concentration of ownership in the hands of an owner-chair, albeit his and his family's ownership was limited to about 10%. The average internal share holding rate of the top 30 Chaebols rose to well over 40% when cross-ownership of stocks among member companies was included. This high internal share holding in turn rendered a single owner at the top of this ownership structure with ample power to control affiliated firms.

The consequences of the tangled cross-ownership among unit companies were as follows: First, the president of a Chaebol group was able to wield extensive control over its subsidiaries while holding a relatively small number of shares. Second, cross-ownership tended to superficially inflate the amount of capital of a Chaebol group by generating fictitious capital. Third, intercompany share holding made it virtually impossible for outsiders, including creditor-banks and investors, to determine the actual financial status

¹⁶ Under the controversial circular financing scheme, for instance, unit A extends financial aid to unit B, which in turn offers aid to unit C. Firm C again gives financing to unit A to avoid government detection.

of a Chaebol group. Accordingly, cross ownership among affiliates paralyzed the basic responsibility of credit banks, which was to carry out prudent evaluations, follow-up audits, and disciplining measures on Chaebol borrowing¹⁷ (Kim Sang-jo, 1999:234).

Furthermore, intercompany ownership and cross-subsidiary financial transactions incapacitated the government auditing agencies' ability to catch financial problems early on and the investors' ability to act on the performance of enterprises.

In addition, those firms which were marginal, money-losing units and thereby would normally be forced to dissolve, were more likely to survive, owing to illicit fund-channeling to the ailing units. As a result, the intercompany share holding system has prevented the exit market from working in an adequate manner. Furthermore, these ailing firms drained capital resources from viable firms and thereby diminished the competitiveness of viable firms, which tended to be core competencies, because those firms were compelled to neglect R&D investment and technological innovations. When the financial drain of non-profitable units was grossly swollen, the whole Chaebol group could slip into financial default, triggering serial bankruptcies of affiliated firms. This happened to the Hanbo, Kia, New Core, Jinro, Haitai, and Halla groups in 1997.

Not only did the ownership structure but also the control structure of the Chaebol operate against the workings of market forces. The control structure denoted different types of power relationships among stockholders, managers, creditors and employees. On the basis of the overwhelming dominance in terms of stock ownership, the owner

¹⁷ "Although the Korean GAAP (Generally-Accepted Accounting Practices) requires mark-to-market accounting for marketable securities, financial institutions were allowed to recognize only partial unrealized holding gains and losses from these securities" (OECD, 1998: 110).

appointed his family and trusted proteges to the core managerial positions in affiliated firms. With the use of interpersonal networking, an owner-chair could exercise exclusive power in governing the affiliated firms. Decisions on the distribution of capital resources and new investment belonged exclusively to the informal but powerful centralized management teams called the “planning and coordination office” under the owner-chair. Other parts of the corporate governance structure, such as the auditors, a general meeting of shareholders and the board of directors did not play significant roles in managing firms. Therefore, proper accountability for these institutions has been absent. As a result, the existing criminal law provisions concerning the willful breach of fiduciary duty to the company by directors have rarely been enforced by prosecutors (OECD, 1998:106-107).

During the past decades, the concentration of corporate ownership and control structure in the hands of the owner-chairs had some advantages, including reduced agency costs and the ability of companies to react swiftly to changes in the business environment. With the use of diversified business lines and the highly centralized control structure, the owner-chairs were able to make investment decisions which carried high risk and uncertainty. However, the corporate governance structure in Korea, which lacked much of any check-and-balance system or management transparency, became unsuitable as the scale of corporate organization grew and became more complicated. During the post-developmental era under which market forces largely substituted for the role of the government, the management of a firm required high technical skills and managerial entrepreneurship with plentiful experience in a particular industrial field. Furthermore, the organization of business groups, increasingly becoming larger and more complex, presented serious problems to the hierarchical decision-making structure. No longer was

the strict top-down decision structure, which had no shareholder discipline, director accountability, or auditing system, viable for the over-grown business empires. In addition, the corporate governance structure also presented a serious moral hazard problem. An owner-chair wielded extensive power in decision-making but was not accountable for the consequences of the decision, due to the peculiar ownership and managerial structure.

(3) Conglomerate Concentration: Diversification of Business Lines

The diversification power of Korean Chaebol can be assessed by the number of affiliated firms in a business group and of different business lines in which a business group is involved. As we can read from Table 3.26, the number of subsidiaries of the 30 largest Chaebols has swollen dramatically over time, from 126 in 1970, 514 in 1989 to 819 in 1997. During the same period, the average number of affiliates per Chaebol also showed great expansion, climbing from 4.2 in 1970, 17.1 in 1989 to 27.3 in 1997. If we limit our interest to top five Chaebols (Hyundai, Samsung, Daewoo, Lucky-Gold Star, and Sunkyung), the subsidiaries amassed to 210 in 1994, averaging 42 affiliates per Chaebol (FTC, *Whitepaper of FTC*, 1994). The tally of affiliated firms does not measure other aspects of diversification, so that let us take a look at the number of industries in which the Chaebol were involved.

Table 3.26 tells us that the number of industries under each Chaebol soared sharply between 1970 (7.7) and 1979 (17.6), when Heavy/Chemical Industrialization was driven by the Park regime. After stagnancy in the 1980s, in the 1990s we observed a steady growth in the number of industries in each Chaebol (Refer to Table 3.26). This increasing number of business lines per individual Chaebol implies that Korean Chaebol have had a

voracious appetite for all industrial areas, even including traditionally Small-and-Medium-sized enterprise-assigned areas. Thus, Koreans' depict of the Chaebol as "octopus-like diversification" well caricatures the pattern of diversification by the Chaebol.

The Chaebol have been in pursuit of "business line diversification" throughout industrialization. Diversification is not always associated with negative effects on growth, profitability and stability of enterprises, as long as diversification is carefully carried out within related business lines. Unlike foreign conglomerates whose diversification centers on related business lines, Korean Chaebol are extensively involved in unrelated businesses. According to a recent study (Lee Keeyoung, 1996:26), about 57% of new Chaebol affiliates were not linked with previously established enterprises in terms of technology, marketing or production, while 19.4% of American, 6.8% of Japanese, and 6.0% of British enterprises belonged to the category of "unrelated diversification." For instance, the Samsung group, as of 1998, was comprised of a wide range of unrelated business lines, including electronics, heavy equipment, chemicals, insurance and securities, general trade, textiles, plywood, hotels, department stores, and newspapers.

The diversification strategy worked well for the Chaebol during the developmental era. But by the late 1980s, not only did the unfavorable business environment, by and large, fade away but also globalization and the subsequent new trade system (WTO) no longer permitted the government to subsidize the Chaebol. However, the Chaebol did not slow down their "diversification drives" even in the 1990s, as shown in Table 3.28. The core components of business groups were exposed to the international market forces without protectionist policies, so they had to compete with global competitors on an equal footing. Accordingly, the financial drain from profitable units to ailing units directly

weakened the competitiveness of lucrative businesses in the global market.

(4) Market Concentration

Market concentration denotes what percentage of an individual item (specifically classified markets such as automobiles, steel and so forth) is produced by the top leading enterprises. The intensity of market concentration can be empirically measured by the Herfindahl-Hirschman Index, Entrophy Index or the accumulative market dominance by the leading enterprise in a narrowly classified market. For this study, using the last method seems logical because it directly tells the readers the market share held by the largest enterprise.

During the developmental era, the Korean government tolerated and even deliberately nourished the monopoly or oligopoly of markets by a few large conglomerates, based on the belief that monopoly of the market was essential to the development of the corporation. According to the Schumpeterian proposition (Schumpeter 1954:Ch.8), corporations with monopolistic power were assumed to accumulate capital more rapidly and use its capital for technological innovations, eventually resulting in the quick evolution of solid corporations. In addition, monopoly of the market was considered inevitable to attain the economics of scale, especially in the heavy-chemical industries in the 1970s. Therefore, not only was the monopoly of markets by the Chaebol tolerable but also desirable from the viewpoint of the developmental state in Korea, which attempted to shorten the time span of industrialization. As a result, the noncompetitive market remained the predominant form at the end of the developmental era. As shown in Table 4.6, over 80% of the total number of commodities were situated

in a noncompetitive market¹⁸ from the early 1970s up until the early 1980s. Although a close look at the table discloses that the market structure of manufacturing in Korea has steadily crawled toward more competitiveness,¹⁹ the market structure remained largely noncompetitive as of 1987.

Market concentration by the top enterprises continued in the 1990s. As Table 4.7 shows, the percentage of merchandise which was monopolized by a single company stayed somewhere between 7.3% and 14.6% from 1990 to 1996, showing no sign that the percentage of the total number of commodities under monopoly had significantly changed. And the percentage of merchandise which was duopolized and oligopolized did not show any significant changes in the 1990s. However, there was a clear increase in the percentage of the total number of commodities under a competitive market. In 1990, only 19.1% of total commodities were situated under a competitive market, but this rose to 38.6 % by 1996. But market concentration was still unusually high, because 61.4% of the total commodities were under a non-competitive market.

A large part of the market concentration mentioned above was caused by the Chaebol. Table 4.8 illustrates what percentage of market concentration was contributed by the Chaebol. Throughout the 1980s, the Chaebol were predominant contributors to

¹⁸ A non-competitive market is defined as a market in which the top three companies account for more than 60% of the total sales or total number of commodities in that market.

¹⁹ Although the total number of commodities and the total sales under noncompetitive markets remained steady, there were more significant changes in the specific categories of “monopoly,” “duopoly” and “oligopoly.” The percentage of the market share under “monopoly” decreased, while the percentage under “oligopoly” (which is a more competitive market) rose throughout the 1970s and 1980s. For instance, 33.2% of the total number of commodities were under “oligopoly” in 1970 but this number went up to 44.5% by 1987.

market concentration. Over 70% of market concentration was generated by the top 30 Chaebols (Refer to the row “top 30”) and this high percentage has remained unchanged. More surprisingly, the top five Chaebols accounted for most of this market concentration, over 60%.

Table 4.9 clearly shows that the high percentage of market concentration caused by the top Chaebols has continued in the 1990s. This table indicates the contribution of market monopoly by the top 30 Chaebols, calculated on the basis of commodities. For instance, 77% of the total commodities under a noncompetitive market were the products of Chaebol in 1986. More recently, the top 30 Chaebols accounted for 59.4% in 1995, 70.5% in 1997 and 66.4% in 1998, of commodities under a noncompetitive market. High market concentration means that the Chaebol were able to scrape up extra profits through the use of their monopolistic status. In order to protect their market-dominant positions, Chaebol were often tempted to hinder the entry of new competitors into a noncompetitive market, unreasonably fix, maintain, or alter the prices of goods, control the sale of goods, and interfere with the business activities of other enterprises. A highly monopolistic and oligopolistic market structure has been entrenched in Korea for a long time, despite the fact that the government has strengthened its legal regulations and other measures to prevent the abuse of market-dominant positions by the Chaebol. In short, breaking down the non-competitive market structure has become an imperative task in the process of market deepening, not only to protect consumers from the abuse of market dominant positions but also to establish fair and free economic competition.

In summary, as a consequence of the fact that the Chaebol embody the combination of four different types of economic concentration (general, ownership,

market, and conglomerate concentrations), the Chaebol stand in the way of “market deepening” programs. Many aspects of the Chaebol system no longer work as they did in the past, and are now unsuitable for marketization. First, the Chaebol often violate fair and transparent market rules through the use of their market dominant status. The Chaebol impose unreasonable prices of goods, interfere with the business activities of other enterprises, and hinder the entry of new competitors. Second, the ownership structure of the Chaebol is a great hindrance to the exit of ailing affiliated firms and can trigger serial bankruptcies of affiliated firms, in turn putting the national economy in jeopardy. Third, the control structure, which is overshadowed by a single owner-chair, inflicts serious damage on management transparency and creates a moral hazard problem in the context of managerial accountability. Fourth, the diversification strategy of Chaebol through unreasonable financing methods such as cross-ownership and debt-guarantees across affiliates not only weakens the competitiveness of the leading industries in the global market, but also perpetuates debt-ridden management. In addition to these four major problems, the Chaebol system has presented other political issues such as social cleavage between “the haves” and “the have-nots” and corruptive collusion between state and business.

CHAEBOL REFORM POLICIES AND THEIR OUTCOMES

The government developed a parcel of policy measures to repair the Chaebol system which thwarted market mechanisms from working effectively. Each policy measure aimed at a specific kind of economic concentration described above. For instance, the “core business line policy” was to dissolve “conglomerate concentration”

(diversified business lines within a Chaebol group); the “credit basket system” was designed for both the improvement of capital structure and to repair the credit allocations biased toward Chaebol groups; the cap on cross-unit equity investments was to reduce the high general economic concentration; the prohibition of the cross debt-guarantees and the drive for listing firms in the stock market were to dissolve the concentrated ownership structure; the strengthening of inheritance tax regulations was to prohibit intra-family transfers of managerial rights; and the combined financial statements were to improve managerial transparency (Lee Kee-young 1996:12). This section explores the extent to which these policy measures were successful and points out some clues as to why most of these policy measures ended up with mediocre results under the Roh and Kim governments. However, given the limitations of space in this section, the detailed interactions of business-state will be examined for only a few policy measures.

(1) Policy Measures against Aggregated Economic Concentration

Since 1987, the Korean state has taken comprehensive policy measures to reduce the high general (aggregated) economic concentration in the hands of the Chaebol. These policy measures can be divided into five main categories: 1) Monopoly Regulations and the Fair Trade Act; 2) Credit Regulations; 3) Restrictions on Chaebol’s ownership of financial institutions; 4) Prohibition of media take-over by Chaebol; and 5) Protection of SMEs from Chaebol (Refer to Table 4.19). A large portion of these measures aimed not only at reducing the highly aggregated economic concentration, but also ownership concentration and conglomerate concentration. As shown in Figure 4.1, the Korean government’s immediate target of market deepening was to resolve “ownership” and

“conglomerate” concentration, rather than the “aggregated economic concentration” and “market concentration.” It was thought that, by centering on those two immediate targets, the government could eventually reduce the highly aggregated economic concentration.

As clearly laid-out in Figure 4.1 by the FTC, the priorities of major policy measures to cutdown the various economic concentrations can be listed as follows: 1) prohibition of cross-investment; 2) a cap on inter-unit capital investment; 3) prohibition of cross-debt guarantees; 4) prohibition of illegal financial transactions; and 5) regulation of bank credit (Refer to the box in the bottom right corner of Figure 4.1). Other acts and decrees will not be dealt with in this chapter due to limited space even though they are significant in the overall picture of regulatory policy over the Chaebol in the 1990s. Because the government’s direct intentions were to reduce ownership and conglomerate concentration through the use of these five policy measures, these policy measures will be discussed in the following sections, beginning with a brief comment on the outcome of the policy measures against aggregated economic concentration.

In a word, the government’s efforts to lessen aggregated economic concentration were in vain. As shown in Table 4.2, between 1988 and 1995, the ratio of employment, total sales, total assets, and value-added in the manufacturing sector by the 30 largest Chaebols kept rising. Although there were some differentials in the rising trends across different categories, Chaebol added to their prowess in every single category during Roh and Kim Young-sam’s administrations. For instance, the sales of the top 10 Chaebols accounted for 25.1% of total sales in 1988, but soared to 44.1% in 1995, while sales of the top 30 Chaebols went from 31.5% in 1988, to 52.1% in 1995. Only employment size

grew at a snail's pace because the capital size per person rose dramatically during this period. In conclusion, the Korean state failed to reduce the Chaebol's overall economic prowess despite all the policy measures listed in Table 4.19.

(2) Core Business Line Policies: Against Diversification

The objective of the “core business line” policies was to dissolve the “conglomerate concentration” by restructuring Chaebol into leaner business groups which specialized in a few industrial lines. The octopus-like diversification of the Chaebol became a primary policy concern around 1989 when the national economy began to slide into a slump. Policy makers pointed out that the overly diversified Chaebol could not cope with market globalization, under which only firms which obtain high productivity and profitability through heavy investment in R&D could survive. The Chaebol needed to concentrate their capital and managerial resources into a few core industries to regain their competitiveness. Thus, in March 1991, the government introduced the “core business line policy,” whose main objective was to enhance the global competitiveness of the flagship firms of the Chaebol. By doing so, the Korean state also tried to improve the worsening balance of trade (*Hankyeorae Shinmun*, 3/29/1991). It was thought that, in order to compete with foreign enterprises, some core businesses must be freed from credit regulations in which the government put a cap on the amount of credit to be used for a corporation. Some flagship corporations within Chaebol groups needed financial assistance to be competitive in the global market.

Under the “core corporation policies,”²⁰ each of the 30 largest Chaebols was able to submit a maximum of three major businesses as its core businesses to designated banks. In return, the government excluded the core businesses from the “credit basket regulation”²¹ and from the “category of self-rescue efforts,” so that those corporations could be freer to mobilize business funds from commercial banks. Designated banks were accountable for monitoring whether or not the money they loaned out was utilized by other than the designated firms. On the other hand, those corporations who were not selected as core businesses were placed at a disadvantage regarding credit allocation. These incentives to induce Chaebol groups to adopt core business lines were not extensive but very limited.

The first response of the Chaebol to the “core business line policy” was negative. The FKI made it clear that the “core business line policy” was a backward move against the wave of diversification going on in the global market (*Chosun Daily*, 3/12/1991). The FKI declared that whether or not a Chaebol group sought to be specialized in a certain industry must be left in the Chaebol’s hands or determined by the market’s hands. In addition, the government might unintentionally be placing hurdles in the way of the exit or

²⁰ Concerning the “core business line policy,” there were two distinct policy concepts. Early on, the Korean government adopted the “core corporation policy” under which each Chaebol group selected 2-3 firms as its strategic core enterprises. But from 1993 on, under the “core business line policy,” the government encouraged each Chaebol to select a few business lines as its core industries, instead of firms.

²¹ The Korean state had been controlling credit distribution through the “basket system of credit” in order to prevent bank credit from flowing only into Chaebol groups. Under the basket system of credit, the government limited the amount of credit available to an individual Chaebol from each commercial bank. Bank loans had been quite elusive for Small- and Medium-sized firms under collateral- or debt-guarantee-based loan practices. The government also designated a certain amount of bank loans to SMEs from the mid-1980s.

entrance of firms by designating a few strategic firms as target enterprises. What the FKI wanted was for the government to abolish the licensing practices and credit regulations on Chaebol in order to improve the competitiveness of Korean firms (*Choongang Economic Shinmun* 3/16/1991). Later on, the chair group of FKI put direct pressure on the ruling party, asking the government to abandon the “core business line policy” and the credit basket system.

However, being aware that the government’s position was firm, the 30 largest Chaebols handed in their lists of core businesses to the designated banks. A brief investigation into the list of corporations selected by the 30 Chaebols discloses that the Chaebol simply exploited the “core business line policy.” First, most of the selected firms were owned by the owner-chair of the Chaebol group. For instance, of 88 corporations designated as the core businesses, 12 firms were owned completely by their owner-chairs and the average share holding of all 88 corporations by the owner-chair was 50.6%. Second, a large number of selected corporations had high debt/equity ratios or were money-losing units. As a matter of fact, the selected firms’ average debt/equity ratios (330.6% in 1990, 352.9% in 1991, and 368.9% in 1992) were much higher than the averages of firms listed in the stock market (273.2% in 1990, 294.7% in 1991, 307.6% in 1992). Thus, it is clear that the Chaebol attempted to improve the capital structure of their debt-ridden affiliates, even though the directives of the government were meant to eliminate money-losing ventures (Shin Hee-keun 1993:132).

The government, giving priority to manufacturing, selected 61 corporations out of the 88 applicants for the core business line program. Despite the government’s attempt to eliminate privately-owned, debt-ridden firms, the government ended up supporting firms

with those traits because the Chaebol chose those debt-ridden or capital-demanding firms for their core business privileges. Thus, the effect of the core business policy was the opposite of the government's intent from the very beginning, due to the Chaebol's strategic response to exploit it. However, the government intensified its regulations on credit channeled into the selected firms with the promulgation of a new law in January 1992. Responding to the new credit regulations, the Chaebol requested the government revise, increase the number of valid candidates for the "core business line policy," or abrogate the whole policy.

Under the Kim Young-sam government (1993-1997), the "core corporation policy" was transformed into the "core business line policy" in which each Chaebol selected its strategic business lines, instead of strategic individual firms. In April 1994, the Chaebol were allowed to re-select the core business lines because three years had passed from 1991 when the 30 largest Chaebols had selected their core businesses. Of the 28 Chaebols which had remained within the top 30 during those three years, only 10 did not change their core corporations. The other 18 dropped a large number of previously selected firms. The extensive changeover of core corporations implied that the Chaebol exploited the "core business line policy" for other purposes. Again, the capital structure of the selected corporations in 1994 was much weaker than firms listed in the stock market. The average debt/equity ratio of the selected firms was 324.9%, compared to 298.3% for listed firms. More specifically, of 61 selected firms, there were 35 firms whose debt/equity ratio was over 400% (Lee Kee-young 1996:30-43).

The "core business line policy" ended up fruitless as the Kim Young-sam government came to a close. First, the deficiency of the "core business line policy" was

clearly observed in the spiraling number of subsidiaries under the 30 largest Chaebols and in the number of industries involved. Between 1991 and 1997, during the time the “core business line policy” was implemented, the number of subsidiaries of the top 30 Chaebols vaulted from 561 in 1991 to 819 in 1997, while the average number of business lines the top 30 Chaebols were involved in jumped from 11.8 in 1990 to 19.8 in 1997 (Refer to Table 3.28). The government failed to stop the voracious appetite of the Chaebol for diversification and asset swelling via the “core business line policy.” Second, evaluation of the profitability, productivity, and financial stability of the core businesses also shows that the Korean state failed to steer the flagship affiliates of Chaebol into globally competitive firms. Concerning profitability, the selected firms under the “core business line policy” obtained lower income to total assets, or financial expenses & ordinary income to total assets, than other firms between 1990 and 1994. More importantly, however, the selected firms remained far behind foreign firms in terms of profitability. For instance, the ordinary income to sales rate of the selected firms was 0.9 % in 1991, while those of average Japanese, American and Taiwanese firms were 3.4%, 3.7%, and 4.0% respectively. The selected firms’ comparatively low profitability has not improved since then (Lee Kee-young 1996). In the context of growth, however, the selected firms showed splendid development. The growth rate of total assets and the growth rate of sales of the selected firms were ahead of the firms in the stock market. Lastly, despite the preferential credit allocation to the selected firms, the capital structure of the selected firms did not improve. Rather, the debt/equity ratio, stockholder’s equity to total assets, current ratio, and financial expenses to sales remained far behind foreign firms. For instance, between 1990 and 1994, the selected firms’ debt/equity ratio remained around 350%, whereas those of

American, Japanese, and Taiwanese firms were about 150%, 210%, and 90% respectively. In other categories measuring the capital structure of firms, the same cleavage between Korean firms and their foreign counterparts between 1990 and 1994 was observed (for profitability, growth and productivity of Korean and foreign firms, refer to *Analysis of Financial Statements*, published by BOK). In short, the Roh and Kim governments failed to guide the flagships of the top 30 Chaebols into becoming more competitive enterprises in the global market or to curtail the voracious diversification drive by the Chaebol. Instead, the Chaebol bloated the asset sizes of the selected firms through cunning use of the “core business line policy.”

The disastrous failure of the “core business line policy” can be attributed to several factors: First, there had been no consensus on the core business line policy among involved agencies. MOEF (KDI and FTC) and MOCI clashed on the issue early on. The MOEF side contended that the core business line policy inherently contradicted the “deregulation drive” and diversification had become a worldwide popular wave by leading global competitors. On the other hand, MOCI pointed to the core business line policy as the singular means to resolve the excessive investment in the limited number of industries and to improve the competitiveness of Chaebol in the global market (For the bureaucratic bickering over this issue, refer to *Kukmin Daily*, 1/15/1993; *Dongah Daily* 10/24/1993; *Maeil Kyungje Shinmun*, 10/24/1994 & 5/08/1996). Second, the incentive package to induce the Chaebol into the “core business line policy” could not override the gains incurred from continual diversification by the Chaebol. The benefits embedded in the protected domestic market, extra gains occurring from having real estate and media, and financial security granted from non-banking financial institutions kept Chaebol on the track

of diversification throughout the 1990s. In a word, there were incentives implanted in the domestic market which drove Chaebol to diversify. Loosening credit regulations for the core corporations did not create enough stimulus to draw Chaebol into the “core business line policy.” Third, there was no collective political leadership which was determined to push this policy through, as manifested in the absence of a strong incentive package. Kim’s decision in 1994 to license Samsung to enter the already overcrowded automobile industry demonstrated that critical policies could be swayed according to the regime’s imminent political interests.

(3) Reform of Ownership Concentration

The government’s efforts to resolve the issue of concentration of ownership in the hands of the founding families involved several policy measures: 1) a cap on cross-unit equity investments; 2) prohibition of direct reciprocal investment between two affiliates; 3) prohibition of cross debt-guarantees among affiliated firms; 4) a drive to list firms in the stock market; and 5) limitations on exercising the voting rights of their shares of financial and insurance subsidiaries. First, the government tried to reduce the concentration of ownership by untangling the complex intercompany share holdings because Korean Chaebol were utilizing inter-unit investment as a method of ensuring secure control over their affiliated firms. By the “monopoly regulation and fair trade act,” amended in December 1986, Chaebol affiliates were required, over three years, to dissolve the direct mutual holding of stocks between two units, which was a notorious method of superficially inflating capital size. Recognizing that direct mutual investments were unethical in any respect, the Chaebol quickly dissolved the mutual investments. However,

other types of capital investments among affiliates (circular share holdings, radial holdings between parent and daughter units) were not restrained by the prohibition of direct mutual holding of stocks. Thus, a law which limited the total amount of capital investment across affiliated firms was introduced in 1986. According to the new law, No. 3875, no firm belonging to a large business group could invest in excess of 40% of its net assets in sister firms. Those corporations whose investment capital exceeded 40% were supposed to reduce it within one year. As a matter of fact, as shown in Table 4.15, the ratio of total capital investment to the total net assets quickly dropped below 40% after 1987.

In 1994, the government intensified its drive for disentangling intercompany share holding by imposing a new ceiling (25%) on inter-unit investment. To do so, the government amended the “monopoly regulation and fair trade act” in December 1994, again despite stiff Chaebol resistance. As illustrated in Table 4.15, the total capital investment to the total net assets of affiliated firms dropped below 25% for three years. Notwithstanding that the government obtained its policy target in terms of numbers, several problems occurred with this policy measure. First, a large share of the reduction in the ratio of capital investments to total net assets came from the growing size of net assets, rather than from the resolution of intercompany investments. Second, the government extended exemptions to some companies, so they did not have to observe the 25% ceiling requirement in the 1994 law. When the government attempted to amend the “monopoly regulation and fair trade act” in 1994, the Chaebol took collective action, insisting that the government’s new move toward stricter regulations on inter-unit investments definitely would result in investment contraction and accordingly a 35% or 40% cap must be imposed over five years (Yoo Seung-min, 1996:44). Responding to the

Chaebol's pressure, the government softened its original stand, so that those firms whose capital structure was in good shape, those firms which invested in infrastructure, and those who adopted the "core business line policy," were excused from this regulation.

Nevertheless, the ceiling on intercompany investment curbed the corporations' voracious appetites for diversification by demanding that affiliates concentrate their capital in their own businesses. In addition, this policy measure contributed slightly to the lessening of ownership concentration. As shown in Table 4.3, the average internal share holding rate of the top 30 Chaebols declined bit by bit from 1987 until 1994, and stayed almost unchanged between 1994 and 1997. However, the Kim Young-sam government removed the 25% ceiling in 1997, after relaxing the regulations concerning foreign investors' equity ownership of Korean firms. The removal was in response to Chaebol complaints that the rule seriously limited their ability to raise funds to defend themselves and their affiliates against hostile takeover bids by foreign investors. But since the removal of the restrictions, there have been no hostile takeover bids made by foreign investors. Rather the removal of the restrictions allowed Chaebol groups to shore up the capital structures of their weaker units. As Table 4.15 shows, the total amount of inter-unit investment has been on the rise since 1997. The ratio of total inter-unit investments to the total net assets by affiliates climbed to 24.2% in 1997 and 31.0% in 1999. Reflecting the rising inter-unit investment, ownership concentration has gotten worse since 1997, as shown in Table 4.3.

Another policy measure aimed at disentangling the intercompany financial transactions was the governmental effort to limit the cross-debt payment guarantees among affiliates. Legislation concerning the cross debt-guarantees was promulgated in

December 1992, for the first time. The main content of the promulgated law was as follows: 1) No affiliated firms may use more than 200% of their shareholder's equity for sister companies' debt-payment guarantees. 2) Current debt-guarantees which exceeded 200% must be reduced over three years. Those firms which did not attain this target would be punished, but new debt-guarantees by affiliated firms were allowed for those new venture firms which invested in high technology. The debt-guarantees also extended to the debts of companies undertaken in accordance with the rationalization plan (FTC, *Yearbook of Fair Trade Practices*, 1993, 1994, 1995).

However, the government's bid to resolve the cross-debt guarantees did not go through without a struggle against the Chaebol's stubborn resistance. At the moment the government announced its intent to eventually eliminate cross-debt guarantees, in November 1991, the FKI announced its opposition to the government, saying that, as long as banks continued to lend money on the basis of collateral and third-party debt-payment guarantees, debt-guarantees among subsidiaries could never be dissolved. Especially small affiliated firms, which had no real estate to offer as collateral, would face an uphill battle against banks and, as a result, be forced to reduce their facility investments. The FKI claimed that these circumstances would eventually lead to economic recession.

Ignoring the Chaebol's collective action against the program, the government laid out three steps for the debt-guarantee resolution over several years. The first step was for the government to halt the increasing size of the debt-guarantees, already reaching over 400% of asset size. As of March 1992, the average debt-payment guarantee relative to total assets of each affiliate in the top five Chaebols was 538%. In the following two to three years, the government planned to reduce the average cross-debt guarantees of

affiliated firms to 100%. In the third phase, the government would decide what percentage would be allowed considering future development. The Minister of Finance blocked 465 affiliated firms from extending their debt-payment guarantees in June 1992. However, the government did allow affiliates to give each other debt-payment guarantees when they borrowed from non-banking financial institutions, considering that a complete halt of the cross-debt guarantees at one time might put too much strain on the whole economy.

At a business-government conference held at the Blue House in July 1992, the Chaebol insisted that the dissolution of debt-guarantees could not be realized without revolutionary changes in the banks' conventional collateral loan practices. The program could trigger economic recession by installing too many institutional hurdles to obtaining bank credit. The Chaebol also mentioned the danger that banks, worrying about the repayment of loans without debt-payment guarantees, might increase interest rates, and high interest rates, in turn, would compel Chaebol to mobilize business funds from the curb market. The overall side effects of this program would slow economic growth. In a word, the Chaebol not only lobbied the government to halt this program but also threatened the Korean state, using its overwhelming weight in the national economy. In particular, Chaebol made use of presidential election politics to frustrate the government program in late 1992 (the election was scheduled to be held in December 1992). The FKI intensified its lobbying to the ruling and opposition parties, along with threats to reduce campaign donations to those parties which did not advocate a liberal economy.²²

²² Yoo Chang-sun, the chair of the FKI, the lobbyist arm of the Chaebol, denounced the government's attempt to strike the Chaebol system through cross-debt

Yielding to the mounting pressure from the Chaebol, the legislative process was retarded time and again. In addition, the government revised a few key regulations in the context of the cross-debt guarantee system. The government retreated from the initial idea that Chaebol affiliates must reduce the ratio of debt-guarantees relative to capital size to 100% over 2-3 years. Instead, financial legislation imposed a 200% limit on the Chaebol. And the final draft of the bill multiplied the number of exceptions under which Chaebol were immune to the debt-guarantee regulations. For instance, R&D funds, industrial rationalization-related funds, and export/import-related funds were immune to these regulations. In addition, loans from non-banking financial institutions were also not subject to these regulations. The retreat of the government was attributable not only to the Chaebol's lobbying but also to policy conflicts within the policy-making agencies. The MOF and MOCI insisted on the expansion of cases immune to the cross-debt guarantee legislation, while the FTC upheld the initial draft. Especially the MOCI, which had the Chaebol as its departmental constituents and had become more vulnerable to the Chaebol's lobbying, strongly sided with the Chaebol's position in the policy making process (Ibid. 170).

Nevertheless, the cross-debt guarantee regulation seemed to attain its policy target at least superficially. As shown in Table 4.17, in 1993, the ratio of illegal debt-guarantees relative to capital size for the thirty largest Chaebol was 342.4%, totaling 120.6 trillion won. But this number decreased to 169.3% in 1994 and 47.7% in 1997. The larger the

guarantees, saying that the FKI would stop supplying political funds to those political parties which did not advocate the cause of liberal economy. Then he promised to raise the issue of the cross-debt guarantees time and again (*Joongang Daily*, 11/6/1992).

business group, the speedier the cutbacks in cross-debt guarantees were attained. By 1997, the top 10 Chaebol recorded debt-guarantees of 74.7% relative to capital size, while the 21st-30th Chaebol recorded 174.1%²³ (Lee Byoungki, 1998:26-31). However, despite the seemingly successful outcome, this policy did not make much contribution to either cutting back ownership concentration or to improving capital structure. As mentioned previously, the average internal share holding of the top 30 Chaebol remained very high and the average debt-to-equity ratio of Chaebol remained extremely high throughout this period.

Other measures to dissolve high ownership concentration included the government's drive toward listing affiliated firms in the stock market and the issuance of stocks. By inducing the public into the stock market, it was thought that the diffusion of ownership concentration would be accomplished. The government's attempt led to the listing of a substantial number of affiliates in the stock market and the issuance of a large volume of stocks between 1987 and 1989, but since 1990, the government's drive for listing affiliates did not create any substantial difference. As shown in Table 4.18, in 1994 only 27.6% of Chaebol-affiliated firms were listed in the stock market, decreasing 22.6% in 1996. More importantly, the ratio of listed firms relative to the total number of affiliated firms declined between 1994 and 1996. In terms of capital size, Chaebol showed a better record (Refer to Table 4.18). On the other hand, Chaebol remained extremely unwilling to issue stocks, mainly because of the owner-chairs' fear of losing control over

²³The means utilized by Chaebol to dissolve the cross-debt guarantees could be listed as: 1) debt-to-equity swaps, 2) repayment of loans 3) turning collateral loans to credit-based loans 4) abolishment of overlapping debt-guarantees, and 5) merger and issuance of stocks.

affiliated firms. As of 1997, only 1.3% of business funds came from the issuance of securities (Choi Seung-roh 1998:53). In short, the governmental attempts to reduce high ownership concentration continued to be ineffective.

The failure of ownership structure reform had its origin in weak political will. For instance, notwithstanding that the government had strengthened the fair trade watchdogs through frequent institutional reform, the watchdogs did not have enough institutional prowess to monitor and discipline the Chaebol. First, the FTC, as an adjunct judiciary agency, did not have the right to probe into the financial statements of the Chaebol. Second, the frequent replacement of the chair of the FTC prevented the FTC from being specialized and autonomous from politics. Third, the lack of political will to discipline Chaebol through diligent execution of the Fair Trade Act was found in many instances. For example, between 1991 and 1995, the FTC discovered only three cases of violations against restrictions on cross-unit investment. This extremely low number suggests that the FTC neglected its duty. In addition, no comprehensive probe into illegal financial transactions among affiliates was ever launched and no surcharge was ever placed on violators.

(4) Improvement of Monopolistic and Oligopolistic Market Structure

Although the high “market concentration” needed to be resolved to promote free and fair competition and to encourage innovative business activities, dealing with the abuse of the market-dominating position by the Chaebol was not the most critical issue with respect to Chaebol reform. Therefore, this section will only briefly review the development of fair trade practice laws and their effects on market structure under the

Roh and Kim Young-sam governments. The “Monopoly Regulation and Fair Trade Act” (hereafter “Fair Trade Act”) was first promulgated in December 1980. As of 1998, the Fair Trade Act basically consisted of five main sections: regulation of the abuse of market-dominance, restrictions on business combinations, restrictions on economic concentration, restrictions on improper acts, and prohibition of unfair business practices. The substance of the act was about how to regulate big business groups, which were most likely to violate free and fair trade practices. The act, since its birth in 1980, was amended five times, in 1986, 1990, 1992, 1994, and 1996 (FTC website). The frequent revisions of the act reflected the fact that the regulatory policy over the Chaebol had become the center piece of economic policy in the 1990s. Although the act consists of five different sections (some articles of this act were already discussed at length earlier), this discussion will be centered on article three²⁴ (improvement of monopolistic and oligopolistic market structure), article seven²⁵ (restrictions on business combinations) and the organizational evolution of the Fair Trade Commission, because only these parts are directly related to the issue of market concentration being dealt with in this section.

In 1980, the Fair Trade Commission (FTC) was established as an adjunct

²⁴ This article concerns restrictions on the abuse of market-dominant positions. “No market-dominating enterprise shall engage in any act included under any of the following items: 1) unreasonably fix, maintain, or lower the price of a good or set fees; 2) unreasonably control the sales of goods; 3) unreasonably interfere with the business activities of other enterprises; 4) unreasonably hinder the entry of new competitors; 5) otherwise threaten to substantially restrain competition or hinder interests of consumers” (Refer to Article 3 of Law No. 5235).

²⁵ According to this article, the government tried to prevent Chaebol-affiliated firms from acquiring or merging with another corporation if this take-over would lead to substantially restrained competition. No person or corporation was allowed to engage in a business combination with another company by means of compulsion or any other unfair measures (Refer to Article 7 of Law No. 5235).

institution of the now-defunct Economic Planning Board (EPB). The Fair Trade Office was organized as an executive office to enforce the decisions of the FTC, which was a deliberating body. A January, 1990, amendment of the Fair Trade Act made the FTC a more independent and specialized agency. Under the old law, the FTC basically carried out decisions of the head of the EPB with respect to the Fair Trade Act, but under the newly amended act, the FTC was no longer a subordinate arm of the head of the EPB. In 1994, the FTC was declared an independent central agency with quasi-judicial power under the Office of the Prime Minister. By separating the FTC from the EPB, the FTC's role was no longer subject to macroeconomic management of the EPB. In the fifth amendment to Fair Trade Act in December, 1996, the status of the FTC chairman was elevated to the ministerial level. The continual organizational restructuring of the FTC throughout the 1990s again indicates that the government was intensifying its regulatory policy over the Chaebol (Refer to *Yearbook of Fair Trade Practices*, each year).

Along with the organizational restructuring of the FTC, from 1987 on, the government also tried to establish and enforce measures designed to promote competition in the supply and demand markets with frequent revisions of the Fair Trade Act. In every single amendment of the Fair Trade Act, the government intensified regulations against the abuse of market-dominant positions. Before the 1987 amendment, the regulations concentrated on individual corporations but, from 1987 on, business groups became the focus of the regulations. According to the new laws, for instance, the FTC was allowed to investigate illegal financial transactions among Chaebol-affiliated firms. In addition, restrictions on business combinations were intensified as the FTC was granted control over the issuance of permits for business combinations. In 1990, when the government

freed the FTC from the head of the EPB, the FTC was able to expand its regulatory role against unfair trade practices beyond the turf previously designated by the EPB (FTC, *10 years of Fair Trade Practices*, 1991:54-59).

The government continued its efforts to restructure the monopolistic and oligopolistic market. In the 1994 amended version of the Fair Trade Act, stricter surcharges of 5% of total sales were imposed on those firms which violated the restrictions on business combinations. In the past, some large conglomerates did not take the surcharge punishment seriously, due to the negligible size of the surcharge (1% of total sales). Even a 5% surcharge did not seem high enough to constrain Chaebol groups from getting involved in illegal business combinations, considering that Japan imposed a 6% surcharge for the same reason, and the EU charged 10%. With respect to those firms which abused their market-dominant positions, an additional 2% surcharge, up to 30 million won, was imposed on violators (FTC, *Yearbook of Fair Trade Practices*, 1995:29-30). In the 1996 revision of the Fair Trade Act, the scope of firms to which the restriction of business combinations was applicable was extended, so that even small-sized firms' mergers and acquisitions came under the regulations. The FTC intensified its review of business combinations by more closely checking on whether or not new business combinations led to oligopolistic or monopolistic market structures. In addition, the surcharge on the abuser of a market-dominant position went from 2% up to 3% of total sales (FTC, *Yearbook of Fair Trade Practices*, 1997:19).

Now let us measure whether or not the governmental efforts to reduce market oligopoly and monopoly were successful under the Roh and Kim governments. Throughout the 1990s, improvements in the market structure of Korean manufacturing

proceeded at a snail's pace, as seen in Table 4.7. The Chaebol's contributions to the oligopolistic and monopolistic market structure remained almost unchanged. A year after the first intensified Fair Trade Act was introduced in 1988, the 30 largest Chaebol accounted for 68.9% of the monopolistic market structure, and during the last year of the Kim Young-sam administration, 1997, their contribution remained nearly constant at 70.5%. So the Korean market structure, as of 1997, remained highly concentrated in the hands of the Chaebol.

There seem to be many reasons why Korean Chaebol were able to remain deeply entrenched in the monopolistic market structure. First, it basically takes time for the government to undo the legacy of the developmental era, that is, the monopolistic market structure. Second, the limited size of the domestic market in some industrial sectors could only viably support one or two producers. Third, and most importantly, the government did not carry through on measures against firms which violated regulations. For instance, between 1981 and 1995, only 23 cases of "abuse of market-dominant positions" were detected by the FTC. Considering the Chaebol's market dominating power, this number directly reflects the fact that the government did not have the will to carry out adequate measures against the Chaebol. Furthermore, the government showed leniency toward those market-violating Chaebol. Of the 23 cases, none of the violators were fined, 13 of them (56.5%) received correction orders, 5 (21.7%) correction recommendations, and 5 (21.7%) warnings (Refer to FTC, *Yearbook of Fair Trade Practices*, 1995:369). With respect to "restrictions on business combinations," the FTC showed the same lenient attitude toward violators (Ibid, p. 369). In conclusion, the government's efforts to lessen the market concentration in the hands of Chaebol bore little fruit.

CHAEBOL REFORM FAILURE AND ECONOMIC CRISIS

The immediate causes that triggered the currency crisis at the end of 1997 were the massive exodus of international hot money, irresponsible measures of the government, and a series of errors in the timing of policy measures. However, the Korean economic crisis had its roots in the structural weakness of Korean corporations and financial industries. The crisis began with a spate of business bankruptcies. The serial bankruptcies of Chaebol groups showed the weakness of the Chaebol system under the liquidity crisis. Korean conglomerates' strategic focus had been on growth (total asset and total sales growth) based on a strategy of diversification, neglecting profitability and productivity. The world system required the Korean Chaebol to make a "paradigm shift" from a growth-oriented to a profit- and productivity-oriented strategy. Chaebol reform attempted to manufacture this "paradigm shift" from the top down, because the internal dynamics of the Chaebol system were prohibitive of this kind of move. The Korean state strove to improve the competitiveness of Chaebol by reduction of their debt/equity ratios, singling out the core business lines for each Chaebol, and reforming their control structure and high ownership concentration. But the Korean state, which became increasingly entrapped under the Chaebol's rent-seeking, could not manage Chaebol reform programs effectively, resulting in the low competitiveness of the Chaebol in the global market.

Since 1996, as a consequence of Chaebol reform failure, Korean corporations' profitability²⁶ has set record lows and debt-to-equity ratios²⁷ have multiplied with the rise

²⁶ Korean firms of different sizes have suffered the loss of profitability since 1996. The top five Chaebol especially suffered the most. The 1st-5th Chaebol recorded 5.6% in "ordinary income to total assets" (which means that companies incurred a profit of 56 won per 1,000 won worth of assets) in 1995, but this number dropped to 1.0%, while average

of their unit financial and labor costs. R&D investment has been contracting. For instance, as shown in Table 4.5, “interest expenses to sales” of Korean firms have been much higher than those of their counterparts throughout the 1990s. As of 1995, the average hourly wage of workers in the manufacturing sector was recorded at 7.4 dollars in Korea, 5.8 dollars in Taiwan, and 7.2 dollars in Singapore. High interest rates and high costs of raw materials for production also contributed to the poor performance of Korean corporations. A litany of the elements embedded in the Chaebol system which accounted for deteriorating profitability and productivity include the weak capital structure (high debt/equity ratio), low productivity as a result of non-specialization in narrowly-defined industrial lines at the Chaebol level, systematic hindrances to the exit of ailing firms

firms in the manufacturing sector observed a 2.6% loss in terms of “ordinary income to total assets.” A comparison of profitability across different countries (Refer to Table 4.5) also demonstrated that the profitability of Korean corporations (in terms of “ordinary income to total assets”) was much lower than their global competitors. This low profitability was mostly attributable to the gross financial burden (which is demonstrated in the high “interest expenses to sales”). The average Korean firms’ financial expenses were almost three times as high as their counterparts in the United States, Japan, and Taiwan. Accordingly, the “ordinary income to sales” of Korean corporations were recorded as higher than or about the same as their global competitors throughout the 1990s (as shown in Table 4.5), but the high “interest expenses to sales” substantially cut down the “ordinary income to total assets,” pushing Korean firms behind their competitors.

²⁷Korean firms’ financial stability has worsened since 1996. As shown in Table 5.2, every single category of business group in the table accumulated a large amount of debt. For instance, mid-size Chaebol’s debt-to-equity ratio, which had neared 500% in 1994, accumulated to 621% in 1997 (as a consequence, mid-size Chaebol were the first to experience a chain of bankruptcies in 1997). Equity to asset ratio, debt-to-equity ratio and total borrowing to total assets in all different sizes of Korean corporations deteriorated gradually from 1994 to 1997. For instance, the top 11-30th Chaebols recorded only 13.9% in terms of equity-to-assets in 1997, which is much lower than their counterparts in the global market. As shown in Table 4.5, the average Taiwanese firms in the manufacturing sector recorded over 50% in terms of equity to total assets in 1994, whereas Korean firms averaged only 24.8%.

through illegal financial subsidies from other affiliates, and irrational decision-making of the owner-chair on investment projects.

As long as the Korean economy maintained high growth either from the export boom between 1986 and 1988, or on the basis of hot domestic consumption between 1990 and 1992, big business was able to shoulder the excessively high finance costs. But the sagging economy put most debt-ridden businesses in a precarious financial situation. In addition, under the WTO system and as an OECD member, the Korean government was no longer permitted to finance export industries in order to offset the disadvantages of Korean big businesses, leaving big business under the forces of the international market. Structural market reform, including the adoption of the real name transaction system and real name transactions in real estate, also removed many easy profiteering opportunities of speculating in real estate and the curb market by the Chaebol (Refer to Figure 4.1) (Jung Ku-hyun 1988; Rhee Sung-sup 1998).

As a result of dwindling competitiveness in the global market, mid-sized Chaebol burdened with exceptionally high debt-to-equity ratios first went bankrupt in early 1997. The bankruptcy of a single ailing affiliate often pushed the whole Chaebol group into financial insolvency because of the financial entanglements among affiliated firms via the cross-debt guarantees, the inter-unit investments, and illegal financial transactions. The serial bankruptcies²⁸ of mid-sized Chaebol groups in turn stressed the financial market, as

²⁸ The serial bankruptcies of the mid-sized Chaebol were as follows: Hanbo Group (January 13), Woosung (March 8), Sammee (March 24), Jinro (April 28), Keunyoung (May 19), Daeryong (May 26), Hanshinkongyoung (June 12), Kia (July 15), and Hanra (December 8). Their accumulative debt from financial institutions amassed to 44.94 trillion won (about 52.6 billion dollars) (Lee Jong-wook, 1998, *Currency Crisis and IMF in South Korea*, Seoul: Kyongmoonsah Publisher, 1998:86.)

creditors amassed a large amount of non-performing loans and lost their investments. For instance, the accumulative debt owed to financial institutions by bankrupt firms in the first half of 1997 was 42.73 trillion won. As shown in Table 5.5, the total non-performing loans of commercial banks since 1996 has been rising sharply (this non-performing loan ratio is extremely high by international standards) (Refer to Figure 4.1). Accordingly, the serial insolvencies of commercial banks, merchant banks and other financial institutions followed the serial bankruptcies of mid-size Chaebol groups, eventually causing the currency crisis at the end of 1997.

A combination of inadequate financial sector supervision, poor assessment and management for financial risk, and the maintenance of relatively fixed exchange rates led banks and corporations to borrow large amounts of international capital, much of it short-term, denominated in foreign currency and unhedged. Especially the non-banking financial intermediaries, working as the financial arm of the top Chaebols, borrowed excessively from foreign commercial banks on a short-term basis. The profligate and excessive use of foreign funds was not closely monitored or disciplined by government regulators, instead the government used a hands-off approach in pursuit of unprepared financial liberalization. This hands-off approach was attributable to: 1) the lack of institutional provisions for supervision, regulation, and market-discipline over big business and the financial market; and 2) the high wave of false neoliberalism during the market-oriented reform. In particular, the outdated financial supervisory system made it almost impossible to closely monitor the flow of foreign capital. The financial crisis was not triggered by an overly excessive interventionist policy but by inadequate regulatory policy measures (Haggard 1999). Chaebol used their own financial institutions, such as merchant banks, investment

& trust fund firms, and insurance firms to finance excessive investments. The stability of the financial system was held hostage by a few Chaebol-dominated superstructures, whose viability could not be monitored due to their ability to raise financial resources more or less at their whim. Thus, it was almost impossible to prevent the use of public money arbitrarily and to preserve the stability of the financial system without reform of the Chaebol system.

The non-transparent ties between big business and financial institutions permitted Chaebol to carry out excessive investments which in turn triggered the foreign exchange crisis. According to the KDI report (4/5/1999), about 20% of investments carried out by the top five Chaebol between 1992 and 1997 were not economically sound in principle. About 20% of the top five Chaebol's investments are believed to have been conducted in anticipation of financial rescue by the government. In the 1992-1997 period, the top five Chaebol's average ratio of investments to their fixed assets stood at 38%, compared with 26% for mid-sized firms. At a time when mid-ranking conglomerates cut investments by 0.9 percentage points amid business uncertainties, the top-five Chaebol groups increased their investments by five percentage points. Duplicated investment led to excess capacity in 10 major industrial areas, including automobiles, ship engines, semiconductors, railroad vehicles, petrochemical, aerospace, power generation, and oil refining. This overinvestment was carried out in the belief that they were "too big to fail" (*Korea Herald*, 4/5/1999). The overcapacity in major industries in turn lowered the corporations' profitability and put most of them under financial strain.

The changes in the global trading system also set Korean corporations under a quandary. Under the WTO system and as a member of OECD, Korean firms were forced

to compete against foreign firms on a level playing field that left no room for rent-seeking activities or generous subsidies from the government. Thus, Chaebol had to handle the problems occurring from their excessive investments by themselves, but did not have the financial capacity to do so, except by postponing their problems through the infusion of short-term foreign funds. The Chaebol were able to bring in a huge amount of short-term foreign capital via their financial subsidiaries, such as merchant banks, lease firms, security companies, and trust & investment funds. These non-banking intermediaries were permitted to borrow foreign capital without limit, unlike commercial banks which were under an 8% BIS regulation. Additionally, non-banking institutions had remained almost outside governmental supervision because of the compartmentalized financial supervisory institutions. For instance, merchant banks, lease firms, and trust & investment companies were under the MOEF's supervision, whereas commercial banks were under the Bank Supervisory Commission without an overarching financial regulator. To make matters worse, these supervisory institutions were not equipped with trained personnel, owing to frequent bureaucratic reshuffling under the Kim Young-sam administration (Lee Jong-wook, 1998:105-108).

Under the slackened financial supervision, the short-term foreign capital borrowing reached 100 billion dollars by the end of 1996, and stood at 88.9 billion dollars in November 1998. The foreign debt structure was dominated by short-term borrowing, which constituted 63.5% of total foreign debt in 1996 and 54.9% in 1997. Another important trait of Korean foreign debt was that, unlike Latin American countries which went through a currency crisis, Korean public debt accounted for a small portion of the total debt, only 1.5% in 1996 and 1.2% in 1997, just before falling into the IMF bailout

program. However, a large portion of financial institutions involved in foreign borrowing were backed by the Korean government's debt repayment guarantees, so that most financial institutions were able to obtain more foreign capital than they could repay. But foreign creditors began to seriously doubt the Korean government's capacity to make payments amid the enormously rising foreign debt. There was also a general loss of confidence in the economic stewardship of the government by foreign creditors. As for foreign creditors, who became aware that there was no reliable risk management means for their Korean loans amid the rising financial market instability, the only means by which they could secure their capital was to withdraw matured loans. Thus, the massive exodus of international hot money put the concluding mark on the long dragged-out Chaebol-led bubble economy.

CONCLUSION

The economic crisis of 1997 had its origins in the failure of the market deepening programs pursued under the rule of Roh (1988-1992) and Kim (1993-1997). The core market deepening program, that is, corporate (Chaebol) restructuring, was deferred or abandoned time and again, resulting in the lingering instability of market rules. The failure of corporate restructuring is attributable largely to the fact that the Korean state was increasingly swayed by the particular interests of the Chaebol. The Korean state found, at the end of dense industrialization, that it was supposed to act not only as a regulator and supervisor but also as a new type of entrepreneur carrying out "firm-specific transformation." Because of the Chaebol's organizational characteristics, which were against market rules, the Korean state was called to more directly intervene in the

corporate sector. However, being deprived of its autonomy from private powerholders, the Korean state became increasingly ineffective in repairing the legacy of state-led development, that is, the four different types of economic concentrations embodied by the Chaebol (“general,” “ownership,” “conglomerate” and “market” concentrations).

Restructuring the Chaebol was a prerequisite step for Korea to promote the competitiveness of Korean corporations and to set solid institutional foundations for a market-oriented economy. But every single policy measure initiated by the state encountered a harsh challenge from big business groups, which commanded ample power through their sheer size, diversification, and well-defined organizational strength. Although big business groups which are highly diversified over unrelated business lines are commonly found in developing countries, Korean Chaebol stand out in terms of the degree of their size, high diversification of business lines, and share in the national economy. Needless to say, the distinct organizational structure of the Chaebol made a huge contribution to the rapid deprivation of the Korean state’s autonomy, compared with Taiwan and Singapore. In other words, the Korean state could not but encounter a daunting challenge from the private sector, owing to the Chaebol’s heavy weight in the national economy. As demonstrated in this chapter, the democratic government (1988-1997) became more sensitive to the economic performance and investment decisions of the Chaebol and gradually lost its leverage against the Chaebol during this period. The state’s structural dependency upon big capital increasingly deepened throughout this period.

The question raised here was why the Korean state displayed its “structural dependency upon big capital” more saliently during this period (1988-1997) than the

previous period (Chun's reign: 1980-1987), despite the fact that the Chaebol's share in the national economy remained more or less at the same level as before. The short answer is that the Korean state's high structural dependency upon capital was caused largely by changes that occurred in the internal structure of the state under the rule of Roh and Kim. The Chaebol's influential power over the state accelerated between the two different periods (1980-1987 and 1988-1997), mainly owing to the fact that the "premature procedural democracy" exhausted the institutional sources of the developmental state. The deprivation of the Korean state's source of autonomy began with the democratic regime's clear departure from previous regimes' survival strategies (Refer to Chapter II). Electoral politics forced the chief-executives to change their political survival tactics. Region-based political coalitions came to substitute for the traditional growth-oriented coalitions during the post-developmental era. In an effort to construct region-based political coalitions, the chief-executives began to implant their political proteges in the core economic agencies and machinery, inflicting serious damage on the institutional autonomy of economic agencies. The politicization of elite assignments in turn shattered the coherent cohesiveness of the policy-making regime, resulting in rising bureaucratic rivalry amongst major economic agencies. Politicization also forced economic technocrats to be more sensitive to day-to-day political quarrels than to the collective goals, such as the promotion of economic progress. The vanishing unity among economic agencies in turn provided the Chaebol with ample opportunity to manipulate the policy-making process. The Chaebol's access to separate individual state managers has increasingly become more permissible. The Chaebol also turned themselves into rent-seekers, by engaging in turf wars for more and better credit allocation and business licensing. The

government lost its disciplinary and supervisory role over the Chaebol's investments and financial transactions, leading to the mounting speculative investments by the Chaebol during the late 1980s and the early 1990s.

In short, the state's salient structural dependency upon the Chaebol during the rule of Roh and Kim must be understood in the context of "participatory politics" and subsequent changes in the internal structure of the state (described extensively in Chapter II). This historic comparative analysis again proves the notion that structural factors (capital size) have always been intermediated by and channeled through an institutional context. Without specifying the changes in the political aspects of the Korean state brought about by democratization, one cannot adequately interpret the structural characteristics of business-state interactions. Democratization placed more stress upon the already outdated developmental machinery without a timely replacement. As shown in Chapter II, which explored the effects of democratization on the internal structure of the state, the overall character of political coalition during this period changed from development-based to region-based. In other words, the power circle of coalition politics has become filled up with a particular species of elites, that is, Youngnam elites. More problematically, the presidents' proteges occupied a large portion of the nuclear bureaus of pilot economic agencies. In addition, the policy-making regime has increasingly lost its corporate cohesiveness due to the rising rivalry of cabinet ministries and ideological confusions during democratization. As a consequence, the Korean state lost its dominant status in the business-state nexus. Rather, state managers were swayed by the vested interests of private powerholders.

The business-state nexus, which had been utilized as the driving force for rapid

economic development, increasingly turned into a rent-seeking cartel, though not completely. The informal and interpersonal networks between the private and public sectors evolved from an efficient conduit for market and information channeling into a source of rent-seeking. On the other hand, the state more or less held on to its discretionary approach to credit allocation and business licensing, resulting in the creation of huge rents. Despite the sheer scale of the Korean economy and the complexity of economic transactions in the private sector which prevented the business-state nexus from working as an effective device for resource distribution, the old-fashioned practices of credit allocation through government-controlled banks remained a predominant form. Without the replacement of the old-fashioned rules with institutionalized, transparent, open rules regulating business-state interactions, the close business-state link became preoccupied with corruption and pork-barreling. Accordingly, the business-state nexus lost its high flexibility and responsiveness as an institution in carrying out transformative programs. When the state fell into disarray and lost its autonomy from and dominance over private powerholders, cronies within the intimate circle of the business-state linkage pursued their separate interests, instead of their collective goals such as the promotion of national wealth.

This chapter demonstrates that ideological confusion was responsible for the derailing of the business-state nexus from working as an effective tool for the market deepening program. “Market deepening” often involved conflicting or complementary policy measures such as “deregulation,” “structural reform for further economic liberalization,” such as RNFTS, “market regulations,” and “supervision and disciplining.” These policy concepts were confusing by nature and were entangled with social/political

issues following democratization. Popular demand for “economic justice” and “economic democracy” complicated the policy-making process. Bickering over policy within the economic bureaucracy already existed widely, because the economic issues to be dealt with during the post-developmental era were by nature puzzling. The ideological confusion made it impossible for the democratic government to persuade big business, that, for instance, “deregulation” and “structural reform” could be complementary over the long-run, and that genuine market-oriented reform could be conducive to the eventual prosperity of corporations. Rather, the government was coaxed by big business toward “false liberalism.”

The consequences of the failure of Chaebol reform were demonstrated in the rising aggregated economic concentration in the hands of the Chaebol. In particular, during 1990 and 1997 when the government’s regulatory policies over the Chaebol were slackened, the economic concentration ratio in the context of employment, sales, fixed assets, and value added rose. Considering that there was a slight decline in these numbers during Chun’s rule when Chaebol regulation was not the top policy priority, this rising concentration ratio clearly implies the failure of regulatory policies over the Chaebol (Refer to Graph 3.6). In addition, the Korean government’s efforts to single out flagship firms for each Chaebol and thereby improve the competitiveness of Korean corporations in the global market ended up in disastrous failure. As shown in Graph 3.5, the average number of industries each individual Chaebol was involved in declined slightly during the 1980s. But this number began to rise from 1990 on, reaching a pinnacle in 1997 when Korean firms went into serial bankruptcy. The mounting economic concentration in the hands of the Chaebol, which became increasingly free from government supervision and

regulation, turned out to be costly in the late 1990s. In short, deregulation without strengthening the supervisory and regulatory role of the state in a timely manner eventually led to the breakdown of the economy at the end of 1997.

Table 4.1

The Ratio of Export Volume by the 7 Largest GTCs to Total Export Volume

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Total export volume	30	35	47	61	62	65	72	77	82	96	125	130	137
Export by 7 GTCs	15	14	18	24	24	24	30	33	36	42	58	62	67
(percentage)	48.0	40.3	37.4	39.0	37.9	37.6	42.2	43.2	43.4	43.6	46.3	47.7	48.9
Total import volume	31	32	41	52	61	70	82	82	84	102	135	150	145
Import by 7 GTCs	5	3	6	7	9	10	11	12	12	15	25	33	33
(percentage)	17.6	10.8	14.1	14.3	14.6	14.2	13.3	15.1	13.9	15.0	18.5	22.2	22.9

Source: Choi, Seoung-roh, *Big Business Groups in Korea*, 1995, 1996, 1997, 1998.

Table 4.3
Internal Share Holding Rate of Top 30 & Top 5 Chaebols: 1983-1999

	1983	1987	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Top thirty Chaebols (A+B+C)	57.2	56.2	47.2	45.4	46.9	46.1	43.4	42.7	43.3	44.1	43.0	44.5	50.5
by owner-chair (A)	-	-	-	-	-	-	4.1	4.2	4.9	4.8	3.7	3.1	2.0
by his family (B)	-	-	-	-	-	-	6.2	5.5	5.6	5.5	4.8	4.8	3.4
(A+B)	17.2	15.8	14.7	13.7	13.9	12.6	10.3	9.7	10.5	10.3	8.5	7.9	5.4
by member companies (C.)	40.4	40.4	32.5	31.7	33.0	33.5	33.1	33.1	32.4	33.3	33.7	35.7	44.1
Top five Chaebols (A+B+C)	-	60.3	49.4	49.6	51.6	51.9	49.0	47.5	-	-	-	46.8	53.5
(A+B)	-	15.6	13.7	13.3	13.2	13.3	11.8	12.5	-	-	-	7.2	4.6
by member companies (C.)	-	44.7	35.7	36.3	38.4	38.6	37.2	35.0	-	-	-	39.6	48.9
Hyundai (A+B+C)	81.4	79.9	69.0	60.2	67.8	65.7	57.8	61.3	60.4	61.4	56.2	52.9	55.8
Samsung (A+B+C)	59.5	56.5	50.3	51.4	53.2	58.3	52.9	48.9	49.3	49.0	46.7	43.7	41.2
Daewoo (A+B+C)	70.6	56.2	43.6	49.1	50.4	48.8	46.9	42.4	41.4	41.7	38.3	40.1	53.1
LG (A+B+C)	30.2	41.5	33.8	35.2	38.3	39.7	38.8	37.7	39.7	39.9	40.1	41.6	51.7

Reference: Internal Share Holding Rate is a weighted average (where the weight is the size of capital) for each business group of the ownership shares of the founding family and relatives plus those of other companies in the group.

Source: Fair Trade Commission, *Whitepaper of Fair Trade Practices*, various issues.

Table 4.4
Korean Corporate Sector

	Indicators concerning each category	1990	1991	1992	1993	1994	1995	1996	1997
Growth	Growth rate of sales (a)	18.6	17.1	10.3	9.9	18.2	20.4	10.3	11.0
	Growth rate of total assets (b)	18.9	20.9	11.0	13.2	13.2	19.0	18.2	13.7
Profitability	Operating income to sales (c.)	6.5	6.6	6.6	7.0	7.7	8.3	6.5	8.3
	Ordinary income to sales (d)	2.3	1.8	1.5	1.7	2.7	3.6	1.0	-0.3
	Interest expenses to sales (e)	5.1	-	6.3	5.9	5.6	5.6	5.8	6.4
Activity	Gross capital turnover (f)	1.04	1.00	0.95	0.93	0.97	1.00	-	-
Financial Stability	Stockholder equity to total assets (g)	25.9	24.4	23.9	25.3	24.8	25.9	24.0	20.2
	Debt-to-equity ratio (h)	286.3	309.2	318.7	294.9	302.5	286.8	317.1	396.3
	Total borrowing to total assets (I)	42.8	44.6	47.2	46.8	44.5	44.8	47.7	54.2
	Current ratio (j)	99.4	95.8	92.8	94.1	94.6	95.4	91.9	91.8
Productivity	Growth rate of gross value added per capita (k)	18.6	16.9	12.6	14.0	18.1	19.2	1.1	4.7

(a) Growth rate of sales = current sales / previous sales * 100 - 100: This is a primary indicator which measures the quantity growth of a firm.

(b) Growth rate of total assets = current total assets/previous total assets * 100 - 100: This is an indicator which measures the overall growth of a firm.

(c.) Operating income to sales = operating income / sales * 100. This measures the effectiveness of business operation.

(d) Ordinary income to sales = ordinary income / sales * 100: This indicator grasps the aspects of both sales and financial activities of a firm, unlike "Operating income to sales."

(e) Interest expenses to sales = interest expenses / sales * 100: This indicator measures the degree to which a firm pays financial

(Table 4.4 continued on next page)

Table 4.4 Continued

expenses.

(f) Gross Capital Turnover

(g) Equity to total assets = stockholders' equity to total assets * 100: This indicator measures the weight of equity to total assets.

(h) Debt-to-equity ratio

(I) Total borrowing to total assets

(j) Current ratio = currents / fixed assets * 100.

(k) Growth rate of gross value added per capita = current value-added per capita / previous value-added per capita * 100 - 100.

Source: BOK, *Financial Statement of Management*, various years.

Table 4.5
Corporate Sectors in Korea, USA, Japan, & Taiwan

	Indicators for each category	1990	1991	1992	1993	1994	1995	1996	1997	
Profit-ability	Operating income to sales	Korea	6.5	6.6	6.6	7.0	7.7	8.3	6.5	8.3
		America	-	4.9	-	6.0	7.4	-	7.4	-
		Japan	4.8	-	3.3	-	2.9	-	3.6	-
		Taiwan	7.0	-	5.7	-	6.6	7.3	-	-
	Ordinary income to sales	Korea	2.3	1.8	1.5	1.7	2.7	3.6	1.0	-0.3
		America	-	3.7	-	4.0	7.5	-	8.3	-
		Japan	4.3	-	2.6	-	2.4	-	3.4	-
		Taiwan	4.5	-	3.4	-	4.9	5.1	-	-
	Interest expenses to sales	Korea	5.1	-	6.3	5.9	5.6	5.6	5.8	6.4
		America	-	-	-	-	-	-	-	-
		Japan	2.1	-	2.0	-	1.6	-	1.0	-
		Taiwan	2.5	-	2.3	-	1.7	2.2	-	-

(Table 4.5 continued on next page)

Table 4.5 Continued

Financial Stability	Stockholder's equity to total assets	Korea											
		America	Japan	Taiwan	Korea	America	Japan	Taiwan	Korea	America	Japan	Taiwan	
		25.9	24.4	23.9	25.3	24.8	25.9	24.0	20.2				
		-	40.4	-	36.4	37.5	-	39.4	-				
		30.6	-	31.6	-	32.3	-	34.1	-				
		54.5	-	51.8	-	53.4	53.9	-	-				
	Debt-to-equity ratio	286.3	309.2	318.7	294.9	302.5	286.8	317.1	396.3				
		-	147.3	-	174.5	166.5	-	153.5	-				
		227.1	-	216.4	-	209.3	-	193.2	-				
		83.4	-	93.0	-	87.2	85.7	-	-				
	Total borrowing to total assets	42.8	44.6	47.2	46.8	44.5	44.8	47.7	54.2				
		-	29.4	-	27.4	26.8	-	25.6	-				
		33.0	-	39.6	-	36.2	-	33.1	-				
		24.2	-	35.6	-	24.2	26.2	-	-				
	Current ratio	99.4	95.8	92.8	94.1	94.6	95.4	91.9	91.8				
		-	140.9	-	140.3	139.4	-	137.9	-				
		131.2	-	130.9	-	131.8	-	130.0	-				
		123.4	-	119.7	-	124.9	129.4	-	-				

Source: BOK, *Financial Statements of Management*, each year.

Table 4.6
Market Structure of Korean Manufacturing (%)

	1970	1974	1977	1982	1987
Monopoly					
Commodities	29.6	30.8	31.6	23.4	20.2
Sales	8.7	12.7	16.3	11.4	7.8
Duopoly					
Commodities	18.7	17.9	20.1	11.1	10.5
Sales	16.3	12.6	11.0	6.6	7.7
Oligopoly					
Commodities	33.2	34.2	32.0	47.4	44.5
Sales	35.1	38.6	33.9	50.6	40.2
Noncompetitive					
Commodities	81.5	82.8	83.7	82.1	75.2
Sales	61.1	63.9	61.2	68.6	55.7
Competitive					
Commodities	18.5	17.2	16.3	17.9	24.8
Sales	39.9	36.2	38.8	31.4	44.3

Reference: a) Monopoly: indicates that one-firm concentration exceeds 80 percent.

b) Duopoly: indicates that two-firm concentration exceeds 80 percent.

c) Oligopoly: indicates that the top three firms produce more than 60 percent.

Source: Jung-en Woo, 1991 or Whitepaper of FTC.

Table 4.7
Market Structure of Korean Manufacturing in 1990s

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Monopoly	24	24	17	14	27	29	28	24	21	24
Commodities	(14.4)	(14.2)	(9.3)	(7.3)	(14.6)	(15.0)	(12.3)			
Duopoly	46	50	52	47	44	47	45	41	44	39
Commodities	(27.5)	(29.6)	(28.4)	(24.6)	(23.8)	(24.3)	(19.7)			
Oligopoly	65	62	75	79	71	62	67	64	63	66
Commodities	(38.9)	(36.7)	(41.0)	(41.4)	(38.4)	(32.1)	(29.4)			
Total commod.	135	136	144	140	140	138	140	129	128	129
Competitive	19.1	19.6	21.2	26.7	24.2	28.4	38.6			
Non-competitive	80.9	80.4	78.8	73.3	75.8	71.6	61.4			

Reference: a) Monopoly indicates that one-firm concentration exceeds 50 percent.

b) Duopoly indicates that two-firm concentration exceeds 50 percent.

c) Oligopoly indicates that the top three firms produce more than 50 percent.

*** For each category, the table lists the number of commodities and its percentage.

Source: FTC, *Whitepaper of FTC*, each year.

Table 4.8
Percentage of Market Concentration Caused by Top Chaebols in Manufacturing
Sectors (in which Chaebols participated) in the 1980s
(Unit: percent)

Top Chaebols	1982	1983	1984	1985	1986	1987
Top 5	1.0	62.5	65.7	67.6	65.6	67.8
Top 10	64.6	66.6	67.7	71.8	69.1	70.5
Top 20	70.1	71.4	73.6	75.8	72.4	73.7
Top 30	72.6	73.4	74.6	77.5	75.0	75.1

Source: Jeong Byung-huy and Yang Young-sik (1992:55)

Table 4.9
Market Domination by Top 30 Chaebols According to Commodities

	1984	1986	1988	1989	1995	1996	1997	1998	1999
Total commodities (A)	71	100	122	131	138	140	166	128	129
Top 30 Chaebols (B)	45	77	84	99	82	90	117	98	87
B/A (%)	63.4	77.0	68.9	75.0	59.4	64.3	70.5	66.4	67.4

Reference: (A) indicates the number of commodities of which over 50% of the market share was concentrated in the hands of three or fewer firms.

(B) indicates the number of monopolistic commodities held by the top 30 Chaebols.

(B/A) indicates the contribution of market monopoly by top 30 Chaebols, when calculated on the basis of commodities.
Source: FTC, *Whitepaper of FTC*, each year.

Table 4.10
Trend of Youngnam Elites in Government-run Banks

	1961- 1973	1974- 1979	1980- 1987	1988- 1992	1993- 1997	1998-
Korea Development Bank	3/9 (0) 1/20 (12)	2/6 (0) 2/12 (4)	3/7 (0) 3/15 (2)	2/5 (0) 3/14 (1)	1/5 (0) 6/12 (0)	0/2 (0) 2/9 (0)
Export-Import Bank		1/4 (0) 0/4 (3)	3/6 (0) 1/13 (5)	2/7 (0) 3/12 (0)	1/4 (0) 2/9 (0)	0/2 (0) 0/6 (0)
Banks for SMEs	4/6 (0) 4/19 (7)	3/7 (0) 0/10 (4)	2/6 (0) 1/15 (6)	2/5 (0) 6/17 (0)	2/4 (0) 6/19 (0)	½ (0) 3/9 (0)
Bank of Housing	3/4 (0) 1/7 (4)	1/6 (3) 0/9 (9)	5/6 (0) 4/12 (2)	1/4 (0) 2/9 (0)	0/5 (0) 6/16 (0)	0/2 (0) 4/8 (0)
Shinyoung bojeung gikum		1/3 (1) 1/1 (0)	1/8 (2) 0/3 (1)	1/4 (0) 0/2 (0)	1/6 (0) ½ (0)	½ (0) 1/1 (0)
Total	10/19 (0) 6/46 (23)	8/26 (4) 3/36 (20)	14/33 (2) 9/58 (16)	8/25 (0) 14/54 (1)	5/24 (0) 21/58 (0)	2/10 (0) 10/33 (0)
Effective percentage	*	11/38 (29.0%)	23/73 (31.5%)	22/78 (28.2%)	26/82 (31.7%)	12/43 (27.9%)
Missing cases	23/65	24/62	18/91	1/79	0/82	0/43

Source: Data was compiled by collecting lists of elites (Chairs, vice chairs and boards of directors) and determining their hometowns using information from *Dongah Inmulyunkam*.

Reference: The top row in each cell represents chairs and vice-chairs (or presidents and vice-presidents).

2nd row represents boards of directors.

numerator represents number of elites from Youngnam Province who held those positions during that time period.

denominator represents the total number of elites who held those positions during that time period.

number in parenthesis represents cases where the hometown is unknown.

*Data not available for many cases in the early years. Too many variables are missing in this column, so the validity of the data is in doubt.

Table 4.11
Trend of Youngnam Elites in 6 Major Commercial Banks

	1961- 1973	1974- 1979	1980- 1987	1988- 1992	1993- 1997	1998-
Foreign Exchange Bank	2/6(0) 1/15(5)	2/8 (1) 5/28 (10)	1/6 (0) 3/22 (7)	2/5 (0) 4/20/ (0)	0/6 (0) 4/22 (0)	0/2 (0) 1/9 (0)
Seoul Bank	3/9 (0) 3/16 (7)	0/7 (1) 2/17 (13)	0/5 (1) 3/18 (8)	2/4 (0) 3/15 (0)	1/6 (0) 6/20 (0)	0/2 (0) 2/7 (0)
Choheung Bank	4/11 (1) 0/15 (11)	0/7 (0) 0/14 (11)	4/8 (2) 4/16 (7)	2/4 (0) 3/16 (2)	2/6 (0) 4/18 (0)	0/3 (0) 2/8 (0)
Hanil Bank	2/11 (1) 5/22 (11)	1/6 (1) 3/15 (10)	1/10 (1) 2/19 (5)	1/6 (0) 3/20 (1)	1/6 (0) 10/18 (0)	0/3 (0) 4/9 (0)
Korea First Bank	4/13 (5) 0/7 (4)	2/14 (4) 1/4 (3)	2/12 (1) 1/8 (3)	5/9 (0) 2/8 (0)	3/6 (0) 3/16 (0)	½ (0) 1/6 (0)
Sangub Bank	4/9 (0) 6/16 (8)	2/5 (1) 2/11 (7)	2/7 (0) 0/16 (0)	2/7 (0) 3/16 (0)	1/3 (0) 5/18 (0)	0/2 (0) 4/9 (0)
Total	19/59 (7) 15/91/ (46)	7/47 (8) 13/89 (54)	10/48 (5) 13/99 (39)	14/35 (0) 18/95 (3)	8/33 (0) 32/112 (0)	1/14 (0) 14/48 (0)
Effective Percentage	*	*	23/103 (22.3%)	32/127 (25.2%)	40/145 (27.6)	15/62 (24.2)
Missing cases	97/150	62/136	44/147	3/130	0/145	0/62

Source: Data was compiled by collecting lists of elites (Chairs, vice chairs and boards of directors) and determining their hometowns using information from *Dongah Inmulyunkam*.

Reference: The top row in each cell represents chairs and vice-chairs (or presidents and vice-presidents).

The second row represents boards of directors.

The numerator represents the number of elites from Youngnam Province who held those positions during that time period.

The denominator represents the total number of elites who held those positions during that time period.

The number in parenthesis represents cases where the hometown is unknown.

*Data was not available for many cases in the early years. Too many variables are missing in this column, so the validity of the data is in doubt.

Table 4.12
Trends in Youngnam Elites in the Central Bank and
Financial Supervisory Institutions

	1961- 1973	1974- 1979	1980- 1987	1988- 1992	1993- 1997	1998-
Bank of Korea (BOK)	3/7 (0)	1/4 (0)	6/8 (1)	2/4 (0)	2/5 (0)	½(0)
Banking Supervisory Authority	0/5 (1)	1/5 (1)	6/10 (1)	3/6 (0)	3/6 (0)	½(0)
Insurance Supervisory Board		½(0)	0/3 (0)	2/3 (0)	2/3 (0)	0/1 (0)
Security Supervisory Board		2/3 (0)	3/5 (1)	4/6 (0)	3/5 (0)	½(0)
Subtotal	3/12 (1)	5/14 (1)	15/26 (3)	11/19 (0)	10/19 (0)	3/7 (0)
Percentage	25.0%	35.7%	57.7%	57.9%	52.6%	42.9%
Monetary Policy Committee	15/39 (1)	7/18 (0)	13/30 (1)	7/10 (1)	10/27 (0)	4/14 (0)
Alternate Members	3/13 (0)	1/4 (0)	4/11 (2)	0/4 (0)	7/9 (0)	0/1 (0)
Subtotal	18/52 (1)	8/22 (0)	17/41 (3)	7/14 (1)	17/25 (0)	3/15 (0)
Percentage	34.6%	36.4%	41.5%	50%	68.0%	20%
Grand total	21/62 (2)	13/35 (1)	32/61 (6)	18/33 (1)	27/44	6/22
Percentage	33.9%	37.1%	52.5%	54.6%	61.4%	27.3%

Source: Data was compiled by collecting lists of elites (Chairs, vice chairs and boards of directors) and determining their hometowns using information from Dongah Inmulyunkam.

Reference: The top row in each cell represents chairs and vice-chairs (or presidents and vice-presidents).

The second row represents boards of directors.

The numerator represents the number of elites from Youngnam Province who held those positions during that time period.

The denominator represents the total number of elites who held those positions during that time period.

The number in parenthesis represents cases where the hometown is unknown.

*Data was not available for many cases in the early years.

Table 4.13
Trend of Slush funds by Korean firms over time
(Unit: 0.1 billion won)

	Slush funds relative to total sales (%)	Total amount of slush funds
1987	0.25	4,187
1990	0.28	7,959
1991	0.25	8,592
1992	0.24	9,435
1993	0.25	11,358
1994	0.26	13,669
1995	-	25,000
1996	-	29,000
1997	0.31	35,000

Source: National Tax Office reports, *Joongang Daily*, 8/5/1996; 8/19/1997; 10/28/1998.

Reference: Between 1987 and 1994, finance, insurance, city water, and agriculture-fishery industries were excluded from the calculation of slush funds.

Table 4.14
Defining Characteristics of Economic Cycles Between 1986 and 1997

(Unit: 0.1 billion dollars)

	First Period			Second Period				Third Period				
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
GDP growth rate	11.6	12.3	12.0	6.9	9.6	9.1	5.0	5.8	8.4	8.7	6.9	5.5
Manufacturing Civilian Consumption	18.5	19.5	13.8	4.2	9.7	9.1	5.1	5.0	10.5	10.8	7.4	6.2
Equipment investment	8.1	8.1	9.0	10.8	10.7	9.5	6.6	5.7	7.6	8.3	6.9	3.1
Construction investment	23.5	18.9	13.0	14.7	18.8	12.1	-1.1	-0.1	23.6	15.8	8.2	-11.3
Export growth rate	2.6	15.5	14.3	16.8	31.2	13.0	-0.6	8.9	4.5	8.7	6.3	2.7
Import growth rate	26.5	21.7	12.5	-4.1	4.2	11.8	11.0	11.3	16.5	24.0	14.1	6.6
	17.9	19.6	12.9	16.3	14.3	19.2	5.1	6.7	21.7	22.0	14.8	-1.7
Balance of payment (unit: 100 million US\$)	46.2	98.5	141.5	50.5	-21.8	-87.3	-45.3	3.8	-45.3	-89.5	-237.2	-86.2
Foreign Debt (unit: billion US\$)	3.2	2.2	0.7	0.3	0.6	1.1	1.1	0.7	1.0	1.7	3.4	5.5
Consumer price	2.7	3.0	7.1	5.7	8.6	9.3	6.2	4.8	6.2	4.5	5.0	

(Table 4.14 continued on next page)

Table 4.14 Continued

Characteristics	*Increase in exports across heavy & light industries led to investment expansion. *Three favorable factors (exchange rate, low interest rate, low price of natural resources including oil) have positive impact on economy. *Positive international payments reduce foreign debt.	*While exports became stagnant, increased wages and inflated value of assets led to increase in consumption (expansion of domestic market), in turn led to investment expansion. *International payment turned into negative. *Growing inflation. *Industrial restructuring began with the exit of decaying industries such as textiles, footwear.	*Heavy-chemical industry remained as a leading force while light industries were in rapid decline. *Only handful of industries including semi-conductors, computers, steel and chemicals performed well in exporting. *Rapid accumulation of foreign debt. *Limited industrial restructuring ended up with financial crisis in 1997.
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Source: MOEF

Table 4.15

The Total Amount of Capital Investment across Affiliated Firms by the Thirty Largest Chaebols

(Unit: billion won, percent)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total assets (a)	7476	9430	13460	18327	12148	26458	29145	36100	49200	62200	69800	68500	96700
Total investment (b)	3257	3569	4401	5890	6747	7636	8158	9683	11300	13600	16900	17700	29900
Ratio of total investment to total assets (b/a, percent)	43.6	37.8	32.7	32.1	31.8	28.9	28.0	26.8	23.0	21.9	24.2	25.8	31.0

Source: FTC, *Yearbook of Fair Trade Practices*, each year.

Reference: Total assets (a) represents assets of all affiliated firms of the thirty largest Chaebols.

Total investment (b) represents the total investments of those firms in sister firms.

Table 4.16
Exports by Principal Commodities

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
	(Unit: Million US dollars)									
Woven fabrics	3057	3461	4150	5114	5735	6444	7838	8735	8703	8864
Iron and steel plates	1966	2351	2536	2811	3257	3515	3261	3923	3747	4139
Office machinery	2573	2762	2702	2918	3091	3474	3607	4967	5673	6405
TVS	1421	1362	1506	1633	1537	1463	1698	1901	2207	1558
Radios	1424	1321	1337	1232	1184	1126	1092	909	530	377
Recorders	1766	1633	1408	1555	1479	1582	1757	1824	1747	1293
Telecommunication equipment	1597	1762	1981	2116	2337	2922	3678	4244	4404	4572
Household electric goods	1274	1085	833	1024	1091	1213	1485	1685	1909	1901
Semi-conductors	3856	4702	5364	6645	7763	8078	11848	19373	17035	19663
Cars	3336	2048	1849	2124	2534	3884	4470	7243	9089	9264
Ships	1759	1788	2800	4129	4113	4061	4945	5533	7127	6520
Apparel	8694	9096	7879	7420	6770	6166	5652	4958	4221	4192
Footwear	3800	3587	4307	3836	3184	2309	1780	1506	1236	982
Musical instruments	986	1058	1137	1185	1104	1133	1199	1385	1451	1196
Total of above	37,509	38,016	39,829	43,742	45,179	47,370	54,319	68,184	69,079	70,924
Other products	23,187	24,361	25,187	28,128	31,452	34,866	41,694	56,874	60,636	65,240
Total exports	60,696	62,377	65,016	71,870	76,631	82,236	96,013	125,058	129,715	136,164

Source: Bank of Korea, *Monthly Bulletin*, various years.

Table 4.17
Cross Debt-guarantees by Thirty Largest Chaebols
(Unit: trillion won, percent)

Year	Capital Size (A)	Cross Debt-guarantee			Ratio of Debt-guarantee Relative to Capital Size	
		Total (B)	Illegal (C.)	Non-illegal	B/A	C/A
1993.4	35.2	165.5	120.6	44.9	469.8	342.4
1994.4	42.8	110.7	72.5	38.2	258.1	169.3
1995.4	50.7	82.1	48.3	33.8	161.9	95.2
1996.4	62.9	67.5	35.2	32.3	107.3	55.9
1997.4	70.5	64.9	33.6	31.3	92.2	47.7
1998.4	68.1	63.5	26.9	36.6	93.1	39.5
1999.4	100.4	22.4	9.8	12.6	22.3	9.7

Source: FTC, *Report on debt-guarantee by 30 largest business groups*, each year.
 FTC, Web Site Report.

Table 4.18
The Ratio of Corporations (Owned by the 30 Largest Chaebols) Listed in the Stock Market
(Unit: firms, billion won)

	Subsidiaries		Subsidiaries listed in stock market		Ratio of listed subsidiaries	
	# of subsidiaries	total assets	# of subsidiaries	total assets	# of subsidiaries	total assets
1983	n/a	n/a	n/a	n/a	14.0	44.8
1991	561	n/a	161	n/a	28.7	n/a
1992, 12	604	20,131	167	11,450	22.7	56.9
1993, 12	616	22,232	164	12,629	26.6	56.8
1994, 12	623	24,439	172	15,418	27.6	63.1
1995, 12	669	26,802	171	16,641	25.6	62.1
1996, 12	817	30,476	185	18,173	22.6	59.6
1998, 4	804	32.4	186	18,500	23.1	57.2
1999, 4	686	42.7	171	23,400	23.3	53.1

Source: FTC, *Yearbook of FTC*, 1996, 1997.

Table 4.19
Major Acts and Decrees in the Context of Regulatory Policy over Chaebol

Major Acts	Contents
Monopoly Regulation and Fair Trade Act	* designation and notification of market-dominant enterprise (article 4) * restrictions on business combinations (article 7) * prohibition on the establishment of holding companies (article 8) * prohibition on cross-capital investment (article 9) * limitations on total amount of capital investment (article 10) * limitations on debt guarantees for affiliated corporations (article 10) * restriction on the voting rights of finance or insurance companies (article 11) * regulation on internal financial transaction (article 23) * designation of large business groups (article 14)
Credit Regulation Act	* regulations on core business self-help (article 2) * credit restrictions on affiliated firms of big business groups (article 4) * regulation on big business group's investment in new business line (article 10) * prohibitions on corporations' real estates and licensing on business investments (articles 11-13) * regulation on business self-help financing (article 15) * obligations for pre- and post- reporting (article 20) * core business line policy (articles 27, 28)
Banking Act	* restriction on Chaebol's ownership of banks (article 17)
Insurance Act	* restriction on Chaebol's control over insurance companies (article 23)
Broadcast Act	* prohibition on Chaebol's shareholding of broadcasting companies (article 6)
Wire Broadcasting Act	* prohibition on Chaebol's shareholding of wire broadcasting companies (article 6)
Periodical Registration Act	* prohibition on Chaebol's shareholding of daily newspaper and communication companies (article 6)
Act to promote SMEs' New Investments	* restrictions on Chaebol's investment in SMEs' new investment projects (article 13)

(Table 4.19 continued on next page)

Table 4.19 Continued

Act of SMEs	* prohibition on Chaebol's investment in classical SMEs' business areas
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Source: Kim Il-joong, *The Logic and Effects of Economic Concentration Regulations*, Seoul: Korea Economic Research Institute, 1994:8-9.

CHAPTER V

ECONOMIC RESTRUCTURING UNDER THE IMF BAILOUT PROGRAM: REPOSITIONING THE KOREAN STATE IN THE BUSINESS-STATE NEXUS 1997-1999

This chapter concerns the Korean state's impressive handling of the currency crisis and subsequent restructuring programs in the financial sector and Chaebol system under the Kim Dae-jung government (1998-1999). The IMF and World Bank point to South Korea as an exemplary model of successful reform under the IMF bailout program. Initially, the Korean economy slid into a much deeper recession than the IMF had anticipated.¹ The GDP contracted by 5.8% in 1998, resulting in an unprecedented unemployment rate (8.2% in the second quarter of 1998 with about 1.5 million unemployed workers) (Refer to other macroeconomic indicators in Table 5.1). As a result, the overall standard of living declined sharply. Korea's per capita GNP for 1998 was estimated to have fallen by more than \$3,000, from \$10,307 in 1997 to about \$6,823. This means that Korea regressed at least seven years in personal well-being between 1997 and 1998 (in 1991, Korea's per capita GNP was \$6810). More importantly, the income gap between the haves and the have-nots, which had been the pride of the Korean economy, increased dramatically.² Up until the fourth quarter of 1998, every single

¹ According to the first letter of intent exchanged between the IMF and Korea on December 3, 1997, the IMF and the Korean government planned to maintain a 3% annual GDP growth with 5% inflation. But the overall economy suffered a negative GDP in the first quarter of 1998 and later slid into a deeper economic slump.

² According to the National Statistical Office (8/27/1998), in the first quarter of 1998, income distribution across different income groups deteriorated greatly. Of the five different income groups, people in the highest monthly income tier, riding the high interest rate benefits, increased their monthly income by 0.9% even amid economic crisis while the

economic indicator experienced an unprecedented negative record, except for the trade surplus³ and an increase in the foreign currency reserve because of the inflow of the IMF rescue loan.

However, the Korean economy began to turn around dramatically in the fourth quarter of 1998. Once the influential international credit rating agencies (such as Moody's Investor Service) upgraded Korea's sovereign credit rating, foreign investment followed Korea's improved external credit status and investment environment. Foreign investment in Korea amounted to \$1.37 billion in November, 1998, the second-highest monthly figure ever. Thanks to the foreign investment and trade surplus, Korea, as of September 1999, had become a net creditor country for the first time since 1979. It was a miraculous turn-around, considering that Korea fell into the IMF rescue program less than two years before. Stock prices began to rise, rebounding to the previous level by mid-1999 (see Table 5.1). As a result, the GDP recorded a 12.3% growth rate in the third quarter of 1999. More positively, the manufacturing sector observed a 20% growth rate during the same period (Refer to Table 5.1). Despite the Daewoo liquidity crisis in mid-1999, the industrial parks went back to full-scale operation, recording an 81.0% operating ratio in

people in the lowest tier suffered most, decreasing their income by 12% (*Chosun Daily*, 8/27/1998). Under the year long IMF bailout program, the top bracket of 20% of the population increased their income by 20% while the bottom 20% saw a reduction in their income by 14.9%. (*Joongang Daily*, 11/14/98). The widening income gap is attributable to shrinking wages, high interest rates, and unemployment of temporary workers (63% of laid-off workers under IMF were temporary workers).

³ The trade surplus was positive throughout 1998. But this was not due to increased competitiveness of Korean products or increased volume of exports, but mainly to the plummeting value of Korean currency and the sharply reduced volume of imports. Korea's imports in 1998 shrank by 35.5% while exports decreased a mere 2.2%. Korea improved its trade account by \$48.4 billion, the largest annual growth ever, from a deficit of \$8.5 billion in 1997 to a surplus of \$39.9 billion.

July 1999.

The splendid success of the restructuring program under Kim Dae-jung throws some critical questions to political economists: 1) What drove the Korean state to take such quick and decisive actions in the context of reform? The Kim Dae-jung government's accomplishments seem to stand out in various respects, as compared with the Roh Tae-woo and Kim Young-sam governments (1988-1997). What sorts of forces motivated the political leadership to remain steadfastly on the track of reform? 2) Did the "currency crisis" play a critical role in bringing the political leadership back on track? If so, how did the dynamics of crisis politics play out? 3) Did deepening democratization play any role in this success story? For instance, the newly evolving social groups could have worked as a force in checking the overpowering influence of the Chaebol over the policy-making regime. 4) How did the structural characteristics of the business-state nexus during the Kim Dae-jung government differ from those during the Roh and Kim governments (1988-1997)? Is the business-state network formulating into a new democratic, transparent, open scheme? And 5) Which configuration of the business-state nexus is positively associated with better performance in carrying out transformative programs? In other words, which factors in the "combined model of business-state nexus" were most accountable for the state's dominance over big business during the crisis management?

CHANGING DYNAMICS OF THE BUSINESS-STATE NEXUS UNDER CRISIS

(1) The role of the crisis

Many political economists wonder how the Kim Dae-jung government has been able to take such decisive policy measures against the Chaebol system and the outdated financial institutions, as compared with the preceding regimes. This study answers that question by exploring the dynamics of crisis politics. Kim Dae-jung was elected president (December 1997) amid the currency crisis with a popular mandate to resolve the economic crisis. If the economic crisis had not erupted during the presidential campaign, there would have been little chance for him to come to power. Kim came from Honam province, from which no one had ever come to power throughout the modern history of Korea. But voters, looking for political leadership competent in handling economic affairs, elected him to the presidency. Needless to say, this popular mandate worked as a driving force for him to take resolute actions.

Kim was the first popularly-elected president from the opposition party. That meant that Kim's political coalition was more geared toward the middle class and the grass-roots, as compared with the previous regimes whose major coalition partners lived upon the status quo system. Among the major political parties (the National Congress for New Politics (NCNP), the Grand National Party (GNP), and the United Liberal Democrats (ULD)), as the catch-all party, firmly anchored in conservatism, the NCNP was more closely associated with the middle class and the grass-roots than the other parties. The fact that the middle class and grass-roots constituted the key regime constituents worked as a double edged sword in carrying out reform programs. First, Kim's government was positioned favorably for manufacturing political cooperation from the

working class and middle class who suffered the most economic pain under structural adjustment, at least at the beginning of the reform process. Later on, it became increasingly difficult for Kim's government to handle the angry working class. Second, the political base of his coalition also made it more plausible for him to take bold measures against the Chaebol. In other words, Kim Dae-jung was less indebted to the Chaebol throughout his political career, as compared with the preceding regime. In addition, his own ideological stand toward the Chaebol was distinct from his predecessors'. During the democratic struggle in the 1970s and 1980s, he took a radical position on economic justice and was very supportive of the political/economic interests of the grass-roots. His "Dae-jung Economics," emphasizing the synchronized combination of "democracy" and "market," contrasts with the Chaebol-dominant economic system in Korea. However, his political pragmatism under a shaky political coalition with ULD led his government to take on a convenient mixture of conservatism and left-leaning ideas. Neo-keynesians from universities and pragmatic bureaucratic technocrats were two important pillars in his economic elite circle. Thus, Kim juggled these two groups of economists in handling Chaebol reform programs.

The "system crisis" also put tremendous pressure on the newly-elected president to push through the reform program for his own political survival. Only successful management of the economic crisis could guarantee the political stability of his regime. As a matter of fact, Kim's approval rating fluctuated along with the populace's evaluation of his crisis management. Unlike the previous period (1988-1997), the political logic of Chaebol-favoring policies or soft-stands against the Chaebol could not stand up under the pressure of economic crisis. The dynamics of crisis politics led the chief-executive to

refocus on economic issues, unlike Kim's predecessors who were distracted by daily political quarrels. As demonstrated in his inaugural address (Refer to Table 2.18), he put crisis management prior to other social and political issues. The first and foremost effect of the chief-executive's focus on economic affairs was the "reestablishment of developmentally-driven collective political leadership".

Kim Dae-jung's elite assignment, concerning the pilot economic agencies (FSC, FTC, MOEF, and Principal Economic Advisor to the President), diverged from his predecessors' in many respects. First, Kim Dae-jung restored the "dual system of state elites" by applying different standards for the recruitment of elites across economic and non-economic agencies. For instance, although Kim Dae-jung assigned the nucleus positions of power agencies (such as the National Security Agency, law enforcement agency, and high ranking military officers) to Honam elites, he did not let Honam elites dominate the core bureaus of economic agencies. For instance, the directors of the core bureaus within MOEF were chosen on the basis of individual competency. This principle was applied to the middle-level managers in other economic agencies and financial supervisory institutions as well (*Shindongah Magazine*, February 1999). Table 4.12 demonstrates how far off track the elite assignments in financial supervisory institutions were during the Kim Young-sam government. However, under Kim Dae-jung, the proportion of Youngnam elites diminished dramatically to 31.8%, while Honam elites remained a minor power (Refer to *Shindongah Magazine*, February 1999). In short, the injection of Honam elites into bureaucratic organs under Kim Dae-jung helped the Korean state reinstate its leadership over the private sector by slashing down the old region-based elite networks.

Another distinct feature of elite assignment under Kim Dae-jung was his long-term commitment to his appointees in the core economic agencies. For instance, Kim Dae-jung reshuffled his cabinet twice in two years, but key posts remained almost unchanged. No policy changes were expected to follow the cabinet reshuffling, unlike the reshuffling during the two preceding administrations. In particular, Kim delivered his firm mandate to the head of FSC and singled out the FSC as the *de facto* pilot agency to steer the reform program. Later on, the head of the FSC took over MOEF. The long-term appointments tended to guarantee not only “policy consistency” but also the “institutional autonomy” of the economic agencies from political pork-barreling. Longer terms of office are likely to promote “policy consistency” by keeping a career technocrat in charge of policy-making. The Chaebol, which always lobby to oust anti-Chaebol figures from the core economic ministries, would be more attentive to directives by long-term office-holders. When the office-holders in charge of reform programs change frequently, the Chaebol’s primary tactic against unfavorable policies would be foot-dragging. Also, the long-duration of office-holders improved the institutional autonomy of the core economic agencies under the Kim Dae-jung government, especially the guarantee of long tenure for the mid-level managers of the core bureaus. In the past, the mid-level managers were reshuffled in line with cabinet member replacements. Accordingly, the directors of the core bureaus were not able to develop their own policies on the basis of strategic market analysis. Rather, they tended to go along with their new ministers regarding policy positions. As a result, the economic agencies swung back and forth, like a pendulum, without their own institutional positions on critical policy issues. Kim’s delegation of his mandate to his appointees and the careful selection of professional technocrats, to a large extent, restored

the institutional autonomy of the economic agencies.

(2) Crisis Politics and its Effects on Institutional Rearrangement

Kim's survival tactics under crisis led to the institutional rearrangement of the policy coordination system, pivotal economic agencies, and financial regulators. Right after being sworn into presidential office, Kim overhauled the policy coordination system to respond to the crisis effectively. The Conference of Economic Ministers, which had worked as an economic coordination system from 1972, was replaced with the Policy Coordination Council (PCC)⁴ which was presided over by the President himself. In order to avoid policy conflicts among rival agencies during that critical period, President Kim himself acted as the policy coordinator among the agencies involved. The PCC was primarily constructed to overcome the local interests of economic agencies (organizational interests) and strike down different policy positions. Under the previous coordination system, which had been chaired by the Minister of Economy & Finance, individual ministers were likely to represent their organizational interests, constituent interests, or ideological positions. The rivalry and dissimilarity of policies often dealt a devastating blow to the smooth implementation of the reform programs. Under the PCC system, Kim himself refereed and coordinated among pilot economic agencies. In addition, the crisis reduced the bureaucratic bickering by imposing a pressing need to act in a timely fashion.

⁴ The Policy Coordination Council (PCC) consisted of the President, heads of MOEF, MOI, MOL, MPB, MFSC, HBOK, Principal Secretary of Economic Affairs and Planning at the presidential office, and two other economic advisors. Regular meetings were held once a week, but at the request of the President, meetings could be convened at any time (Park Jong-in, *DJ Government's Economic Elites* 25, Seoul: Darakwon Publisher, 1998:38-39).

As a result, hardly any squabbling among the pilot agencies took place under the PCC system. However, the PCC carried its own dangers in that the policy-making process was likely to reflect President Kim's political interests. By mid-1999, when the currency crisis was pretty much resolved, President Kim, in a timely fashion, returned his policy coordination power to the newly established Economic Policy Coordination System (EPCS).⁵ The EPCS, although presided over by the head of the MOEF, was quite distinct from the preceding coordination system in many perspectives. Above all, the MOEF became equipped with higher coordination authority and institutional instruments, including the establishment of a bureau for policy coordination. In addition, the President diffused the central controlling authority over financial and economic management among four offices: MOEF, MPB, FSC (Financial Supervisory Commission), and the Bank of Korea. During the Kim Young-sam government (1993-1997), MOEF, which monopolized a wide range of economic policy arenas, wielded almost unbounded power. The overly concentrated power of MOEF during the Kim Young-sam government prevented any possibility of monitoring the policy measures initiated by MOEF. Reflecting on the shortcomings of the previous coordination system, the new coordination system, established in February 1998, installed the head of MOEF as the central controller of economic administration, but redistributed other functions to maintain a system of

⁵ EPSC had dual systems. At the higher level, the heads of leading agencies got together on an irregular basis to coordinate the reform policies. Included were the heads of MOEF, FTC, FSC, Presidential Economic Secretarial Office, the Policy Planning Director under the Prime Minister, and the Head of the Budgeting and Planning Office. At the lower level, the heads of all the economic agencies and agents held regular meetings to coordinate and steer macroeconomic management and financial policies (*Joongang Daily*, 6/29/1999).

checks and balances. During the approximately two years of reform programs, the new policy coordination system has worked effectively.

The Financial Supervisory Commission was established as the *de facto* single financial regulator in Korea on April 1, 1998. The FSC's mandate was to regulate the entire financial services industry including the banking, securities, insurance, and non-bank deposit insurance sectors. Having industry-specific supervisory agencies, each with its own approach and administration, had created difficulties for efficient regulatory cooperation and consistent supervisory policies across constituents. To address these issues, the 1997 Act for the Establishment of Financial Supervisory Organizations gave birth to the FSC. It was necessary to establish an independent supervisory organization with sufficient enforcement powers over the full range of businesses in order to coordinate and oversee the reform process in a systematic and efficient manner. Thus, a comprehensive mandate was given to the FSC in the context of economic restructuring. For instance, the FSC took over the authority to issue business licenses for financial institutions, which had been held by the MOEF, authority to review the appointment of bank chairs, and authority to look into corporate bank accounts without obtaining search warrants from the court⁶. These provisions empowered the financial watchdog's governing ability to discipline the diverse financial industries. Armed with these ample powers, the FSC played a key role in coordinating and steering financial reform programs and subsequently Chaebol reform.

⁶ Thus, the FSC was given all the power to monitor, discipline and control the financial industries except for the authority to make and revise financial laws, which was still held by the MOEF.

In addition, Kim also empowered the Fair Trade Commission with new institutional provisions such as the right to look into bank accounts. Kim strengthened the FTC's monitoring capacity not only with more personnel but also with his entrusted mandate to the FTC. As a result, the trade watchdog was able to manage three consecutive investigations into unfair in-house transactions among the nation's top five business groups and probed into some of the top 30 Chaebol groups on illegal internal trading. In the past, the FTC did not have sufficient authority to monitor and/or discipline the violators of fair trade rules. Thus, the government introduced legislation that allowed the fair trade watchdog to have the authority to look into the internal financial transactions among Chaebols' affiliated firms. More importantly, the key positions within the FSC, FTC, and Presidential Economic Advisory Offices were filled by economic technocrats who had demonstrated their firm stands against the Chaebol system (*Joongang Daily* 8/28/1998).

(3) The Role of Weak Capital and Financing Structure under Crisis

The economic crisis released the Korean state from the captivity of the particular interests of big business in a peculiar way. The currency crisis that erupted in late 1997 threatened all Korean corporations and financial institutions with bankruptcy. The Korean state was the last resort for bankers and businessmen to escape insolvency. As long as the economy was healthy, the high debt/equity ratio of the Chaebol failed to give the state an edge over the Chaebol, but whenever the economy plunged into catastrophe, the debt-ridden conglomerates were at the mercy of the Korean government. The mid-sized

Chaebols with higher debt-to-equity ratios,⁷ as compared with the top five Chaebols, were especially threatened with total breakdown, so that they were the first to become more attentive to the directives of the state in the reform process. In other words, the mid-sized Chaebols, whose financing capabilities were relatively limited, caved in first to the reform pressure of the Kim Dae-jung government, while the Big Five Chaebols stubbornly resisted even up until early 1999. The financing ability of the different sizes of Chaebol groups during the liquidity crisis played a critical role in the strategic interactions of business-state throughout the reform implementation process. The prompt recovery of state autonomy from the dominant social class, the Chaebol, was attributable to the fact that the Korean state had taken control of the major financial resources by the end of the financial reform program,⁸ which was almost completed by August 1998. The Korean state, which temporarily took over the ownership of most commercial banks through an equity-to-debt swap, was able to force more decisive measures on the stubborn Chaebol. In short, the currency crisis put the debt-ridden Chaebols in the defensive position, whereas the state arose as the only alternative instrument to dissolve the liquidity crisis with its control over financial institutions.

⁷ Refer to Table 5.3. There has been a substantial difference between the Big Five Chaebols and the mid-sized Chaebols in terms of debt/equity ratio, equity/assets ratio, and borrowing to total assets. The mid-sized Chaebols were more heavily indebted than the top five Chaebols.

⁸ By purchasing non-performing loans and through the injection of public funds, the government has become a controlling shareholder for several commercial banks: Seoul Bank (93.8%), First Bank of Korea (93.8%), Commercial Bank (94.2%), Hanil (95.3%), Foreign Exchange Bank (33.6%), Housing Bank (16.1%), Kukmin Bank (10.4%), Cho Hung Bank (95.7%). The numbers within parenthesis indicate the percentage of stock held by the Korean state.

(4) International Force and Reform Incentive during Crisis

Kim perceived the rapid and massive infusion of foreign capital as the best solution to the currency crisis. “Tapping into the global stock and bond market” and “seeking out multinationals to invest in Korea” was viewed as the only strategic alternative to quickly relieve the financial crisis. But, seducing foreign investors back into the Korean market required quick and extensive provisions for new institutions in Korean corporations’ governance and financial industries which would insure “predictability,” “transparency” and “openness.” The “global capital herd” tends to reward the systems which are characterized with those traits. Thus, Kim’s government was strongly compelled to carry out a package of policies which dramatically improved the transparency, predictability and foreign investors’ ability to transfer and protect its private property. Before the financial crisis, the Kim Young-sam government (1993-1997), although being aware that Korea must improve the stability, predictability and transparency of the corporate and financial systems, did not have much political incentive to take action. But, under the severe liquidity crunch and mounting political pressure for reform, the Kim Dae-jung government had strong political motivation to signal foreign investors through institutional provisions. Engaging reform was not one of several options but the only option to seduce much needed foreign capital into the Korean market.

During the crisis, foreign powers, especially the IMF, also worked as a positive force in restoring the balance of power in favor of the Korean state. IMF-suggested Chaebol reform programs had been the focal point of policy discourse and some were even partially carried out under the administrations of Roh and Kim (1987-1997), but there had been a lack of determination to implement the reform programs, owing to the

absence of both solid consensus among economic technocrats and broad political support. Specific policy targets and the policy means to attain these targets were not clarified in the circle of power economic elites amid the rivalry of bureaucratic organizations and ideological cleavage, although a general policy preference toward Chaebol reform existed widely. But the IMF's strong policy recommendations cleared away any doubt about Chaebol reform. The IMF not only had the legitimate authority to oversee the reform process through capital lending, but also enormously helped policy makers to be in accordance with Chaebol reform by curtailing the influence of the Chaebol-owned research institutes⁹. IMF-drawn Chaebol reform programs were often used to vindicate the economic validity of the governmental programs.

⁹ The consolidation of policy consensus on Chaebol restructuring also owed to the infusion of "neo-institutionalists" into the policy making mechanism. During the last years of Kim Young-sam's rule, market-oriented reform appeared to be almost identical to "deregulation without the regulatory state," notwithstanding that marketization must go along with the strengthening of the state's regulatory role. FKI-sponsored research institutes, Korean Economic Research Institute (KERI), the Center for Free Enterprises (CFEs), and Chaebol-owned research institutes (Samsung, Hyundai, and Daewoo Economic Institutes) had all bred the "myth of market" through relentless attacks on the government's regulatory policies against the Chaebol during the 1990s. The Chaebol's ideological propaganda (*laissez-faire*) eventually won over the Kim Young-sam government during the last years, leading to the hands-off approach concerning Chaebol problems (Lee Yeon-ho 1998). However, Kim Dae-jung's assignment of neo-institutionalists into the core economic agencies (such as KDI, chief presidential economic advisors, and FTC) helped to restore anti-Chaebol policy measures (Park Jong-in 1998). Neo-institutionalists basically agreed that it had been impossible to regulate the Chaebol with the market mechanism, who had already consolidated their monopolistic status through their sheer size and diversified power. Only firm-specific reform measures by the state would restore open and transparent market rules in the Korean economy. It was perceived by this group of scholars that the failure of economic liberalization stemmed from the absence of supervisory and regulatory institutional provisions which must guarantee the soundness of economic liberalization.

(5) Critical Changes in the Business-State Nexus

As a result of the above-mentioned dynamics of crisis politics, there have been several distinct changes in the structural characteristics of the business-state nexus. First, the transparency and openness of the business-state relationship has been partially improved by transforming the business-state nexus into a more encompassing institution through the participation of other social groups, including labor. The government-initiated “Labor-Management-Government Commission,”¹⁰ which was basically composed of three major parties: labor, business and government; was established in the early phase of restructuring efforts. Although the “Tripartite Panel of Labor, Capital and State” (TPLCS) has not worked as a primary institution to carry out concerted reform efforts, it, at least, substantially curtailed the potential for rent-seeking collusion between business and state. The Korean state was also able to reinforce its autonomy from the particular interests of the Chaebol by shuffling between capital and labor as an intermediary. Information sharing and consultations among peak associations have been unprecedented and have resulted in ending the closed-door deal-making between big business and the

¹⁰ Labor is represented by leaders of the two national trade union centers, KCTU (Korean Confederation of Trade Unions,) and FKTU (Federation of Korean Trade Unions). Representing interests of business are participants from FKI (Federation of Korean Industries), KEF (Korean Entrepreneurs Federation) and the KASMEs (Korean Association of Small- and Medium-sized Enterprises). In addition to the traditional tripartite composition, a number of other civil society organizations, including the Citizens’ Coalition of Economic Justice and the Korean Federation of Environment Movement participated in the “Tripartite Panel of Labor, Capital and State.” The Tripartite Panel suspended its activities on and off because of severe conflicts of interest among the participants. From the third term of this panel (from September 1999 on), the government was obliged to consult with this committee before announcing major economic policies that would affect workers’ job security and working conditions. Throughout its activities, the committee enjoyed direct access to vital government information as well as to the views of related government departments.

state. In addition, the rising middle class movements (the People's Solidarity for Participatory Democracy (PSPD) and the Citizens' Coalition for Economic Justice (CCEJ)) stepped forward to accelerate their monitoring of the business-state interactions. As mentioned by Peter Evans and Stephan Haggard (1998), the strengthened democratic forces definitely diminished the likelihood of rent-seeking collusion between the dominant class and state power. That notion was clearly demonstrated in the case of Korea with the rise of democratic social groups, especially with the later evolution of organized middle class movements such as the PSPD and CCEJ. Unlike the early popular movements, including student and labor movements, the PSPD and CCEJ, whose membership consists mostly of college faculty, lawyers, church leaders, medical doctors, technicians, and other professionals, were able to enhance their monitoring ability on oligarchical capitalists with their professional knowledge and organizational strength. In short, the business-state nexus, which should take the primary blame for the currency crisis, experienced considerable transformation into a more transparent and open form, with rising political attention and other social classes joining the nexus.

The second important change in the structural traits of business-state interactions under the Kim Dae-jung government was that the Korean state promptly regained its autonomy and dominance over the Chaebol. Political economists wonder why and how this happened. There were several significant factors. First of all, it is believed that the political climate of economic crisis always makes the government more autonomous from the particular interests of any social class. According to Marxists, a state is likely to recover its relative autonomy from a particular social class, especially from the propertied class, when the capitalist system itself is placed on the brink of collapse. Capitalists tend

to make political concessions to the state so that the state can take more decisive measures in handling the “system crisis” for the survival of capitalism. Especially when the capitalist system itself is pushed to the edge of breakdown, owing to an antagonistic confrontation between the propertied class and the grass-roots, the state is likely to reclaim its relative autonomy as an intermediary among the conflicting social classes. In the case of Korea, the economic crisis robbed the Chaebol of their prowess by pushing them to the brink of full-scale collapse, which gave rise to the relative autonomy of the state.

Despite apparent conflicts, the close connectedness between business and state has been sustained throughout the crisis management. Regular business-state conferences at high ranking levels,¹¹ invitational conventions and seminars,¹² Blue House talks between the President and the owner-chairs,¹³ and other institutional channels have remained intact

¹¹ At this level of meetings, the ministers of economic agencies and the presidents of conglomerates get together for consultation and information sharing. There have been formal and informal meetings at this level on a regular basis.

¹² This kind of business-state contact provides the heads of economic agencies with the chance to clarify the government’s position on critical issues and to hear the position of businesses on those issues. The seminars and academic debates also give both sides a chance to engage in open academic talk on which economic programs would be helpful for the overall national economy over the long run. These meetings are organized by both private and public research institutes.

¹³ The highest level talks, convened by President Kim, were often used to lay out reform programs with businesses at each phase and to verify progress on these programs. The President often used his supreme power at these meetings to dissolve deadlocks among bankers, big business, and government. The first meeting, in January, 1998, laid-out the five reform targets concerning the Chaebol system. The meeting in August, 1998, put pressure on the foot-dragging Chaebol. The meeting in December, 1998, was used to settle the so-called “big deals” among the industries which were producing beyond market capacity under the Big Five Chaebols. The meeting in April, 1999, was used to determine whether or not the reform agreements of business-state were proceeding as planned. And finally, the meeting in August, 1999, was used to reach a contractual agreement on three new reform targets. The sequence of the highest level meetings of business-state clearly shows that the Korean state has slowly but steadily elevated its stand on Chaebol reform

as paths of information sharing, governmental guidance, and directives, notwithstanding that criticism from various social/political groups has been poured upon the close business-state linkage. The Chaebol reform program inevitably gave rise to an antagonistic confrontation between state and big business, owing to their divergent policy preferences. But both sides still need each other. Big business, on the one hand, which wanted to cope with the liquidity crisis efficiently, craved help from the government by institutional provisions and financial assistance. In addition, the Chaebol did not want to misread the genuine intent of the state in order to minimize the damage which could incur from mistakenly revolting against the governmental programs or from dragging their feet. The state, on the other hand, desired to keep the linkage to deliver the economic rationale and genuine intent of the reform program, so that its persuasion and threats could be more effective and less costly. Thus, both sides were well aware that only a close collaboration would minimize the damage on business and thereby on the national economy. In short, mutual understanding and cooperation were critical ingredients for the successful management of the crisis and reform programs.

REFORM PROGRAMS AND THEIR PROCESSES

The Kim Dae-jung government's immediate challenge was to overcome the foreign exchange shortage and stabilize the economic system. To meet this challenge, a top policy priority was to gain international confidence through a comprehensive structural reform

issues. Participants in the meeting which was held on August 25, 1999, included the owner-chairs of the Big Five Chaebols, heads of the MOEF, FSC, FTC, and MPB (Minister of Planning and Budget), the chief presidential economic adviser, and the heads of major banks (Hanbit, Korea First, Korea Exchange and Korea Development Banks).

under the stringent IMF program, which seriously limited the Korean government's policy options. Under the IMF-supported program of economic reform,¹⁴ the government pursued restructuring in four different areas: 1) the Chaebol system; 2) financial institutions; 3) the labor market; and 4) state-owned enterprises. This study focuses on Chaebol reform programs while paying limited attention to financial restructuring, because whether or not reform efforts would succeed in the long-run depended upon Chaebol reform, which was the most difficult transformative task to be carried out. Reform programs basically proceeded in the following sequence: 1) financial sector restructuring; 2) Mid-sized Chaebol and large enterprise restructuring; and 3) Big Five Chaebol restructuring.

(1) Financial Sector Reform

The Korean government pursued reform in the financial industries prior to corporate restructuring, because eliminating disorder in the financial market was more urgent to stabilizing the economic system and, in addition, the Korean government planned to tackle Chaebol reform using the financial institutions as leverage. With respect

¹⁴ On December 4, 1997, the IMF's Executive Board approved financing of up to US\$21 billion to rescue financially troubled South Korea. In return for this rescue package, the Korean government agreed to carry out the IMF-dictated macroeconomic policies and reform programs. The immediate policy measures the Korean government took following the agreement included: 1) the abolishment of the daily exchange rate band; 2) speeding up the liberalization of capital and money market, including the lifting of all capital account restrictions on foreign investors' access to the Korean bond market by December 31, 1997; 3) accelerating the implementation of the comprehensive restructuring plan for the financial sector; and 4) speeding up trade liberalization measures. Other macroeconomic, monetary, fiscal, and financial policies were also imposed by the IMF.

to financial reform, there were two basic tasks: 1) bank restructuring; and 2) institutional reform of financial institutions. Bank restructuring included the closure or merger of insolvent institutions (priority policy), the disposal of non-performing assets, and the recapitalization of weak but viable institutions. This reform was designed to restore a banking system that was able to serve a modern, advanced economy. On the other hand, financial sector reform concerned establishing the independence of the central bank, the consolidation of supervisory agencies, the upgrading of prudential regulations, and the establishment of a deposit insurance scheme. These elements were important safeguards against future banking crises.

Financial sector reform involved the establishment of the central bank as autonomous from the government, the construction of a unified financial supervisory agency, the tightening of prudential regulations and accounting rules, the heightened transparency of financial information, and the reorganization of the corporate governance of financial institutions. These institutions were considered critical safeguards against future financial troubles. Under the old system, the Bank of Korea (BOK) had served as a subordinate arm of the government. For instance, the head of the MOEF controlled the Monetary Policy Committee as the chair of the Committee, which is at the apex of the BOK's organization. Thus, monetary policy, efforts to control the supply and price (interest rate) of money, could not be formulated neutrally or carried out autonomously under the full sovereignty of the BOK. However, under the new law promulgated on December 31, 1997, the BOK was given extensive authority to carry out independent

monetary and credit policy. For example, the Monetary Policy Committee,¹⁵ which deliberates on and resolves monetary and credit policies and major matters concerning the operations of the BOK, came under the control of the head of the BOK, instead of the head of the MOEF, while the authority previously held by the head of MOEF to intervene in the internal affairs of the BOK was wiped out. The members were appointed by the President for four-year terms. All members served on a full-time basis and no member could be discharged from office against his or her will. The head of the MOEF no longer retained the authority to convene meetings of the Monetary Policy Committee or audit the management of the BOK. Instead, the head of the BOK, as the Chair of the Monetary Policy Committee, called the meetings of the Committee and could submit proposals to the Committee on his own motion. At present, the BOK has become an entirely autonomous institution from the government except that the MOEF still controls the budget of the BOK (MOEF & KDI, 1997:74-79).

Along with the overhaul restructuring, the Financial Supervisory Commission (FSC) was established as the *de facto* single financial regulator on April 1, 1998, under the 1997 Act Concerning Establishment of Financial Supervisory Organizations. The Financial Supervisory Service (FSS), the implementing body of the FSC, was subsequently instituted on January 2, 1999. The creation of the FSS brought together under one roof the four existing supervisory bodies: the Banking Supervisory Authority, Securities

¹⁵ The MPC is composed of seven members representing various groups in the national economy: 1) the Chair; 2) one member recommended by the MOEF; 3) one by the Governor of BOK; 4) one by the Chair of the FSC; 5) one by the President of the Korea Chamber of Commerce and Industry; 6) one by the Chair of the Korea Federation of Banks; and 7) one by the Chair of the Korea Securities Dealers Association.

Supervisory Board, Insurance Supervisory Board and Non-bank Supervisory Authority. Under the old system, each of these supervisory agencies had belonged to a different economic ministry with its own approach and administration. For instance, the Banking Supervisory Authority was controlled by the Bank of Korea, while the rest of the supervisory agencies were under the MOEF's command. More importantly, there was no coordination system to supervise different sectors of the financial industry. Under the new system, the overarching authority of the FSC over different constituents addressed the loophole problems in the context of financial supervision which occurred from the fragmented supervisory institutions (FSC Web site, MOEF & KDI, 1997:74-79).

Other institutional provisions which were newly installed under the financial reform program were new prudential regulations and accounting rules. First, to enhance operational efficiency and the soundness of financial institutions, the FSC tightened its risk management surveillance through stricter loan classification provisioning requirements. For example, previously, loans over six months past due were classified as substandard. Under the new provisions, loans over three months past due were classified as substandard. In addition, the FSC is planning to introduce "forward looking criteria" in 1999, which will put more emphasis on the borrower's future debt-repaying ability rather than on past track records. Under the new stricter regulations, financial institutions will also have to make more provision for loan-loss reserves. Under the new system, banks and other financial institutions will lend money on the basis of the client's financial position, funding status, profitability, transaction record, and overall assessment of the customer's liabilities rather than on collateral or third-party debt-guarantees (FSC, various press releases in 1998).

Along with these regulations, the FSC upgraded market-to-market accounting, auditing, and disclosure systems to enhance transparency to meet the highest international standards. The FSS now has a mandatory obligation to issue prompt corrective action notices. Previously, regulators had the option of taking regulatory action against financial institutions when their BIS ratios fell below certain requirements. However, under the new provisions, regulators automatically executed the action without exception. Lastly, the control structure of banks was overhauled with substantial restructuring of the boards of directors and improvement of auditors' authority. As of the end of March 1999, the boards of commercial banks had come to consist primarily of non-executive directors, who accounted for around 70% of the total. The restriction on the nomination of foreigners as directors was lifted in 1998. The office of the chairman of the board was separated from that of the president in some banks and various subcommittees reporting to the boards were established to promote their effectiveness. Additionally, most banks appointed an auditor from outside their organizations in order to heighten the independence and professional expertise of the position. In short, these institutional provisions ensured that the practices of financial institutions would be based on clear and transparent market principles and would heighten the soundness of capital structure (FSC, various press releases in 1998).

(2) Bank Restructuring

Korean banks were dangerously undercapitalized and staggering under the weight of bad loans before the reform program was launched, as shown in Table 5.4. Fourteen out of Korea's 33 banks failed to satisfy the Bank for International Settlements (BIS)

required minimum capital adequacy ratio of 8% at the end of 1997. As of Dec. 31, 1997, the nation's 33 banks registered an average of 7.04% in the BIS capital adequacy ratio, which reflects 100% of their appraisal losses in their securities investment and loan loss reserves. For instance, Korea First Bank and Seoul Bank scored a negative 2.7% and 0.97% respectively in the BIS ratio at the end of 1997. As for bank loans, bad loans held by the 26 banks at the end of 1997 totaled 10.08 trillion won (about \$6.08 billion) on an outstanding basis, accounting for 2.7% of their combined loans. Non-performing loans, which combined bad loans and substandard loans, amounted to 22.6 trillion won for the 26 banks at the end of 1997, representing 5.8% of the total credit. In the case of Seoul and Korea First Bank, the non-performing loan ratio relative to total credit, as of December 1997, reached 10.4% and 11.4% respectively (Refer to Table 5.4) (OBS report, Office of Bank Supervision, 6/25/98).

The Korean banking system also shared similarities with its corporate partners in terms of "financial stability," and "profitability." The overall financial stability across different financial institutions was extremely low, implying high vulnerability to any outside financial shock. For instance, as of December 1997, the debt-to-equity ratio of the financial industry climbed to 2,553.3%, paralyzing normal banking practices (Refer to Table 5.2). Needless to say, this huge accumulation of debt was attributable to the serial bankruptcies of Chaebols in 1996 and 1997. As a result of lost loans, the financial industry recorded negative profitability in 1997. As shown in Table 5.3, the average "ordinary income to sales" for the financial industry was recorded as a negative 8.1% in 1997. Other indicators concerning "profitability" over time also demonstrate that the Korean banking system was not able to compete with its global competitors. Korean

banks' "return on equity" remained around 4-6% in the first half of the 1990s (Refer to Table 5.5), while in the United States, the United Kingdom, Canada and the Netherlands, the "return on equity" regularly exceeded 15% (OECD, 1998:61). In addition, Korean banks' "net interest margin" was recorded as about 2.55% between 1991 and 1997 whereas American banks "net interest margin" was recorded as about 4.30% during the same period (BSA, *Financial Supervision Information*, 1999-31). In short, the Korean banking system was characterized by low profitability and vulnerability.

This tremendous accumulation of bad loans, low profitability, and financial vulnerability was attributable to the old-fashioned loan practices by Korean banks. Korean banks used to lend their money on the basis of collateral, third party debt-guarantees, or the notion that the business was "too big to fail." All these lending criteria were favorable for big business. Accordingly, banks paid little attention to their borrowers' earnings performance or generation of cash flow, that is, to their ability to repay the loans. There was also a lack of institutions which allowed banks to monitor and discipline borrowers, such as transparency of the borrowers' financial statements, transparency of the lending process with clear criteria for deciding whether or not to make loans, follow-up monitoring, institutionalization of early warning systems, or improvement of risk management techniques.

The Korean government classified the major commercial banks into three categories: 1) banks to be closed, 2) ailing banks to be restructured, and 3) healthy banks. First of all, two banks in the acutest danger of insolvency (Seoul Bank and the First Bank of Korea) were nationalized through recapitalization by the government after reduction of

their capital. Five banks (Daedong, Dongnam, Donghwa, Kyungki, Chungchong)¹⁶ which were severely undercapitalized were ordered to dissolve through P&A (purchase and assumption mode) arrangements. The FSC arranged for Kyungki Bank to be taken over by Hanmi bank, Dongnam Bank by the Housing and Commercial Bank of Korea, Daedong Bank by Kookmin Bank, Donghwa Bank by Shinhan Bank, and Chungchong Bank by Hana Bank. Seven troubled banks (Commercial Bank of Korea, Hanil Bank, Cho Hung Bank, Korea Exchange Bank, Peace Bank of Korea, Kangwon Bank, Chungbuk Bank) received conditional approval for their survival under the promise to take corrective actions. The FTC required submission of management rehabilitation plans for those financial institutions that failed to satisfy prescribed capital adequacy standards. These seven troubled banks were forced to execute management improvement orders, such as a change in management or merger with other banks later on. Twelve banks that satisfied the BIS capital adequacy ratio of 8% were classified as healthy banks but went through a due diligence review by the FTC by the end of August 1998.

To support rehabilitation efforts undertaken by financial institutions, the government mobilized sizable financial resources which amounted to an outlay of 64 trillion won, although not all of this was used for bank rehabilitation. Fiscal support was provided to viable institutions only as a way to expedite their rehabilitation, conditional upon the institutions' comprehensive self-rescue efforts and accountable loss-sharing to

¹⁶ Among these five banks which were ordered to close by the government, Daedong, Dongnam, and Donghwa were licensed right after President Roh Tae-woo got elected in 1989 in return for electing him to power. Roh made political promises to issue licenses to banks in each region to build popular support during his presidential campaign. Licensing these banks was opposed by MOF (Ministry of Finance). Roh wanted to compensate his electorates (*Dongah Daily*, 6/29/98).

prevent moral hazards. Their implementation was closely monitored by the FSC. In order to establish the notion that the bankers were accountable for managerial failure, the FSC ordered seven commercial banks to replace their top managers with fresh blood. The top managers of ailing commercial banks faced replacement and punishment (*Korea Herald*, 7/17/98).

The development of a few super banking institutions was believed to be a feasible alternative to compete with the giant foreign banks. Not only had Korean banks been undercapitalized but also their capital size had been relatively small in comparison with foreign banks. Thus, Cho Hung and six other ailing commercial banks, which barely avoided being forced to close on condition of stringent self-rescue efforts, were under growing pressure to merge among themselves and other healthier banks. First, Commercial Bank of Korea and Hanil Bank were merged into one super bank (now Hanbit Bank) with total assets of 102 trillion won (\$82 billion) (*Korea Herald*, 6/30/1998). This merger triggered a series of consolidations among other banks. Hana and Boram Bank set up a new “Hana Bank,” and Kookmin and Long-term Credit Bank set up a new Kookmin Bank. The terms of reference (TOR) given to merged banks as conditions for government support were designed to improve management measures, which will bring productivity and earning potential of the merged banks up to those of advanced countries. The TOR contains short-term profit improvements, disposition of bad assets, M&A integration and post-merger management, recapitalization plans, improvement of corporate governance, risk management, information technology, and organizational structure. In return for the merger, the government injected financial support for capital increase and for the liquidation of bad loans. Basically, capital (public

resources) was injected into the newly merged banks to maintain the BIS ratio of a sound bank (the amount depended on each case of merger). The total amount the government injected into ailing banks amounted to 21.1 trillion won (\$15.1 billion) by mid 1998. The total broke down into 9.1 trillion won to help finance the purchase of bad loans from banks and credit insurance firms and 11.9 trillion won for making rights issues and preparing for future losses in acquiring banks and life insurance companies (BSA, *Financial Supervision Information*, 9/29/1998).

Two major commercial banks which practically went insolvent early on, Seoul Bank and First Bank of Korea, were also under the government rescue program during the first phase of financial restructuring. For instance, to help Seoul Bank improve its financial standing, the government pumped in 4.5 trillion won (roughly \$3.75 billion). Korea Asset Management Company purchased the bank's non-performing loans and the Korea Deposit Insurance Corporation made capital investments. First Bank of Korea was also injected with a large amount of public money. As a consequence, these two banks were nationalized. After curing their financial ills, the government put these two major banks up for international bidding. But the government's effort to sell these two banks was protracted, owing to a conflict in asset evaluation with prospective buyers. At last, a deal with Newbridge Capital was finalized in which Newbridge Capital would take over the Korean government-held shares of stock (51% of total shares) in the First Bank of Korea in September 1999 (*Hankyeorae*, 9/17/1999). On the other hand, Seoul Bank, which failed to find an international buyer, was placed under a rehabilitation process with new leadership in December 1999.

Those banks which defied the demands of the government for merger came under

mounting pressure. Cho Hung Bank, which strove to stand by itself by inducing foreign capital, faced management reshuffling and the head of the bank was replaced. Finally, Cho Hung Bank and Kangwon Bank caved in to the pressure of the government, announcing a merger with Hyundai International Merchant Bank in December 1998. The three-bank consolidation created the nation's third largest bank with total assets of 2.53 trillion won (\$51.2 billion) and had a capital adequacy ratio of 12.47%. Following the merger, the new bank received 2.5 trillion won (\$2 billion) of public funds from the government (*Korea Herald*, 12/17/98).

By mid-1998, the first phase of bank restructuring, which mainly focused on deposit banks, was roughly completed, although there were some lingering issues with which to deal. In the second phase of bank restructuring, the FSC began to focus on non-banking financial intermediaries such as merchant banks, investment firms, insurance companies, security firms and other saving & loans institutions, while dealing with the remaining issues of commercial banks. In relation to non-banking financial institutions (NBFIs), the government also took sweeping measures. Most NBFIs were also severely undercapitalized, with low capital adequacy ratios. Especially those NBFIs which were affiliated with Chaebols were found to be unhealthy because they were basically used to pump capital into the subsidiaries of Chaebols. For instance, ten merchant banks were found to have heavy debts which exceeded their assets and it was considered impossible for them to meet the capital adequacy ratios (8%) set by the Bank of International Settlement. Four of the nation's 32 security firms were also found to have net operating fund ratios of less than 100%, far below the 150% level required by regulators (the Securities Supervisory Commission (SSC)). The capital adequacy ratios for the four

financially-shaky firms were minus 73.9% for Dongbang Peregrine; minus 62.7% for SK; minus 49.2% for Korea Development; and 4.8% for KLB (*Korea Herald*, 7/16/98).

Sixteen ailing merchant banks out of a total of thirty merchant banks had their licenses revoked immediately and went through closure procedures. As of June 1999, only eleven merchant banks survived, all of which satisfied the BIS capital adequacy ratio of 8%, ranging from 8.54% to 14.53% (FSC, *Financial Supervision Information* 99-32).

Ten out of twenty-five leasing companies were to be either liquidated or bought off by other leasing companies. Eleven companies were under recapitalization programs, and only the remaining four were considered financially healthy. Regarding insurance companies, the FSC ordered that four out of 42 life insurance companies must be closed and 18 were placed under management improvement programs. Among the 14 life insurance companies that were subject to submission of management improvement implementation plans, 10 companies failed to implement plans as originally scheduled and were asked to promptly come up with ways to complete implementation. Some of those firms which did not meet the deadline drawn by the government were disciplined with punishment such as closure. For instance, Daehan Life Insurance was ordered to be sold after the injection of public funds. The remaining 28 insurance firms were classified as healthy ones. Regarding securities companies, five firms' licenses were revoked and one was dissolved by its own decision, while the remaining twenty-eight survived. Regarding investment trust companies: one license was to be revoked, one was to be closed, and six were placed under a management improvement program (*FSC Report*, 9/29/98).

Investment trust companies, insurance firms and leasing companies, as of September 1999, were still under restructuring. Reform of non-bank financial institutions has been

progressing at a slower pace than that of banks due in part to prioritization in the government's reform strategy. In short, as a consequence of the extensive banking industry restructuring, as of December 1999, the number of commercial banks was reduced to 23 through the merger or liquidation of 10 banks. Regarding NBFIs, the total number was reduced from 2,069 in December 1997, to 1,732 in December 1999, through merger, liquidation, or debt/asset transfer (FSC, *FSC Report*, 2/09/2000).

(3) Progress Report & Results of Financial Restructuring

Restructuring in the financial industry progressed in a relatively smooth manner, although there was some social resistance, like the strikes of defiant bank unions and the challenge of bank managers unyielding to governmental directives. The relative success of restructuring owed to the following facts: 1) The Korean state has maintained a coherent and consistent policy stand regarding the critical issues involved in the restructuring program. The establishment of a *de facto* single financial watchdog (FSC) eliminated institutional loopholes, and rearrangement of the policy coordination system made it possible for the FSC to stand firm throughout reform. The political dynamics of economic crisis were also helpful in putting aside the rivalry of economic agencies in pursuit of the reform program. 2) The financially crippled banks could not but be attentive to the directives of the government which turned out to be the only lifeguard during the crisis. The Korean government took advantage of the relatively small government deficit at the beginning of the IMF bailout program. Unlike Latin American countries which were burdened with gigantic governmental budget deficits, fiscal policy in Korea has given priority to balancing the consolidated central government budget, an objective that has

been attained during the past 15 years. Korea recorded the second-largest budget surplus in the OECD at almost 5% of GDP in 1996 (OECD, 1998:42). Thus, the government was able to jack up its expenditures to improve the balance sheets of banks without creating an over-sized governmental-deficit.

Financial sector restructuring has achieved a high degree of success, first of all, in setting institutional foundations for transparent and open market principles. The institutional safeguards against future financial crisis were firmly installed, including the tightening of standards for accounting and public disclosure, and the strengthening of the prompt corrective-action system. Additionally, the new institutional environment would largely prevent the stockholders of financial institutions from getting involved in moral hazardous behavior. Second, the government's actions, such as the purchase of non-performing loans with public funds, have cleaned up the financial institutions' books and put their management back on the right track. Consequently, the average capital adequacy ratio of the banking industry rose to 9.84%, as of June 1999 (Refer to Table 5.4).

Excluding Seoul Bank and First Bank of Korea (which were still under capital rehabilitation programs), the average capital adequacy ratio of the eight remaining nationwide banks was 12.59%, which was way above the international standard ratio of 8%. The bottom row of Table 5.4 shows that the BIS capital ratio has been steadily increasing since 1997. On the other hand, concerning non-performing loans, both the nationwide banks and local banks were burdened with a large number of bad loans, reflecting financial losses incurred from the series of corporation bankruptcies. The high non-performing loan ratio of several nationwide banks' stemmed primarily from the breakdown of the Daewoo group (Refer to Table 5.4). Third, thanks to the improved

balance sheet position of banks, Korean banks also substantially improved their profitability. In 1998, the overall return on the assets of 20 banks was recorded at negative 14.5 trillion won. But they achieved a return of 540 billion won during the first half of 1999 (Financial Supervisory Information, 99-21, 7/12/1999). Except for Korea First and Seoul Banks (which were scheduled to be sold to foreign buyers), and Kangwon Bank (which was supposed to merge into Cho Hung Bank), all the banks recorded positive net profits in the first half of 1999. As shown in Table 5.5, the five major banks' return on equity rose sharply to 6.2% in 1998 and to 19.21 in the first half of 1999, which surpassed the average return on equity in the United States, although smaller banks recorded more moderate profitability. Other categories, including "return on assets" and "net interest margin," also returned to pre-financial crisis levels (Refer to Table 5.5).

More importantly, the financial sector restructuring shattered the myth that "banks never die," which had fomented the reckless loan practices toward the Chaebol. The closures of 10 banks definitely led to changes in the behavioral norms which had created a moral hazard problem in loan practices and bank management. The Korean government's charges against top bankers, who had ill-managed their banks, reset the managerial principles of banks. Out of 35 high ranking bank officials working for five banks which were ordered to be closed by the FSC, 19 were indicted for mismanagement. Many of them had taken large sums of money in bribes in return for extending illegal loans to ailing companies. The Korea Deposit Insurance Corporation (KDIC) plans to investigate a total of 130 closed financial institutions to determine whether their managers and major shareholders were responsible for the illegal management of funds. As part of its efforts to collect public funds injected into the financial sector, the KDIC will seize the properties

of major shareholders and executives if they are found to have violated any financial regulations (*Korea Herald*, 10/18/1999).

However, the overhaul of the banking industry brought about many social problems due to the huge number of laid-off workers. By the end of 1999, when bank restructuring was completed, 40,108 bank employees had been laid-off, meaning one out of three workers employed in the banking industry had been dismissed. The percentage of reduced employment for each commercial bank was as follows: First Bank of Korea (39.1%), Kangwon (38.8%), Busan (37.9%), Seoul (35.9%), Chohung (35.3%) (*Dongah Daily*, 1/11/99).

The restructuring of the banking industry also made a huge dent in the national economy, temporarily. The banks' endeavor to improve their capital adequacy ratios with more restricted loan policies and by calling back matured loans triggered back-to-back corporate bankruptcies and massive lay-offs. As seen in Table 5.1, during the first quarter of 1998, 9449 firms filed for bankruptcy. Reflecting severe liquidity problems, the corporate bill default rate went up to 0.72% in the first quarter of 1998 (Refer to Table 5.1). A new kind of difficulty presented itself that Korea had never before experienced, high unemployment. The number of jobless people had been rising unprecedentedly throughout 1998, reaching an unemployment rate of 6.1% in the first quarter of 1999. Throughout the 1990s Korea had maintained an unemployment rate of between 2.5% and 3.5%. Even in 1997, Korea recorded an unemployment rate of just 2.6%. In addition, Korea's total public debt (which includes government debt, state-run enterprise debt, and all payment guarantees) soared from 45.9% of GDP in 1997, to 66.6% in 1998, and to

83.5 percent in the first quarter of 1999¹⁷ (*Korea Herald*, 11/4/1999).

CORPORATE RESTRUCTURING

The ultimate success of economic reform depended on the speed and scope of corporate restructuring and so it was pursued in tandem with financial restructuring, although the latter was always one step ahead of the former. The burden of NPLs (Non-performing Loans) on financial institutions could not be lessened and sound management could not be secured without restructuring the corporate sector. For instance, the breakdown of debt-ridden Chaebols made a huge dent on the balance sheets of financial institutions, sometimes putting bankers in financial danger. Thus, from the very beginning of the reform program, the attention of the Korean state centered on policy concerning corporate restructuring. My analysis of corporate restructuring will be organized in the six following categories:

1. Approach to Corporate Restructuring
2. Mid-sized Chaebol Restructuring
3. Restructuring of the Top 5 Chaebols
4. The Daewoo Problem
5. Main Policy Targets (Five plus Three) and Reform Results
6. The Outcome of Corporate Restructuring

¹⁷ By the IMF's budget debt standard, which only includes debt by the central and local governments, the total public debt was about 111 trillion won, as of October 1999, (about 23% of GDP). Thus, the Korean government's deficit relative to GDP was lower than other OECD countries. For example, the United States, Japan, and France recorded a deficit of 56.7%, 97.3% and 66.5% in 1998 respectively (MOEF).

(1) Approach to Corporate Restructuring

Corporate restructuring began with a symbolic meeting of then president-elect Kim Dae-jung and the chair-owners of the top five Chaebols on January 13, 1998. In the meeting, the president-elect made it clear that the government was interested in a supervisory role and letting business voluntarily restructure business, especially as far as the so-called “Big Five” Chaebols were concerned. Secondly, they agreed that the five following policy targets for restructuring must be carried out to improve the competitiveness of Korean corporations in the global market: 1) transparent management, 2) dismantling of cross-debt guarantees and cross-ownership, 3) improvement of capital structure, 4) focus on core competencies, and 5) improvement of the controlling shareholders’ accountability (FSC Report). Third, President-elect Kim made it clear that Korea must dissolve its excessive capacity in key industries through the prompt and comprehensive accomplishment of the above-listed policy targets. The agreement was seen by the Korean public as a social contract. The timing of the power shift to the newly elected president was very helpful in drawing this contract and in carrying out the corporate restructuring, owing to several reasons: First, the new government was immune to the political burdens of the policy fall-out which led to the currency crisis. Second, Kim Dae-jung’s party was the first opposition party ever to come to power in modern Korean politics. Thus, the state elites were less likely to be entangled with business elites through the old collusive personal networks. Third, the Chaebol tend to be more attentive to a brand new political regime, due to the anticipation of a long-term relationship with the new regime.

Different approaches to different sized corporations were adopted. First, the “Big

Five” Chaebols, which were believed to have ample financial resources and to be less likely to suffer from liquidity problems, were given initiatives for restructuring business by themselves at the beginning of the restructuring program. The immediate task for the government concerning the “Big Five” was not to resolve a liquidity crisis, rather to improve competitiveness and to lay down reformed institutional foundations. However, for sixth-64th largest Chaebols, which were encountering severe liquidity problems on a day-to-day basis, there was an urgent need for the government to intervene immediately, so “workout” programs were adopted to prevent chain-bankruptcies of the mid-sized Chaebols. The SMEs, which were the most financially vulnerable to the currency shock, required special attention with the government’s financial support (*FSC Report*, 1/29/99).

In the past, the government adopted a more or less direct approach toward corporate restructuring. The government tended to be involved in highly controversial deal-making with favoritism toward certain Chaebol groups or domestic industries. Under globalization and democratization, the government was no longer able to exercise favoritism toward a particular company, owing to the fact that foreign and domestic players (including the media and the public in general under the democratic system) were closely watching the reform programs and would surely bring any kind of favoritism to public attention. Thus, the Kim Dae-jung administration started off by setting up an institutional framework that would induce changes in the Chaebol groups. Second, the major method of corporate restructuring, the “workout program,” was distinct from bail-out programs in the past under which ailing enterprises were rescued by financial subsidies from the government or financial institutions.

The corporate restructuring model in Korea followed the London Approach.¹⁸ The Corporate Restructuring Coordination Committee (CRCC),¹⁹ which was composed of creditor banks, was given the role of arbitrator in each case of corporate restructuring. Each creditor bank established a Corporate Workout Unit and 210 financial institutions signed workout agreements. The major work of the CRCC was to relieve the financial distress of firms through debt relief, debt rescheduling, resetting repayment conditions (maturity, interest), provision of new credit, cancellation of existing debt-guarantee obligations, sale of non-core businesses and debt-equity swaps based on an analysis of financial balance sheets. An important principle of debt-relief programs was “loss sharing” between creditors and corporations through voluntary negotiation. In this process of debt-negotiation, the FSS played the role of intermediary, supervisor and discipliner. In return for the financial rescue package, creditor banks also demanded the troubled corporations take steps towards self-rehabilitation, including asset sales, inducement of foreign investment, and equity sales (FSC, Press Release, 1998). In short, corporate restructuring was basically driven by creditor banks in cooperation with and under the

¹⁸The London Approach, which was named after the corporate restructuring carried out in the 1980s in Great Britain, is positioned between the direct interventionist approach by the state and the market-based approach. Under the London Approach, the government utilizes the lender, that is, financial institutions, as its leverage in handling corporate rehabilitation programs. Creditors (banks), under close collaboration with the governmental policy-makers, and private corporations draft the rehabilitation program autonomously from the government. The government acts as an auditor and supervisor which disciplines and monitors the whole process of the restructuring program (FSC, *FSC Report*, 1998).

¹⁹ Six leading banks-Commercial Bank of Korea, Cho Hung Bank, Hanil Bank, Korea Exchange Bank, Korea First Bank, and Seoul Bank-have been nominated to take charge of corporate restructuring for the 64 large corporate groups. All commercial banks involved in corporate restructuring have created internal workout units.

guidance of the FSC. But the FSC was always behind the decision-making on deadlocked issues between creditors and corporations and behind critical deal-making among the “Big Five” Chaebols.

Corporations were classified into three different categories: a) enterprises to be liquidated, whose capability to make a profit in the near future was almost zero; b) enterprises to be under a “workout program,” which were ailing but could potentially be rehabilitated with the injection of new financing; and c) profit-surplus corporations. After analyzing the financial sheets of 313 troubled enterprises, the FSC and creditor banks concluded that 55 enterprises were ailing, including 20 firms affiliated with the Big Five Chaebols. Following with these categorizations, the government proceeded with the disposal of the ailing Kia Motors Corporation and Hanbo Iron and Steel Corporation whose restructuring had been protracted over a long period of time. The government put Kia Motors Corporation up for sale, open to international bidding.

In tandem with the establishment of the CRCC, the government also prepared a legal/regulatory framework to support the reform programs. The National Assembly passed a series of acts to make the legal/regulatory environment more conducive to corporate restructuring. Key initiatives included the following: 1) Tax Exemption and Reduction Act: Provided tax breaks for restructuring of firms, including exemption of SMEs from capital gains on the sale of real estate used to repay debts to financial institutions and on real estate transfers via mergers and acquisitions. 2) Bank Act: Increased the ceiling on bank ownership of other firms’ equity from 10 to 15%, or higher subject to Financial Supervisory Commission approval. 3) Corporation Tax Act: Advanced removal of deductibility of interest on excessive debt from 2000 to 2002. 4)

Foreign Direct Investment and Foreign Capital Inducement Act: Permitted takeovers of non-strategic companies by foreign investors without government approval and raised the foreign stock ownership ceiling (subsequently raised to 100% for non-strategic companies). 5) Securities Exchange Act: Liberalized mergers and acquisition activity by increasing the portion of shares that could be acquired without board approval from 10% to 33%. 6) Antitrust and Fair Trade Act: Prohibited any new debt guarantees and eliminated all existing cross guarantees by 2000.

(2) Mid-sized Chaebol Restructuring

The government encouraged the leading creditor banks to focus first on voluntary “workouts” for the mid-sized Chaebols (ranked #6-64 in size) for several reasons. The mid-sized Chaebols tended to be the Chaebols in deepest distress, and generally lacked the financial resources and clout to restructure themselves on their own. A large number of insolvencies among this group could create an upsurge in unemployment, bringing severe social distress and political pressure on the government to delay reforms. Moreover, a series of major defaults could provoke a secondary financial crisis, leading to pressure on the currency and interest rate. The 6-64th Chaebols also tended to be less complex and therefore, potentially easier to restructure than the top five. In the FSC’s view, the experience gained in restructuring Chaebols from among the 6-64 group would help creditor banks and the government become better technically prepared for restructuring the Big Five Chaebols.

The government regulator asked eight major commercial banks to select workout candidates from Korea’s #6-64th ranked medium-sized conglomerates. Among the 6-64th

Chaebols, a total of 15 medium-sized conglomerates²⁰ were singled out as workout targets. These Chaebols were under pressure from the FSC to drastically scale down their diversified empires. Those firms under the workout program were obliged to implement drastic restructuring moves, including the liquidation of weak operations and selling off of nonessential assets. In return, creditor banks extended various financial favors, including debt relief, debt rescheduling, and debt-equity swaps to assist in their self-rehabilitation efforts. For instance, Dongah Construction group (10th largest) was forced to sell off 18 out of 19 affiliated firms along with the disposal of real estate owned by the Dongah group. The owner-chair was forced to give up his managerial rights and his private property (stocks and other properties). In return for these self-rehabilitation efforts, creditor banks injected new loans, converted debt into equity, postponed matured returns, and guaranteed loans at the prime interest rate.

However, plans to restructure financially-troubled medium-sized conglomerates encountered some difficulties amid sharp clashes of interest between the concerned firms and their creditor banks over loss sharing. Creditor banks were determined to minimize their financial losses in the process of implementing debt-to-equity swaps for firms under workout programs. Similarly, owners of the workout companies were unwilling to relinquish managerial control, despite receiving huge debt-relief benefits from their creditors. Creditor banks tried to deprive them of managerial control by demanding capital reduction and conversion of debt into equity. Companies subject to workouts,

²⁰ Those fifteen Chaebol groups were as follows: Hyosung (16th largest), Hanwha (8th), Dong-Ah (10th), Kohap (17th), Haitai (24th), Shinho (25th), New Core (27th), Hanil (31st), Tongil, Jinro (19th), Woobang, Goopyong (30th), Sepoong, Kangwon (26th), Kapwool.

even if they were not required to reduce capital or swap debt with equity, opposed their creditors' demands to appoint outside directors and auditors. The companies claimed that creditors should extend bailout loans, but not intervene in management. Amid the fierce tug-of-war, a growing number of workout firms were forced out of the program.

In response to the reform-shy medium-sized Chaebols, the government took tough measures, such as the withdrawal of matured loans, the cut-off of credit lines, tax probes into resistant business groups, the FTC's probes into illegal internal financial transactions among affiliated firms and other political threats. Under the government's mounting pressure, the overwhelming majority of mid-sized Chaebols could not but succumb to the reform demands of the government. Thus, mid-sized Chaebols, in the face of heavy debt, a tight money market and the government's downsizing pressure, rapidly evolved into smaller groups with the dismantling of their groups' structures. For instance, the 6-30th Chaebols consisted of 557 affiliates as of April 1997, but this number dwindled to 433 by October 1999 (Refer to Table 5.8). The FSC announced that, of 248 affiliates from 15 business groups which had been under workout programs, 199 affiliates were sold, liquidated, or merged with financially healthier affiliates, and only 50 affiliated firms survived (*Hankyeorae*, 9/8/1999). As of October 1999, of those business groups which had been under workout programs, about seven business groups were scheduled to dissolve in near future (Refer to Table 5.8).

Along with the shrinking number of affiliates, there have been substantial changes in the control structure of the 6-64th Chaebols. For instance, creditor banks abrogated the managerial rights of owner-chairs under workout programs. Chang Chi-hyok, the owner-chair of the Gohap group, could not live up to his contract with creditor banks to attract a

certain amount of foreign capital by a designated time. Those owner-chairs of business groups which failed to carry out the agreed-upon self-rehabilitation programs were often dismissed from their jobs. The owner-chairs of Daenong, Gohap, DongAh Construction, Dongkuk Trade, and Haitai stepped down in the process of restructuring. The owner-chair of the Shindongah Group was arrested on charges of tax evasion and stripped of his managerial control over Daehan Life Insurance (which was the core component), and the owner-chair of Hanjin was also forced to step down from the Korean Airline CEO position.

The overall process of restructuring the mid-sized Chaebols was easier than that of the “Big Five” Chaebols, and was characterized by the dominance of the state. The mid-sized Chaebols basically did not possess the fundamental resources, that is, the financing capacity, to stand up against the government’s reform demands for several reasons. First, financial institutions had become unwilling to make new loans to the already debt-ridden corporations of the mid-sized Chaebols under the highly uncertain financial market. Second, the weak capital structure and serial bankruptcies of the mid-sized Chaebols destroyed their financial credibility in the stock and money markets, so that the mid-sized Chaebols were not able to mobilize business funds through the issuance of stock, corporate bonds, or corporate papers. On the other hand, the “Big Five” Chaebols, at least in the early phase of restructuring, demonstrated their greater financing capability in the stock and money market, resulting in higher capital concentration amid the restructuring program. Thus, the early rounds of the battle between business and state clearly demonstrated the basic principles of strategic interactions: 1) The more indebted the Chaebols are, the more they are likely to succumb to the reform directives of the state;

and 2) The financing capacity of the Chaebols was positively associated with the success of their resistance to the state's pressure.

(3) Restructuring of the Top 5 Chaebols

The restructuring process of the "Big Five" was a completely different ball game from mid-sized Chaebol reform. President-elect Kim Dae-jung met with the heads of the top five business groups and pulled off a five-point accord in January 1998. But none of the top five had made tangible progress by the end of 1998 in relation to this five-point accord, whereas the first phase of corporate restructuring for the #6-64 Chaebols was completed by the end of September 1998. President Kim, who was initially interested in holding a supervisory role and letting the Big Five voluntarily restructure their businesses, became impatient with their procrastination concerning reform. Thus, the interactions of the Big Five and the state were characterized by the foot-dragging and resistance of the Big Five, the outright threat of retaliation by the state, and arm twisting behind the scenes. During the first half of 1998, almost nothing was accomplished regarding Big Five Chaebol reform, owing to the fact that the government mainly focused on financial sector restructuring and the mid-sized Chaebols, and the Big Five Chaebols with better financing capability were unyielding to governmental directives.

President Kim, who was compelled to engage in direct communication with the major business leaders to assure them of his determination to carry out the restructuring program, held a second meeting with major business leaders on July 6, 1998. The Big Five business leaders promised to speed up corporate reform with the announcement of a nine point pact. This nine point pact dealt with extensive issues including labor, fiscal

allocation, corporate restructuring and macroeconomic policy. More importantly, during the meeting, President Kim convinced them that “big-deal business swaps” were an unavoidable reality of Chaebol reform. In response to the President’s request, the Chaebols promised to come up with a blueprint for swap deals. In addition, a formal business-state channel, a consultative body in which the MOEF and FKI participated, was established to encourage both parties to engage in free discussion of restructuring, corporate financing and other germane issues without having to be wary of the public’s suspicion of possible government-business collusion.

Following the second meeting and bowing to greater government pressure, “Big Deals” were initiated by the Chaebols themselves, with the FKI playing a central role as an intermediary. The government promised to respect market principles and corporate autonomy in pushing the big deals. The main goal of the big deals was to reduce over-capacity²¹ and high leverage, particularly in Korea’s nine leading industries: aerospace, rolling stock, automobiles, ship engines, power plants, petrochemicals, oil refining, semiconductors and electronics (Refer to Table 5.6). These sectors were targeted for reform by the corporations themselves. The Chaebol groups tried to broker big deals in three different ways. One was to merge firms in the same industry and then launch a single unified unit. The second method was for the industry leader to acquire smaller firms from the other groups in the same industry. The third was for the Chaebols to swap their

²¹ According to the Industrial Research Institute (reported on 5/12/99), as of August, 1998, the capacity of the automotive industry exceeded its demands by 40-50%, petrochemical by 10%, steel by 10%, power generation by 50%, and railroad vehicles by 70%. Furthermore, the operation rate of plants in other industries was as low as 50% because of excessive capacity.

different non-core businesses. As shown in Table 5.6, the Chief Planning Officers from the top five Chaebols announced their deals in seven major industries (automobiles were added later) in September, 1998. It was welcomed as the first concerted effort to resolve the excess capacity. But the automotive sector was excluded and there was no strong will implied in the blueprint to carry out restructuring in semi-conductors and petrochemical industries, when the agreement was announced in September 1998.

There has been considerable progress in the first category, merging firms in the same industry and launching a unified unit. For instance, in the aerospace industry, the relevant subsidiaries of Samsung, Daewoo, and Hyundai launched a joint venture company in August 1998. In early July, units of Hyundai, Daewoo and Hanjin also joined forces to form a joint rolling stock firm. This joint enterprise later received a windfall of international investment. Similar agreements were wrapped up in power generation and ship engines in 1999. Korean Heavy Industry (state-owned enterprise) took over Samsung Heavy Industry and later merged with Hyundai Heavy Industry, leading to a monopoly in the power generation industry. In the ship engine industry, a dual system (Korea Heavy & Hyundai Heavy Industry) was established with Korea Heavy Industry's take-over of Samsung (Refer to Table 5.6). Concerning the petrochemical industry, not much progress was made.²² The most difficult problem involved in the establishment of joint firms and consortiums was clarifying managerial control. The big deal programs

²² According to the original agreement, the petrochemical plant of Samsung General Chemical and Hyundai Petrochemical were to merge into a joint-venture, each receiving a 24.5% stake in the envisioned company. The remaining stakes were supposed to go to Japanese investors (25%) and creditor banks which swapped loans for equity (26%). But this agreement was not fulfilled until December 1999 (FSC, *FSC Report*, 2/09/2000).

often deviated from the original blueprint or were stymied by a sharp clash of interests over the issue of managerial control. In response to this wrangling over control, the president threatened to take a variety of punitive steps, including credit suspension or withdrawal for Chaebol groups who failed to live up to the original agreements among the involved parties. For instance, the government threatened to launch a workout program in power generators unless the involved parties came up with a sole managerial authority.

Regarding the second method, in which the industry leaders acquired smaller firms, there were some success stories, but in many cases, there was serious squabbling among the parties involved regarding asset evaluation. In oil refining, for instance, Hyundai took over Hanhwa's energy unit without a protracted battle over the price of Hanhwa assets. But in the semiconductor sector, at the very beginning, LG Semiconductor preferred to pursue its own self-rescue programs instead of cooperating in industry-wide consolidation. Only after a protracted battle between LG and the government did LG give up its ownership of the newly established semi-conductor entity by selling-off its stock shares. In the telecommunications industry, the Chaebols initially pursued their own self-rehabilitation despite the fact that the domestic telecommunications sector was in need of realignment. According to one report, the five telecommunication firms (Korea Telecom, SK Telecom, LG Telecom, Dacom Telecom, and Hansol PSC) competing against one another in the relatively small local market needed to be merged into two or three carriers. The third method, which prescribed direct business swaps among Samsung Motors, Daewoo Electronics, and the Hyundai group, encountered the most daunting obstacles in its way. Concerning the super swap deals, the interactions amongst government, creditor banks, and concerned business groups portrayed a classical power struggle.

As shown in Table 5.6, as of December 1999, the Korean government was successful in pushing through the so-called “big deals” in seven out of eight industrial areas. The saga of the “big deals” was a mixture of continual squabbles, arm-twisting and confrontations over two years. As a matter of fact, there was little progress until late 1998. The voluntary restructuring of the top five Chaebols fell behind in producing concrete results, except for certain industrial sectors, such as aerospace, railroad vehicles and oil refining, especially compared to other corporate categories. For instance, as of October, 1998, 20,000 Small- and Medium-Sized firms had closed and around half of the top 6-30 ranking Chaebols had overhauled their tight control structures. But, of the 20 Big Five units ordered to be dissolved, only one had been forced to close and the remaining 19 companies have been allowed to survive through mergers with sister companies. In addition, the semi-conductor merger talks between LG and Hyundai and the automotive unit swap deal between Daewoo and Samsung were stalled. In most of the six targeted industries, the Big Five Chaebols had failed to resolve disputes over who would manage their joint firms and consortiums, leaving their industrial realignment to the government and creditor banks.

The foot-dragging of the top five Chaebols was possible because their capital structure and financing capability allowed them to deflect the pressures of the government. The Big Five Chaebols dominated the stock and money markets by having their financial arms (non-banking financial institutions) provide unfair financial support to their affiliates directly or indirectly during the crisis. The non-banking industry was under the control of the top five Chaebols. The top five Chaebols, as of June, 1999, held 40.3% of life insurance, 47.3% of non-life insurance, 54.6% of securities, 52.2% of credit cards, and

30.2% of investment trust companies (*Korea Herald*, 7/6/99). More importantly, these high percentages were obtained during economic crisis. The combined market share of 33 non-bank financial firms belonging to the Big Five conglomerates jumped to 34% in 1998, compared with 18.6% in 1997. Their combined assets, which accounted for 22.5% of the entire industry in 1997, surged to 30.4% at the end of March, 1998, and to 34.7% at the end of March, 1999. In the investment trust market, the combined market share held by the investment trust subsidiaries of the Big Five skyrocketed to 31% as of May 1999, from 5.3% at the end of March, 1997.

With the use of non-banking financial intermediaries, the five leading business groups issued about 77.8% of the total domestic volume in outstanding corporate bonds in the first half of 1998. This number soared up from the 39.8% recorded for the previous year. Circumstances were similar in their rights issues. The Big Five accounted for about 90% of rights issues in the Korean stock market during the first half of 1998. In terms of CP (Corporate Paper), the top five accounted for 56.3%, amounting to 775 billion won during the same period (*Chosun Daily*, 8/4/98). These sharp increases meant the increasing monopoly of the capital market by the Big Five (*Korea Herald*, 9/14/98). The top five Chaebols raised huge funds via rights issuance, after the government regulated the issuance of corporate bonds and commercial paper.

The Big Five Chaebol's financing capability made it almost impossible for the government's and creditor banks' pressure on the top five Chaebols to be effective. Furthermore, the Chaebols exploited their financial affiliates to aid other money-losing subsidiaries as a way of deflecting governmental pressure for workout programs. Taking it one step further, the conglomerates called for the government to abandon its heavy-

handed administration and intervention in big swap deals and switch to a hands-off industrial policy. The lobbyist arm of the big Chaebols, the FKI, demanded extended trade financing to Chaebols to help bolster sagging exports, more extensive tax breaks for restructuring programs, and more generous new loans. The chairman of FKI, also head of the Daewoo Group, advanced the so-called “conspiracy theory” that the U.S. continued to pressure the Korean Chaebol to restructure as it felt threatened by the rapidly growing Korean firms, and proclaimed that the government should not yield to the pressure of outside powers which conspired to dismantle the Chaebol system (*Korea Herald*, 11/24/1998).

The government, which became increasingly impatient with the Big Five’s procrastination, slowly took over the initiative of the Big Five restructuring from early October, 1998. There were several factors conducive to the government’s more aggressive pursuit of the Chaebol reform program,²³ the first being public opinion. According to public opinion surveys conducted by various media, the overwhelming

²³ Of course, there were some inimical political variables which blew against Chaebol reform. The opposition party (Grand National Party, GNP) raised its voice against the direct interventionist policy, standing by the Chaebol’s position. Sometimes the GNP attempted to take political advantage of its disgruntled regional constituents who were at a disadvantage. But the overwhelming public opinion toward speedy Chaebol reform frustrated the GNP’s political attempts, so the Korean government did not face much resistance. The second political hindrance to the reform process was the inherently shaky power structure of the coalition government which was composed of the National Congress for New Politics (NCNP) and the United Liberal Democrats (ULD). NCNP consisted of moderate conservative and liberal politicians whereas the majority of ULD members stood for a conservative bloc in the Korean political spectrum. However, the ideological divergence within the coalition government did not become a devastating obstacle to Chaebol reform, because the executive branch regained its dominance over the legislative branch with the recovery of bureaucratic cohesiveness under President Kim’s leadership.

majority of Koreans (78-80%) felt that the government must intervene in the slow paced reform of the Chaebols. Surprisingly, about 60.5% of the populace agreed that the Chaebol system must be dissolved. Direct government intervention in Chaebol reform was supported by 70.4% of the populace (*Joongang Daily*, 1/3/1999). As a matter of fact, according to the *Joongang Daily*, the President's popularity has fluctuated with his attitude toward Chaebol reform. When he toughened up against the Chaebol, his approval rating went up, and vice versa. Second, international pressure played a critical role in inducing the Chaebol to reform. International investors expressed concern over the extremely slow pace of corporate reform, providing the Korean state with additional incentive to speed up the reform process. The Chaebol increasingly became the main focus of IMF policy talks. Even President Clinton and the Ministry of Finance in the United States emphasized successful Chaebol reform as the key barometer for foreign investors to judge whether or not the Korean economy had returned to normalcy, so that the Chaebol were surrounded by criticism (*Korea Herald*, 10/18/1999).

Riding on this favorable political environment, President Kim called for a meeting with the chair-owners of the "Big Five" at the Blue House on December 6, 1998. During the meeting, yielding to political and public pressure, the five Chaebols agreed on a set of sweeping reform programs. The agreement called for each of the five conglomerates to dispose of marginal and money-losing units and focus on a few business lines. The Chaebols promised to raise 2 trillion won by disposing of their owners' private assets and unprofitable and marginal subsidiaries. It also set guidelines for industrial realignment in seven sectors: petrochemicals, aircraft, rolling stock, power generation, ship engines, semiconductors, and oil refining. These so-called "big deal" swaps, spin-offs, sell-offs,

mergers and acquisitions among the five Chaebols would cut the total number of subsidiaries and affiliates of the five Chaebols from 264 to 130. The agreement was worked out after intensive week-long negotiations among the government, the five Chaebols and their creditor banks. This agreement called for a meeting every three months to review the progress of the reform programs. The five Chaebols and their major creditor banks made public the progress of the reform programs. The 10-page restructuring agreement contained the Chaebols' commitments to 20 action programs in five areas, including focusing on a few core business lines, eliminating cross-subsidiary credit among affiliated firms, improving capital structure and raising management transparency. The government and creditor banks in turn pledged to help the Chaebols convert debts into equity, offer tax favors and guarantee they would control the companies which would undergo debt-to-equity conversions.

The agreement was the most tangible outcome to date in President Kim's year-long push for corporate reform. The agreement included two especially "super big deals": 1) the swap deal between the Samsung Group's infant auto-making unit and the Daewoo Group's money-losing home appliances maker; and 2) the merger of LG Semiconductor and Hyundai Electronics. The government twisted the arms of Chaebol owners to sign a document agreeing to give up many of their business lines by threatening to cut off credit lines, probe into illegal financial transactions among affiliated firms, probe into other illegal economic activities such as stock price manipulation, tax evasion and so forth. The Chaebols' heavy dependence on bank loans and consistent threats and persuasion were the primary reasons for their submission to the government directives. But their awareness of the changing business environment also played an important role in their acceptance of

their own restructuring.

The “two super big deals” demonstrated a classic case of political juggling between reform-shy big business and the reform-minded state. The deal to swap Samsung’s auto unit in exchange for Daewoo’s electronics business was considered a litmus test for the Korean state, testing whether or not the Korean state was capable of enforcing the deal, though many questions arose concerning the economic effects of the big deal. The disposal of heavily debt-laden Samsung Motors was supposed to sharply boost the group’s overall finances and dissolve the excessive capacity of the automobile industry. As for the Daewoo Group, by taking over Samsung Motors, Daewoo planned to concentrate its resources on the automobile business. However, from the very beginning, Samsung and Daewoo clashed sharply over the issues of asset evaluation and loss sharing, and the negotiations turned into a continuing stalemate. On the other hand, sales and operating losses at the big deal manufacturers continued to rise, inflicting great damage on the national economy (*Korea Herald*, 1/21/1999). Employees at those companies and their parts suppliers were becoming increasingly hostile to the consolidation reforms and workers launched strikes against the consolidation. As a consequence, the economic damage due to the retardedness of the big deal was snowballing. To make matters worse, the opposition party (GNP) attempted to manipulate the populace in Busan, where the Samsung automobile plant was located, temporarily undercutting the government’s stand on the big swap.

On the other hand, the government stayed firmly on track, intensifying pressure on Daewoo and Samsung. The head of the FSC vowed to mobilize all accessible policy means to punish violators of the initial agreement. President Kim repeated his early

threats to make Chaebol owners accountable for civil and criminal liabilities for mismanagement. Samsung's abrupt decision to request court receivership immediately put an end to the stalled talks on Daewoo Motor Company's takeover of Samsung Motors. Backing off from its earlier plan to sell off the debt-laden auto-making affiliate to the Daewoo Group, Lee Kun-hee, Samsung Group chairman, promised to put up personal assets worth about 2.8 trillion won (\$2.42 billion) to shoulder nearly two-thirds of Samsung Motors' 4.3 trillion won debt. Samsung's filing of court receivership was a procedure towards liquidation of the troubled automaker.

Following Samsung's announcement of court receivership for the auto unit, there have been continual confrontations between the government and creditor banks on the one hand and Samsung on the other hand regarding the financial accountability of the failed Samsung auto unit. Samsung demanded that Samsung Life Insurance must be listed on the stock market in exchange for the chair-owner's cash contribution for Samsung Motors. The government and creditor banks reiterated their demands for Samsung's additional cash contribution beyond the four million Samsung Life shares put up by Samsung chairman Lee Kun-hee to help clear up the automaker's debt problems. Creditor banks set out to sanction the Samsung group by their refusal to extend the maturity of Samsung affiliates' existing debts. Samsung finally caved in to the demands of creditor banks in August 1999. Asking the owner-chair of Samsung to take responsibility for his managerial failure financially and legally was a crucial issue for the Korean government which had to establish market principles for the future. The success of Chaebol reform was, in some sense, dependent upon whether or not the government was able to establish managerial responsibility for mismanagement.

Another super big deal, the Semi-Conductor deal, went through similar steps, although the story ended differently. Based on an international consulting firm's assessment in December 1998, Hyundai Electronics was picked to control management of the joint firm created when Hyundai Electronics and LG Semicon merged. But LG Semicon resisted the decision to give up control of the chip-making giant to Hyundai Electronics. The FSC, fearing a possible collapse of the chip merger deal, sent an ultimatum vowing to call in all existing credit from Hyundai Electronics and LG Semicon if they failed to settle their management control dispute (*Korea Herald*, 12/9/98). The Minister of Economy and Finance warned the Big Five that the government would abolish their managerial rights if they neglected carrying out reform programs (*Korea Herald*, 12/11/98). President Kim announced during his interview with CBS that the government would take severe measures against any party which violated the agreement in the context of the semi-conductor deal (Ibid. 12/14/98). LG Semicon, in preparation for severe punitive financial measures from the government and as an effort to pursue its own self-rehabilitation, raised over 700 billion won (\$583 million) through capital increases and asset sales. But that fell short of meeting the demands of the government. President Kim and his hard line aides repeatedly threatened to cut credit lines to the party responsible for spoiling the big deal. Creditor banks decided to suspend new credit and withdrew maturing loans. The government's punitive step, if accompanied by withdrawal of long-term bank loans, appeared ready to deal a fatal blow to LG's group-wide finances (*Korea Herald*, 12/28/1998). Under high pressure from the government, the chair-owner of LG delivered his final decision during his meeting with President Kim that LG would give up ownership of the newly-established semi-conductor entity by selling-off its stock shares

(Joongang Daily, 1/7/1999).

These two events showed that the Korean state still held an edge even over the top five Chaebols. As long as the Korean government continued to firmly and steadily build cohesive policy measures, the Chaebol could not but cave in to the reform demands. It was also obvious that those Chaebols whose capital structure was weak were more likely to be attentive to governmental directives or to yield to pressure (Refer to Table 5.7 to see the top five Chaebol's debt/equity ratios). For instance, the Daewoo Group, whose capital structure was considered weakest, announced that it would slim down its operations into the automotive, trade and financial sectors, and reduce the number of its subsidiaries from 34 to 8 in early 1999. Subsequently, Hyundai, who was also burdened with a high debt/equity ratio promised to trim its affiliates from 49 to 20 by the end of 1999, mainly focusing on core business lines.²⁴

(4) The Daewoo²⁵ Problem

In the middle of the second phase of Chaebol reform, the Daewoo liquidity crisis was divulged, throwing the national economy back into instability. Unlike the other big five Chaebols, Daewoo did not have self-restructuring capability because of its

²⁴Under this new reform program, Hyundai would even sell lucrative subsidiaries abroad including Inchon Iron & Steel Co., Kumkang Planning, Hyundai Elevator, Daehan Aluminum, Hyundai Oil Refinery Co., and Hyundai Broadcast Station. Hyundai reduced its core business lines from five to four by excluding petrochemicals and oil refinery. The group will be divided into 4 small business groups by 2003, and will double the volume of its rights offerings from the original plan (4/23/99).

²⁵ Daewoo, as of April 1999, was the third largest among Korean Chaebols in terms of capital size (Refer to Table 5.8). The combined output of the group's subsidiaries accounted for as much as 5% of Korea's GDP and contributed more than 10% of the country's total exports in 1998.

substantially weaker financial and operational performance and very limited financial and managerial resources. New rights issues, which were a major tool to reduce the debt ratios of the other top 5 Chaebols, were not possible at all in the case of Daewoo because of the low stock prices, which reflected its poor performance. Reduction of its debt-equity ratio in 1998 to 385% was mainly due to asset reevaluations and investment-in-kind among affiliates. On July 19, 1999, Daewoo, struggling under debts of nearly 60 trillion won,²⁶ sought a bailout from its creditors to avoid insolvency and announced it would conduct a sweeping overhaul of its operations to stay afloat. In return for the bailout, the conglomerate offered domestic creditors about 10 trillion won in group assets, including group chairman Kim Woo-choong's personal fortune,²⁷ as collateral (Kim Woo-choong offered his total assets, worth 1300.5 billion won, as collateral for the loans). Daewoo chairman Kim promised to step down after the auto unit was put back on track or if he failed to fulfill the contracts with creditor banks by the end of 1999. Thus, Daewoo Chairman Kim faced the risk of forfeiting managerial control and almost all of his personal assets.

The key differences between previous workouts for Chaebols in the top five and that for Daewoo were: 1) the scale of the problem and its impact on financial institutions; 2) large foreign debts (total \$9.94 billion dollars): the total collapse of Daewoo inflicted serious damage on the overall national credibility; 3) large debts in the form of CP

²⁶ Daewoo's debts to local financial institutions included 30.7 trillion won in outstanding bonds and commercial paper, and 12.6 trillion won in borrowing from banks and non-bank financial firms. The overall debt totaled 60 trillion won.

²⁷ Kim's shareholdings were set aside to repay Daewoo Motor's debt by creditor banks in September 1999.

(commercial paper) and corporate bonds; and 4) implications for current corporate and financial sector restructuring (Refer to *Monthly Chosun*, August 1999). The 60 trillion won debt (excluding off-balance guarantees to local financial institutions) far exceeded the 27.8 trillion won total debt restructured for all 76 “workout” companies to be completed by June 1999. Daewoo Motors and Daewoo Corporation, whose combined debt was 23.4 trillion won as of March 1999, required enormous debt restructuring, including debt-to-equity swaps. As a result, the banking sector was required to realize significant losses. Coupled with more vigorous classification criteria (forward-looking criteria) planned for the end of 1999, major creditor banks (Korea Development Bank, Korea Exchange Bank, Hanbit, Korea First and Cho Hung) needed significant recapitalization. In return, bank recapitalization required enormous amounts of public money injected by the government. In addition, the Daewoo Group’s liquidity crisis took a heavy toll on the finances of the group’s subcontractors and parts suppliers, pushing many of them to the brink of bankruptcy.

Chaebol groups which went insolvent before Daewoo mobilized capital through commercial banks. The financial losses occurring from those bankruptcies were shared among creditor bankers and the stockholders of bankrupt corporations, so that the shock waves were quite limited in the financial market. But in the case of Daewoo, financing was done via the issuance of corporate paper, bonds, and stocks in the security market and most Daewoo-issued bonds were purchased by investment trust firms and security firms. Thus, when Daewoo went bankrupt, those investors who purchased beneficiary certificates from investment firms shouldered a large part of the financial loss incurred from the Daewoo liquidity crisis. In short, the effects of the Daewoo liquidity problem

were much more extensive than the previous bankruptcies of mid-sized Chaebols. Stock prices, which had been on the rise, tumbled, and the bond market suffered temporarily and bounced back, but instability in the stock and money markets went on. As a result, the long-term interest rate also went up after the Daewoo problem was disclosed. However, the government's swift response played a decisive role in calming down market uneasiness. The commitment of financial authorities to the injection of liquidity, if needed, also helped contain the potential spreading of systemic risks without undermining market principles.

Considering the weight of Daewoo relative to the Korean economy and the impact of Daewoo fallout on the financial market, there was grave concern that Daewoo's possible failure to overcome its liquidity problems would trigger a fresh foreign exchange crisis, sending enormous shock waves to other top Chaebols. This urgent situation led the Korean government to take more bold and swift measures on the Daewoo liquidity crisis. Creditor banks provided new loans to Daewoo and rolled over the matured loans because it was in their interest to prevent Daewoo from going bankrupt. Under FSC monitoring, the four creditor banks, Hanbit, Cho Hung, Korea Exchange and Korea First, formed a task force for Daewoo's immediate overhaul. Later on, being aware that without cooperation from non-banking financial institutions, the commercial banks by themselves could not handle the Daewoo liquidity problem in an appropriate manner, the presidents of banks, securities firms and investment trust companies got together and made a concerted effort to calm the local financial market reeling from the fallout of the Daewoo Group's crisis.

By the end of August, 1999, the government had no choice but to put most

Daewoo units under a workout program in light of their serious credit shortages, because financial institutions were refusing to accept their promissory notes and were pressing them to repay debts. There was also a growing possibility of serial bankruptcies among Daewoo's subcontractors. The financial market slid into an unstable stage with the rise of interest rates and plummeting stock prices. As a consequence, the Korean government felt compelled to proceed posthaste with the workout program. Under the workout program, creditor banks virtually took over Daewoo's managerial control. Their job included rollovers of Daewoo's foreign debts, debt-equity swaps, spin-offs and sell-offs of the affiliated firms and separation of business lines. The FSC took full control of Daewoo affiliate sell-offs, separations, mergers and other self-rescue measures, despite criticism that the Korean state intervened too heavily in the process of Daewoo restructuring. Large-sized and commercially viable units were selected for debt-to-equity swaps before being separated from the group and sold to foreigners. Selling-off many Daewoo firms swiftly was considered the best way to recover market stability (stock prices nose-dived after the Daewoo liquidity crisis was exposed to the public).

Under the restructuring plan signed on August 16, 1999, the Daewoo Group and its creditors agreed to reduce the conglomerate's units to six auto-related businesses, while spinning off and selling the remaining 19 units by the end of 1999. Of 25 affiliated firms, 12 Daewoo units, including Daewoo Motor, Daewoo Motor Sales, Ssangyoung Motor, Daewoo Capital, Daewoo Heavy Industry, Daewoo Electronics, Daewoo Electronic Appliances, Daewoo Telecommunications, Kyongnam Corporation, Orion

Electronics, and Dianus Club Korea, were placed under workout plans²⁸ by Daewoo's creditor banks and other financial institutions (*Joongang Daily*, 8/26/99). As of December 1999, Daewoo, which once had 37 affiliated firms in diverse industries and ranked as the second largest asset holder in Korea, was virtually dissolved, leaving its 12 major firms under workout programs. Kim Woo-choong, the owner-chair of Daewoo, who was once a legendary figure in business circles for his swift rise to the apex, fizzled out, just like his own business.

However, the financial industry bore huge losses that cut into capital adequacy ratios. In the first place, creditors were not able to collect interest payments from the 12 Daewoo firms put under the workout rehabilitation program. Outright debt write-offs and the swapping of loans for equities also raised the financial losses of the financial institutions involved. The Daewoo Economic Institute foretold that the overall losses from the crumbling Daewoo Group would reach 20-30 trillion won. Among these losses, investment trust companies, which should be the first to hold themselves accountable for potential losses from their investments, bore about 13-14 trillion won. Banks which invested in those investment firms bore 2.4 to 2.8 trillion won of that 13-14 trillion won. The government stepped in later with the infusion of public funds to recapitalize trust and investment funds. The total amount of public funds to be infused for the financial rescue was expected to amount to 19 to 28 trillion won over time.

By dissolution of the second largest Chaebol, the government demonstrated its

²⁸ The workout program involved a temporary freeze on the debts of a company while its creditor banks provided it with operational funds. The conversion of loans for investment and write-offs was also an important part of workout program (*Korea Herald*, 8/26/1999).

determination to carry out Chaebol restructuring. The break-up of the Daewoo Group shocked its Chaebol colleagues and made it clear to foreign investors that the Korean state was fully committed to Chaebol restructuring. The other big-five Chaebols became more attentive to the directives of the government and accelerated their reform efforts. The Daewoo case showed that the debt-ridden Chaebols remained vulnerable to the pressure of the government. With the dissolution of the Daewoo group, the Korean myth of “too big to fail” was completely shattered.

(5) Main Policy Targets (Five Plus Three) And Reform Results

The Korean state developed a five-point pact (with the later addition of three more points) with the Chaebol in its efforts to transform the Chaebol into more market-oriented entities. The objective of Chaebol reform was not only to hold the Chaebol subject to the principles of market but also to enhance the competitiveness of Korean corporations in the global market with leaner control structures and healthier capital structures. This study will now consider the results of reform efforts in the context of the “five (plus three) point pact.”

(a) Enhancement of Transparency of Corporate Management and Accountability of the Controlling Shareholder

The main objective of control structure reform was to prevent the owner-chair from wielding despotic power in the decision-making process and to make the managerial process transparent. The control structure of corporations usually consisted of a board of directors, a general meeting of stockholders, auditors, and employees. But most of these

governing institutions had stopped working as originally designed under the Korean Chaebol system. Thus, the owner-chair, who may have been positioned either within or outside an enterprise, exercised a wide range of power, but was not accountable for the consequences of his managerial decisions. As a result, the Chaebol were driven into gigantic investment projects, often reflecting the owner-chairs' aspirations for bigger conglomerates rather than strategic market analysis (see Chapter IV). The fervent drive toward expansion plainly led to overcapacity in major industries over and over. The policy-makers believed that if it was left unclear as to who was accountable for decisions made, Korea would suffer from excess capacity in major industries time and again in the near future. Accordingly, the central reform measures in this area were to diffuse managerial power which was overly concentrated in the hands of the owner-chairs, to rehabilitate the functions of the governing institutions, and to make the corporate managerial process transparent.

First of all, the government revised the law regarding the rights of minor stockholders who had been largely neglected. Under the revised provisions, it became easier for minor shareholders to demand accountability from the chair-owner, because minor shareholders with 0.005% of shares, instead of 0.01% (under previous law) were able to sue the chief-director. Other efforts have been under way to improve the rights of minor stockholders. The Corporate Governance Reform Committee (CGRC)²⁹ suggested

²⁹ The Chair of the FSC announced in March 1999, that the FSC would concentrate its institutional resources on diffusing the control structure concentrated in the hands of the owner-chair. In order to tackle the outdated corporate governance, the government formed the Corporate Governance Reform Committee (CGRC) which consisted of academic specialists, bureaucratic technocrats, business representatives and others. The main task of the CGRC was to draw up a set of principles for better

that, to make corporate data more available to minor shareholders, restrictions on requesting detailed accounting information for a firm must be eased. The current business law requires shareholders to own more than 3% of the total stake of a firm for a period of more than six months to request the firm's accounting information. The suggested stock transaction law requires shareholders to possess more than one percent to acquire detailed accounting information.

Second, concerning audits, corporations listed in the stock market with more than a certain amount of assets were required to establish in each firm an auditing commission, with two-thirds of the membership coming from outside the firm. Then the government toughened qualifications for outside directors to prevent Chaebol owners from appointing their relatives or other faithful proteges. During the past, the founders of Korean firms typically selected outside directors among their friends, colleagues, and relatives, resulting in improper monitoring of the firms' management. Furthermore, the government strengthened disciplinary measures toward outside auditors and persons involved in accounting-related issues.

Third, to rehabilitate the authority of the board of directors in the decision-making process, Korea's listed firms with total assets of more than one trillion won (\$834.72 million) were supposed to have boards of directors comprised of more than eight members, with half of the seats filled by outside directors by the end of 1999, so that the

corporate government of Korean firms. CGRC went through various public hearings and seminars, and unveiled draft guidelines for corporate governance in October 1999. Their work is still under way.

managerial authority would be taken over by the boards of directors from the owner-chairs. Along with the restructuring of the governance structure, the government ordered the Chaebol to introduce combined financial statements by the end of 1999 (the original plan was to introduce combined financial statements by 2000) (*Joongang Daily*, 2/24/1998). The introduction of consolidated financial statements would show the assets and liabilities of a business group and the capital flow among the group's subsidiaries. The consolidated financial statements would also enable the financial watchdogs to see the whole picture of a group's financial operations and its financial status. In addition, the government ordered Chaebol groups to dismantle the control towers under the owner-chairs, such as the Planning Office and the gigantic Secretary Office, and demanded the owner-chairs take over the CEO positions of the core competencies. By doing this, the government tried to impose managerial accountability on the owner-chair who had commanded the affiliated firms from outside.

(b) Significant Improvement of Capital Structure: Lowering Debt/Equity Ratios

During the rapid growth era, from the 1960s to the 1980s, domestic companies had to raise money almost solely through bank loans because the capital market was underdeveloped at that time. In addition, the situation of a closed market, coupled with a monopoly or oligopoly, financial aid and tax support from the government, made the risk of bankruptcy very low, thereby making high debt more attractive. This situation allowed companies to maximize the benefits of debt,³⁰ such as tax subsidies, without concern over

³⁰ According to the M & M model (the theory developed by Modiglianni and Millder), a highly leveraged firm has a higher chance of bankruptcy, thereby incurring

the cost of debt caused by possible bankruptcy, while seizing investment opportunities through aggressive investments financed by bank loans.

Since the mid-1980s, the advantages of a high debt-to-equity ratio have decreased rapidly as potential bankruptcy costs increased with rapid market opening and increasing competition. The advantages of a high debt-to-equity ratio began to decrease further in 1996, with the profitability of domestic companies decreasing. On the other hand, potential bankruptcy costs increased with rapid market openings and increasing competition in globalization in the 1990s.

Thus, the improvement of weak capital structure appeared to be an essential requirement to enhance the competitiveness of Korean corporations in the global market over time and lessen the risk of insolvency. For instance, Korean corporations have much higher interest expenses to total expenses due to higher debt/equity ratios, as compared with their global competitors (Refer to Table 4.5). In turn, the increased interest expenses on borrowed money lowered the corporations' ordinary income to sales, despite the fact that Korean corporations have had relatively good operating income to sales. Accordingly, reducing debt/equity ratios to less than 200% by the end of 1999 was set as a policy target. The reduction of the high debt/equity ratio was also recommended as a way to protect Korean corporations from international hot money attacks. Corporations with healthy capital structures are less vulnerable to financial crisis than highly indebted ones.

In order to carry out the debt-reduction program, the FSC required an agreement

potential bankruptcy costs. So, as the debt of a firm increases, both the benefits of debt (tax subsidies) and the cost of debt (bankruptcy costs) rise. At some point, the cost of debt surpasses the benefits of debt. That is the point where the debt-to-equity ratio maximizes the firm's value, that is, the optimal capital structure.

between each Chaebol and its designated creditor banks on a Capital Structure Improvement Program (CSIP) at the time of a new loan or term extension on existing loans. Each CSIP is supposed to address the following items: phased reduction of debt/equity ratios, asset sales and issuance of new equity, removal of cross-debt guarantees, improved corporate governance, and if necessary, debt/equity conversion. If a Chaebol did not fully comply with its CSIP, the designated creditor banks would suspend new loans and withdraw existing loans to the Chaebol. Yielding to the mounting pressure from the government, each of the Big Five Chaebols submitted the capital structure agreement to their designated creditor banks (*Korea Herald*, 12/16/1998). The financial regulator was to periodically verify that the capital structure agreement was being carried out.

The FSC and creditor banks were encouraged to use the following methods to improve financial status: sale of subsidiaries (including profitable ones), joint ventures with both overseas and domestic enterprises, sale of real estate and other assets, investment of the chair-owner's personal property, and rights offering. However, during the early phase of the CSIP program (1998), the Chaebol largely failed to improve their capital structure. Asset and equity values were depressed amid economic crisis. It took a long time to sell assets or to attract foreign investment for joint ventures. Foreign investors were wary over issues like negative asset values, potential labor unrest, and government interference. The Chaebol resisted, contending that raising cash through joint ventures and the sale of subsidiaries and assets was unrealistic under a depressed market. During a government-business conference, the Chaebol insisted that reevaluation of assets was a feasible way to reduce debt-to-equity ratios (*Joongang Daily*, 7/27/1998). The FKI asserted that

reducing debt-to-equity ratios to 200% by the end of 1999 was an impossible task, considering the amount of capital required to achieve that goal. For instance, the listed firms of 30 Chaebols in the manufacturing sector needed 510-1520 trillion won. Korean companies' debts were simply too huge to be reduced to 200% or lower within two years through asset sales or foreign investment (joint ventures). Debt-to-equity swaps were considered to be an acceptable alternative as long as managerial rights were not taken away by creditor banks (KEI, FKI 10/13/1998). The FKI also insisted that when the government calculated debt-to-equity ratios, it must exclude debts which required no current interest payments. The Chaebol were not able to sell their real estate and firms in the domestic market in which most capitalists were under a cash-crunch. The rights issues in the stock market was not a good method either because the stock market was still at the bottom (*Joongang Daily*, 10/26/98).

The Chaebol attempted to reduce their high debt/equity ratios by reevaluation of assets. In the process of reevaluation, the Chaebol inflated their asset values on purpose. In fact, the aggregate debt ratio for the top five Chaebols was 284% with asset reappraisals at the end of 1998, and 361.2% without (Refer to Table 5.7). Hyundai's debt ratio in particular was 312% with reappraisal, and 449% without. Daewoo's debt ratio was 385% with reappraisal, and 494% without. Thus, during a year-long debt-reduction program, the Chaebol basically pulled down their debt/equity ratios only on paper³¹ (Refer

³¹ There were a few Chaebols which successfully underwent debt-reduction programs. As of the end of 1998, Lotte, a confectionery-retail-service giant, posted the lowest debt-to-equity ratio, at 117.8%, followed by Cheiljedang (133.2%) and Dongkuk Steel (198.4%). In contrast, the average debt ratio for the top 30 Chaebols stood at 379.8%, with those of some heavily indebted groups, like Anam and Ssangyoung, reaching 1,403% and 8,354% respectively. Unlike other Chaebols resorting to asset

to Table 5.7).

The FSC warned that it was not acceptable for the Chaebol to cut their ratios by asset reevaluation. The MOEF made it clear that the government would not recognize the top five Chaebols' debt reductions through asset reevaluation. In addition, the FSC rejected the proposal of the Chaebol that debt-equity swaps must be employed as a realistic way of reducing the high corporate debt-to-equity ratio, because banks were not ready financially to trade debt for equity. The FSC did mention that the exchange of debt for equity could be the last resort, but the FSC intensified pressure on the Chaebol to sell off their cash-surplus affiliates first. At the same time, the FSC encouraged the Chaebol to insure the rights of equity in the stock market. In response to the government's intensified pressure, Hyundai and Daewoo, which were the most indebted among the top five Chaebols, submitted their proposals to reduce their debts without reappraisal in early 1999. As a matter of fact, rights offerings became the dominant method to reduce debt/equity ratios in May-June, 1999, as the stock market rebounded toward higher expansion. From March 1999 on, the Chaebol began to show their sincere efforts to cut debt/equity ratios under a favorable stock market.

As of the end of June, 1999, 58 of the 125 top-30-Chaebol affiliated listed firms, or 46.4%, had already registered debt ratios of below 200%. By contrast, debt ratios at 67 Chaebol affiliates, or 53.6%, were in excess of 200% at that time. The top 30 Chaebols' average debt/equity ratio dropped from 502.9% in December 1997, to 369.1%

reevaluations and capital increases to cut debts, Lotte, Cheiljedang and Dongkuk Steel slashed their liabilities through asset sales and other drastic restructuring means.

in December 1998 (Refer to Table 5.2). The average debt/equity ratio of the top five Chaebols also dropped from 476.0% in December 1997, to 361.2% in December 1998, and to 197.9% in December 1999,³² as shown in Table 5.7. Excluding the asset reevaluation carried out by the Chaebol, the average debt/equity ratio of the top five Chaebols would have still been above 200 percent in December 1999. It can also be observed that, in other categories of firms, such as listed firms, manufacturing, and non-manufacturing, the average debt-to-equity ratio has been substantially improved (Refer to Table 5.2). In short, the speed of debt-reduction by Korean corporations is striking, considering that it took Japanese companies 15 years to reduce their debt-to-equity ratios from 300% to 200%.

(c.) Decentralization of Ownership Structure

The highly concentrated ownership structure also made it possible for the owner-chairs to wield despotic managerial power over the affiliated firms. The higher the internal equity ratio held by the owner-chair, the more powerful he tended to be in controlling group firms. However, during the economic crisis, the government concentrated its efforts on dissolving the cross-debt guarantees among affiliated firms rather than reducing the internal share holdings.

While the government was distracted by other issues, the internal equity ratio of the nation's top 30 groups rose from 43.0% in 1997, to 44.5% in 1998, and to 50.5% in

³² The Big Five raised 17.3 trillion won through self-rescue efforts in the first half of 1999. They raised 7 trillion won through asset sales and 10.3 trillion won through capital increases (*Chosun Daily*, 8/25/1999).

1999. In the midst of the reform drive, Chaebol owners increased their internal equity holdings by 7.5 percentage points, on average, running counter to their pledges to scale down their ownership concentration. A close look at the Table 4.3 discloses that, while the number of internal shares held by the owner-chairs and their families (A+B) decreased between 1997 and 1999, the total share holdings (A+B+C), including shares held by member companies, rose sharply during the same period. The rights offerings in the security market during the crisis helped reduce the owner-chairs' and their families' average internal share holding rate (A+B), as shown in Table 4.3. But the removal of "the cap on the inter-unit investment"³³ in February, 1998, allowed the Chaebol to increase cross-unit equity investment, resulting in higher internal share holding rates among member companies. As shown in Table 4.15, since 1998 when the cap (25% of total investment) on cross-unit equity investment was lifted, the total amount of capital investment across affiliated firms went up. The ratio of cross-unit investment to total investment was recorded as 25.8% in 1998 and 31.0% in 1999. As a consequence, the average internal holdings which are under the owner-chair's control has been on the rise.

Responding to the rising internal share holding rate, Kim Dae-jung revived the

³³ The law, the cap on the inter-unit investment of the 30 largest Chaebols, was promulgated in 1987 as the Roh government's effort to dissolve the ownership concentration. Under the law, a Chaebol unit was barred from investing more than 25% of its net worth in equities of sister firms. The Kim Young-sam government removed the 25% ceiling in February 1998 (just before Kim Dae-jung took power), after relaxing foreign investors' equity ownership of Korean firms. The removal was in response to Chaebol complaints that the rule seriously limited their ability to raise funds to defend against hostile takeover bids on their affiliates by foreign investors. Since the removal of the restrictions, there have been no hostile takeover bids made by foreign investors. Rather, the removal of the restrictions allowed Chaebol groups to shore up the capital structures of their weak units.

restrictions on Chaebol affiliates' equity investment in sister firms. Under the revived restrictions, which are scheduled to be implemented from April 2001, Chaebol-affiliated firms are barred from investing more than 25% of their net worth in equities of sister firms. The increase in the internal holding rate, especially among member companies, meant that cross-equity investment increased even amid the reform process. Most of the increase in internal share holdings stemmed from circular investments across member companies within a business group, which is hardly detectable by a regulator.

(d) Dissolution of Cross-Subsidiary Loan Payment Guarantees and Ending Illegal Financial Transactions

The cross-subsidiary loan payment guarantees and cross-capital investments have been utilized as a way to subsidize the financially weak firms at a business group level. By dissolving the cross-debt guarantees and prohibiting illegal financial transactions among affiliated firms, the Kim Dae-jung government tried to attain four policy objectives: 1) to enable the market mechanism to kick non-profitable Chaebol subsidiaries out of business; 2) to prevent the breakdown of one ailing subsidiary from leading to the insolvency of a whole Chaebol group, which would eventually inflict damage on the national economy; 3) to prevent the money-losing affiliates from affecting the financial statements of cash-surplus firms; and 4) to induce the large business groups to restructure themselves focusing on their core competencies and to create an environment in which independent corporations could compete on an equal footing with the large business groups. Thus, the main policy target was the prohibition of new debt guarantees among affiliated companies within the Chaebol and the dismantling of existing debt guarantees by the end of March

2000. In addition, the government had to carry out the previous, on-going policy target, that is, the elimination of certain debt guarantees among unrelated units by the end of 1998. More importantly, the FSC and FTC had to stop the illegal financial transactions which channeled funds from healthy firms into money-losing affiliates.

Policy measures have been taken by the financial regulators to resolve cross-debt guarantees and illegal financial transactions. First of all, the FSC has prohibited banks from requesting cross-debt guarantees since April 1998. The FSC encouraged banks to lend money on the basis of credit rather than collateral or third party debt-guarantees. Second, the FTC launched investigations into unfair intra-group transactions of the top five Chaebols (Samsung, Hyundai, Daewoo, LG, Sunkyung) and the 6-64th Chaebols as necessary. The first investigation found that eighty subsidiaries provided thirty-five subsidiaries with unfair subsidies totaling 4.02 trillion won. Out of the thirty-five corporations which received subsidies, twenty-five (or 71.4%) have operated in the red for a period of at least one year during the past three years and nine corporations have been in a state of capital encroachment. The core affiliates of the five large business groups provided extensive subsidies to ailing member affiliates. Based on these findings, the FTC imposed 72.2 billion won in surcharges against the eighty subsidiaries and ordered them to stop the violations immediately. It was the first investigation into internal illegal financial transactions and, for the first time, surcharges were imposed following the investigation by the FTC (FTC, *Report 5*, 8/6/1998). However, the government faced mounting resistance from the Chaebol. The Chaebol took the issue to court in an attempt to avoid paying the surcharge at all or to delay the payment.

The FTC launched a second investigation into the top five Chaebols during May-

June 1998 and found that 33 affiliated firms within the top five Chaebols provided 21 affiliates with illegal subsidies totaling 4.93 trillion won. Out of the 21 recipients of subsidies, 17 affiliates (81.%) had operated in the red for a period of at least one year during the past three years and four affiliates had been in a state of capital encroachment. Based on these findings, the FTC imposed 20.9 billion won in surcharges against the violators (Cash-surplus affiliates provided extensive financial assistance to cash-strapped, money-losing units. *FTC Report*, 11/18/1998). The government showed its determination to root out the Chaebol practice of diverting funds from strong affiliates to weaker units. The FTC required the five largest Chaebols to submit their own schedules to eliminate debt guarantees by December 15, 1999, along with the records on debt-guarantees eliminated as of the end of 1998.

Responding to the continuing illegal financial transactions among affiliated firms, the government introduced legislation which gave the FTC the legal authority to look into financial transaction information. Armed with this new authority, the FTC launched a third investigation into illegal internal trading against the top five (May 5-August 10, 1999) and against the top 6-30th Chaebols (June-August, 1999). This time, the FTC was better able to track down illegal inside dealing among Chaebol subsidiaries. During its third investigation of the top-five Chaebols, the FTC uncovered a total of more than 5.5 trillion won of illegal internal transactions. Each of the top five groups was found to have assisted their weaker subsidiaries substantially through illegal internal trading. The FTC imposed a total of 100 billion won in surcharges against the top five (*Joongang Daily*, 8/12/99).

As a result of the fair trade and financial watchdogs' increased pressure to cut

down on cross-debt guarantees and illegal financial transactions, there has been substantial progress in the former, but in the latter, few improvements have been made. As shown in Table 4.17, under the Kim Dae-jung government (April 1998-April 1999), the ratio of illegal debt-guarantees relative to capital size dropped from 39.5% in April 1998, to 9.7% in April 1999, while the ratio of total debt-guarantees to capital size also plunged, from 93.1% to 22.3%, during the same period. And the absolute ratio of both illegal and legal cross-debt-guarantees also fell sharply. Based on this pace of decrease in cross-debt guarantees, the cross-debt guarantee issue is expected to be resolved by the target year, that is, March 2000. On the other hand, as disclosed by the FTC's third investigation, the illegal internal financial transactions have continued. It is almost impossible for the FTC to discover the exact amount of illegal internal trading by the top-five Chaebol groups.

(e) Singling out Core Businesses

This policy target, singling out core businesses, has been discussed throughout the examination of Chaebol reform in this chapter. Thus, no further explanation is needed except for a brief comment on the achievement of this policy target. As shown in Table 5.9, each Chaebol has been involved in a wide range of unrelated industries, with the top five averaging about 30 different industries and the top 30 Chaebols averaging slightly less than 20 industries just before the reform program took off in 1998. During the meeting between the top five owner-chairs and the chief-executive in December 1998, the top five Chaebols promised to concentrate on one to five core industries; Hyundai in auto, construction, petrochemical, electronics, finance & services; Samsung in electronics, finance, and services; Daewoo in automobiles; LG in chemicals, telecommunications,

finance & services; and Sunkyong in information & communication, energy & chemicals, trading and finance. Although Table 5.9 does not show the progress made by the top five Chaebols, their transformation into specialized business groups has been under way. For instance, the top four Chaebols (excluding Daewoo) cut their total number of subsidiaries from 232 in April 1997, to 137 in December 1999. For the top 30 Chaebols, that total number dropped from 819 to 622 during the same period. The large reduction in the number of subsidiaries means that the Chaebol have become more specialized in a smaller number of business lines.

President Kim announced three new reform targets, in addition to the above-mentioned five reform targets, in his Liberation Day speech on August 15, 1999. The three reform measures are aimed at (1) restricting the Chaebol's control of the non-banking financial sector; (2) barring them from circular cross-unit equity investments and inside trading; and (3) regulating inheritances and the transfer of wealth among Chaebol family members. Following the announcement of the three new reform targets, President Kim convened a high profile business-state-bankers meeting at the Blue House. More concrete measures were agreed upon to carry out the additional reform targets. As of October 1999, reform programs in these areas are under way.

(6) The Outcome of Corporate Restructuring

The IMF and World Bank point to South Korea as an exemplary model of successful reform. All macroeconomic indicators show a remarkable turnaround in one and a half years under the Kim Dae-jung government. Above all, Korea's external vulnerability has been greatly reduced since the onset of the financial crisis. Korea, as of

December 1999, enjoyed a record level of foreign exchange reserves, exceeding \$74 billion, thanks to large current account surpluses (Refer to Table 5.1). The country's external debt has declined considerably. Net external debt was \$54.1 billion at the end of 1997 and \$20.2 billion at the end of 1998. Net external debt has continued to drop, falling past \$1.1 billion in August, 1999. In November 1999, Korea turned itself into a net creditor. In addition, the foreign exchange market became stabilized in the fourth quarter of 1999. Second, GDP growth, manufacturing growth, and equipment investment growth returned to high expansion in 1999 (Refer to Table 5.1). Other indicators, including the operation ratio of plants, the number of bankrupt firms, bill default rate and consumer price growth rate, demonstrate that the Korean economy has swung back to its normality. Although, as of December 1999, the stock market is still, to some extent, unstable, mainly owing to the Daewoo liquidity crisis, the overall performance of the Korean economy seems to deserve the IMF and World Bank's applause.

In addition, Korean firms' per capita productivity showed remarkable improvements in 1999, illustrating their successful streamlining reform efforts over the past year. According to the Korea Stock Exchange (KSE), the turnover rate per-employee at listed companies declined 4% in the first half of 1998, but rose 4.4%, to 270 million won, in the same period of 1999 (*Korea Herald*, 8/30/1999). Korea's listed companies also posted record net profits in the first half of 1999. During the first half of 1998, the sales revenue of the listed firms (520 firms) contracted by 4.92% (and by 3.7% for all of 1998), but during the first half of 1999, they registered record-high net profits of 5.95 trillion won in the first half of 1999 (*Hankyeorae*, 8/16/1999). As shown in Table 5.3, the listed firms recorded their ordinary income to sales at 2.8% during the first half of

1999. Firms in the manufacturing and non-manufacturing sectors also improved in both their ordinary income to total assets and ordinary income to sales during the first half of 1999. This sharp turnaround in terms of profitability was attributed to reduced interest expenses stemming from rock-bottom interest rates, lowered debt/equity ratios, increased proceeds from the disposal of assets in the wake of restructuring and valuation profits from their securities investment. It is too early to assume that this pace of profitability will continue in the coming years, because the net profit did not stem from expanded market shares. But, it is safe to say that, as a consequence of corporate restructuring, Korea's corporate sector has been considerably strengthened in terms of its global competitiveness.

Some precautions need to be attached to the bright picture of the successful reform story. Corporate restructuring is still only half completed, so the reform program could lead either way, to failure or success, depending upon the dynamics of domestic politics. The pattern of financing by Korean corporations still remains out-dated by heavy reliance upon borrowing from banks and NBFIs. The ratio of corporate financing via stock and bond issuance remains around 45.2%, as compared with 72.8% in American corporations, as of September 1999 (*Dong-Ah Daily*). Corporate restructuring without solid institutional restructuring, such as a corporate governance system, could result in the dampening of entrepreneurial enthusiasm in equipment investments. Korea had recorded stellar economic growth, mostly due to the large growth in equipment investments in past decades. Entrepreneurs boldly took on the debt-driven expansion of production facilities during dense industrialization. The policy emphasis on the reduction of high debt/equity ratios and profitability is expected to substantially cut into the growth rate. It seems that the high growth rate in the first half of 1999 stemmed largely from the rebounding of the

contracted economy. It is too early to be sure that the Korea economy is not firmly anchored in a long-term growth track. Another worrisome problem following the structural adjustment is the widening income gap between the rich and the poor. According to the National Statistical Office, the Gini coefficient of concentration (a measure of inequality among income brackets) amounted to 0.3204, the highest since 1979 when the NSO began to record its Gini coefficient. Korea recorded 0.2830 in 1997 and 0.3157 in 1998 in its Gini index (*NSO Report*, 3/03/2000). It is clear that, like the other structural adjustments, the restructuring program inflicted more damage on the middle class and the poor than the rich in the Korean case too.

CONCLUSION

The relative success in financial and corporate sector restructuring under the Kim Dae-jung government (1998-1999), as compared with the Roh (1988-1992) and Kim governments (1993-1997), is largely attributable to the reclamation of the Korean state as the dominant, autonomous force in the business-state nexus. The Korean state was able to follow economic rationale in the pursuit of bank and corporate restructuring during the economic crisis, as demonstrated in the detailed interactions of business-state in this chapter. No longer a captive of the Chaebol, the Korean state redefined the dynamics of strategic interaction with big business toward reform-minded collaboration. Because the financial crisis stemmed from the Chaebol's organizational characteristics, that is, their sheer size, diversified business lines, and the concentrated ownership structure, those characteristics lost their potency as sources of influential power over the state and turned into political handicaps. Severe liquidity crises put most of the highly indebted Chaebol on

the brink of outright collapse, throwing the Chaebol at the mercy of the Korean state. As a last resort, the debt-ridden Chaebol were compelled to ask for financial rescue from the state, which was, in turn, able to reclaim its autonomy and leadership over the private sector. There is clear empirical evidence that the financing structure (heavy reliance upon external sources) and high debt/equity ratios of Chaebol have been critical factors in determining the extent to which the Chaebol were resistant to the reform pressure of the government. The mid-size Chaebol, with higher debt/equity ratios and less financing ability, first succumbed to the directives of corporate restructuring, but the big five Chaebols remained unyielding to the call for reform until the government mobilized various policy measures against the non-compliant. In short, without an inquiry into the structural characteristics of Korean corporations, we cannot comprehend the root causes of the relative success in corporate restructuring.

However, this study also demonstrates that the structural characteristics of business-state interactions during crisis must be understood in the context of the political/institutional variables. The swift and decisive reclamation of state autonomy owed not only to the weak organizational characteristics of Korean corporations but also to significant changes in the internal structure of the state (institutional foundations of the bureaucratic system, policy coordination system, and political leadership). Once the liquidity crisis was resolved, corporations became less attentive to the directives of the government. Thus, the long-term success of bank and corporate restructuring basically depended upon the political leadership's resolution to carry out reform programs. Above all, the economic crisis led to changes in the political regime's utility calculation for political survival. The 1997 presidential election delivered the populace's mandate for

economic reform to Kim Dae-jung. Backed with popular consensus on Chaebol reform, Kim was able to take aggressive measures against the Chaebol. As a matter of fact, the regime popularity varied along with whether or not the Kim administration took a harsh stand against the Chaebol. Wide popular support made it easier for the Kim Dae-jung government to be consistent and resolute in enforcing the Chaebol reform program over time.

Reflecting the changing political environment, the resolute chief-executive changed the collective economic leadership with the infusion of new economic technocrats, the firm endorsement of institutional autonomy to the core policy machinery, and the overhauling of the policy coordination system. For instance, the establishment of the Financial Supervisory Commission as the *de facto* single financial regulator and the steering machinery for bank and corporate restructuring helped to rejuvenate policy cooperation among the agencies involved. Once goal-seeking leadership was restored, the business-state nexus transformed into a constructive collaboration concerning reform programs. Even the Big Five Chaebols, which had been recalcitrant throughout 1998, began to acquiesce to the directives of the government from early 1999. The Chaebol became aware that their common foot dragging tactics would not work against Kim's government, as it had under previous regimes (1988-1997). Furthermore, the Chaebol changed their stands on the critical issues of corporate reform, such as debt/equity ratios, singling out the core business lines, and corporate governance structures. Their attitude change stemmed from their realization that the globalized market would not allow corporations to practice the old fashioned business activities. The changes in big business groups' survival strategies were revolutionary and resulted in substantial differences in terms of reform

targets.

Table 5.1
Major Economic Indicators during Economic Crisis

Year	1996	1997				1998				1999			
Quarter	All	1/4	2/4	3/4	4/4	1/4	2/4	3/4	4/4	1/4	2/4	3/4	4/4
GDP growth rate(%)	6.8	4.9	6.2	5.5	3.6	-3.6	-7.2	-7.1	-5.3	4.6	9.8	12.3	13.5
Manufacturing growth rate (%)	6.8	5.6	7.8	7.9	4.9	-4.6	-10.4	-9.1	-4.7	10.7	20.1	26.8	27.9
Equipment investment growth (%)	9.1	4.2	1.3	-12.6	-25.9	-38.3	-46.1	-39.3	-27.4	12.9	37.2	48.0	-
Construction investment (%)	6.1	-1.9	2.9	2.7	4.5	-5.9	-7.8	-12.0	-13.7	-13.7	-8.5	-10.0	-
Export (100 million dollars)	130	-	355	341	367	322	349	305	347	303	358	351	431
(growth rate: %)	3.7	-	7.1	15.6	3.6	8.4	-1.8	-10.8	-5.5	-6.1	2.7	15.2	24.2
Import (100 million dollars)	150	-	373	357	345	236	235	215	246	256	287	292	357
(growth rate:%)	11.3	-	0.8	-3.8	-14.8	-36.1	-37.0	-39.9	-28.7	8.1	22.0	38.5	44.8
Current account (100 million dollars)	-230	-73	-27	-20	40	109	111	98	86	62	64	66	-
Foreign debt (10 billion dollars)	16.4	11.0	-	12.0	15.4	15.1	15.4	15.4	14.9	14.5	14.2	14.1	14.1
Foreign exchange holdings (10 billion dollars)	3.3	2.9	3.3	3.0	2.0	3.0	4.1	4.7	5.2	5.7	6.2	6.5	7.4

(Table 5.1 Continued on next page)

Table 5.1 Continued

Operation ratio of plants (%)	80.8	79.8	81.1	80.1	77.4	68.8	67.0	66.7	69.9	71.3	76.8	79.5	80.1
# of bankrupt firms (#)	-	3443	3790	3834	6101	9449	6357	4221	2801	1932	1631	1477	-
Bill default rate (%)	0.17	0.23	0.30	0.32	1.06	0.72	0.59	0.55	0.23	0.14	0.15	1.15	0.53
Unemployment rate (%)	2.2	3.3	2.8	2.4	2.9	6.1	7.7	8.3	8.1	9.1	7.4	6.2	4.6
Consumer price growth (%)	4.9	4.7	4.0	4.0	5.0	8.9	8.2	7.0	6.0	0.7	0.6	0.7	1.3
Foreign exchange rate (won vs dollar)	844	897	888	914	1415	1379	1395	1373	1207	1225	1156	1219	1145
Korea Composite Stock Price Index (KOSDI)	833	675	724	723	489	507	371	318	438	572	769	943	921
Earning rate of corporate bonds (%)	11.9	12.4	12.1	12.1	17.0	20.7	17.5	12.9	9.3	8.4	8.0	9.6	9.5

Source: National Statistical Office

Table 5.2
Financial Stability in Corporate Sector

(Unit: percent)

	Debt-to-equity ratio			Equity to total asset ratio		
	Dec. 1997	Dec. 1998	June 1999	Dec. 1997	Dec. 1998	Change
Top 5	472.0	386.0	302.2	17.8	24.9	7.1
Top 6-30	597.9	625.5	-	14.3	13.8	-0.5
Top 1-30	502.9	369.1	-	16.6	21.3	4.7
Listed firms	621.4	571.1	286.5	-	-	-
Manufacturing	359.4	293.4	230.7	-	-	-
Non-manufacturing	336.1	310.6	277.0	-	-	-
Financial industry	2,553.3	2,694.4	-	-	-	-

Source: FTC, *Financial Supervisory information 99-20,99-18, and 99-13, 1999.*

Table 5.3
Profitability Rate of the Korean Corporations During Crisis
(Unit: percent)

	Ordinary income to total assets			Ordinary income to sales			Interest expenses to total expenses	
	1997	1998	1999 (first half)	1997	1998	1999 (first half)	1997	1998
Top 5	0.1	-0.3	-	0.1	-0.3	-	4.2	6.8
Top 6-30	-1.6	-8.1	-	-2.1	-12.0	-	6.7	11.8
Top 1-30	-0.5	-2.8	-	-0.5	-3.0	-	4.9	7.9
Listed firms	-0.7	-3.1	2.7	-0.9	-3.7	2.8		
Manufacturing	-0.8	-5.4	-1.2	-0.6	-3.2	-0.2		
Non-manufacturing	-0.3	-0.7	3.0	0.2	0.1	1.6		
Financial industry	-0.8	-2.6	-	-8.1	-22.4	-		

Source: FTC, *Financial Supervisory Information 99-20, 99-18, and 99-13, 1999.*

Table 5.4
Balance-sheet Positions of Commercial Banks

(Unit: percent)

Banks	BIS capital ratio			Non-performing loan ratio		
	as of Dec. 1997	as of Dec. 1998	as of June 1999	as of Dec. 1997	as of Sept. 1998	as of Sept. 1999
Nationwide Banks						
Cho Hung	6.5	0.93	13.09	7.0	6.2	6.6
Hanbit	7.25	12.05	11.57	4.2	4.1	7.0
(Commercial Bank of Korea)	7.6	-	-	4.8	4.3	-
(Hanil)	6.9	-	-	3.6	3.9	-
Korea Exchange Bank	6.8	8.06	10.96	5.7	6.0	5.1
Kookmin	11.58	10.09	10.09	4.5	6.2	6.1
Korea Housing Bank	11.88	10.79	12.43	2.0	5.4	8.9
Shinhan	11.07	14.69	15.03	4.1	5.1	3.9
Hanmi	11.78	15.21	15.95	3.4	4.0	2.8
Hana	13.30	13.10	13.74	2.4	3.7	3.1
Boram	13.3	2.67	-	3.2	3.1	-
Peace	5.4	-1.79	8.88	4.5	9.8	10.7
(Nationalized banks scheduled for privatization)						
Seoul	0.97	-0.88	-10.0	10.4	15.8	9.9
Korea First	-2.7	-1.47	-14.0	11.4	16.1	5.2
Average for nationwide banks	7.02	8.22	9.79	5.5	6.7	6.1
Regional Banks						
Daegu	11.3	11.42	12.45	8.4	8.6	6.2
Busan	9.7	9.25	12.62	8.4	5.8	5.9
Kwangju	10.7	10.12	13.00	8.1	13.9	4.6
Cheju	11.3	9.65	8.61	21.4	22.2	12.8
Jeonbuk	13.3	12.94	13.92	14.9	18.5	5.5
Kwangwon	5.4	-10.65	-	18.3	25.1	-
Kyungnam	12.3	11.87	14.15	7.3	7.6	8.9
Chungbuk	5.9	-4.63	-	11.3	15.9	-
Average for regional banks	9.99	8.31	10.40	9.9	11.4	6.6

(Table 5.4 continued on next page)

Table 5.4 Continued

Average for all banks	7.04	8.23	9.84	5.8	7.1	6.2
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Source: The Banking Supervisory Authority, *Financial Supervision Information*, various issues.

Reference: BIS capital ratio (as of December 1997) of the 5 dissolved banks were as follows: Daedong Bank (3.0), Dongnam Bank (4.5), Donghwa Bank (5.3), Kyungki Bank (6.7), Chung Chong Bank (7.0).

- 1) Commercial Bank of Korea and Hanil Bank were merged into Hanbit Bank;
- 2) Boram was merged into Hana Bank;
- 3) Kangwon Bank and Chungbuk Bank were merged into Cho Hung Bank.

Table 5.5
Profitability of the Banking System

	(unit: percent)						
	Average 1990-93	1994	1995	1996	1997	1998	1999 (first half)
Return on assets (%)							
All banks	1.9	1.0	0.9	0.3	-0.9	-2.8	0.3
Return on equity (%)							
Five Major Banks	6.1	6.0	3.4	1.2	-31.6	6.2	19.21
Nationwide Banks	6.3	6.2	3.9	3.5	-14.1	-44.7	2.8
Regional Banks	6.7	5.7	5.6	5.4	-14.8	-91.1	10.7
All Banks	6.4	6.1	4.2	3.8	-14.2	-49.2	3.55
Net interest margin (basis point)							
All banks	2.7	2.3	3.0	-	-	1.95	2.36
Non-performing loans (commercial banks)							
In trillion won	9.54	11.72	12.48	12.23	21.32	22.22	25.90
As percent of total loans	7.0	5.6	5.2	3.9	5.8	7.4	8.7
Capital adequacy ratios of banks (%)							
Five major banks	8.87	10.46	9.21	8.86	4.46	3.83*	2.32*
Nationwide banks	9.38	10.19	8.97	8.97	6.66	8.22	9.79
Regional banks	13.95	13.11	11.44	10.15	9.60	8.31	10.40
All banks	10.00	10.62	9.33	9.14	7.04	8.23	9.84
Total employees (unit: 1000)	-	-	-	-	113.9	75.3	74.4

Source: The Banking Supervisory Authority, *Financial Supervision Information*, various issues.

Reference: * The capital adequacy ratios of the five major banks in 1998 and 1999 would be 6.36% and 11.87% respectively when the ailing banks, Seoul and Korea First, are excluded.

Table 5.6
The “Big Deals” Agreement among Big Five Chaebols

Industry	As of 1997	Sept. 1998 agreement	As of Dec. 1999
Semiconductors	Samsung Electronics Hyundai Electronics LG Semiconductors	-----> merger of Hyundai & LG	*Hyundai took over LG Semicon. (7/7/99)
Railroad Vehicles	Hyundai Precision & Ind. Co. Daewoo Heavy Industry Hanjin Heavy Industry	-----> First Daewoo and Hanjin would merge into one unit	*later all three merged ('99)
Ship Engines	Korea Heavy Industry Samsung Heavy Industry ----- Hyundai Heavy Industry	-----> Korea Heavy Industry to take over Samsung	*dual system: Korea Heavy and Hyundai Heavy Industries (12/30/99)
Petrochemical	Samsung General Chemical Co. Hyundai Petrochemical Co. ----- Wolsan. Yoochoon Industrial Park	-----> merge into one entity	*not much progress made
Aerospace	Samsung Aerospace Co. The Aerospace Division of Daewoo Heavy Industry Hyundai Space & Air Craft Co.	-----> merge into a single unit	*monopolistic system established (10/01/99)

(Table 5.6 continued on next page)

Table 5.6 Continued

Power Generation	Hyundai Heavy Industry ----- Samsung Heavy Industry Korea Heavy Industry	-----> Korea Heavy Industry to take over Samsung, later, pursue merger with Hyundai Heavy Industry	* merged into a single system (12/30/99)
Oil Refining	Hanhwa Energy Hyundai Oil Refinery	-----> Hyundai to take over Hanhwa	* Hyundai took over (reborn into Incheon Oil) (6/30/99)
Automobiles	Samsung Auto Motor Daewoo Auto Motor ----- Hyundai Automobile Co.	-----> Daewoo to take over Samsung Motor	* Samsung Motor scheduled to be liquidated

Source: Joongang Daily, 10/7/1998; FSC, *FSC Report*, 3/6/1999 and 2/10/2000.

52 Reference: The “big deal” agreement was announced by the FKI and Top 5 Chaebols on September 3, 1998.

Table 5.7
Trend of Debt/Equity Ratios of Top Five Chaebols: 1996-1999

	Dec. 1996	Dec. 1997	Dec. 1998	June 1999	Dec. 1999
Hyundai	436.6	572.0	312 (449)*	340.8 (421.0)*	199.1
Samsung	272.0	366.0	258 (276)*	192.5 (172.9)*	193.5
Daewoo	337.3	471.8	385 (494)*	588.2 (660.7)*	-
Sunkyong	376.3	466.0	250 (355)*	227.3 (305.9)*	199.0
LG	355.2	508.0	316 (341)*	246.5 (239.7)*	199.8
Average	355.5	476.8	284 (361.2)*	302.2 (389.4)*	197.9

Source: FTC, *FTC Report*, various issues.

*The numbers in parentheses refer to the debt/equity ratio of each business group when calculated without recognizing the asset reevaluation carried out by the Chaebols during crisis.

Table 5.8
Thirty Largest Business Groups during Economic Crisis

Business group	Number of affiliated firms				As of April 1999	
	Apr. 1997	Apr. 1998	Apr. 1999	Oct. 1999	Capital size (billion won)	Corporate restructuring process
Hyundai	57	62	62	49	15,021	split into small groups by 2003
Samsung	80	61	49	45	17,128	specialized in light industry
Daewoo	30	37	34	20	16,890	scheduled to be dissolved
Lucky-Gold	49	52	48	39	11,553	
Sunkyung	46	45	41	36	9,490	specialized in energy and communication
Hanjin	24	25	21	20	3,249	specialized in transportation
Ssang-young	25	22	23	22	936	under workout
Hanhwa	31	31	21	21	2,989	under workout
Kumho	26	32	29	26	1,608	-
Lotte	30	28	28	29	4,777	emerged as a healthy group
Dong-Ah	19	22	15	18	854	under workout
Hansol	23	19	19	19	1,789	-
Doosan	25	23	14	14	1,559	-
Daelim	21	21	17	17	1,259	-
Dongkuk	17	17	16	14	1,852	-
Dongbu	34	34	32	33	1,414	-
Hanla	18	18	17	19	-407	scheduled to be dissolved

(Table 5.8 continued on next page)

Table 5.8 Continued

Kohap	13	13	8	7	-863	scheduled to be dissolved
Hyosung	18	21	17	15	1,356	under workout
Kolon	24	25	19	16	1,128	-
Dongyang	24	23	21	22	876	-
Jinro	24	15	17	17	-788	scheduled to be dissolved
Anam	21	15	15	14	47	under court protection
Haitai	15	15	15	15	-629	under court protection
Kangwon	-	27	13	8	932	under workout
New Core	18	18	0	-	-	dissolution
Cheil-jedang	-	-	15	16	1,125	-
Shinho	25	28	21	17	-453	under court protection
Kupyung	22	19	0	-	-	under workout
Daesang	25	20	14	14	758	-
Total	819	804	686	622	96,732	16 groups under workout programs

Source: Fair Trade Commission

Reference: The above-listed business groups were not always ranked within the top thirty. Thus, the numbers in the bottom row are not the exact total or average value of the above-mentioned firms, but the total or average value announced by the FTC each year, because the FTC changed the list of the thirty largest business groups each year. There were more business groups under workout programs besides the above-listed firms. Non-listed groups include Hanil, Tongil, Sepoong, and Kapyul.

Table 5.9
Changes in the Number of Industries Involved in by Chaebols
(Unit: #)

	1995	1996	1997	1998	April 1999
Top 5	29.6	29.6	30.0	31.0	30.0
Top 6-30	16.3	16.6	17.8	17.8	17.0
Top 30	18.5	18.8	19.8	20.0	19.2

Source: FTC, Report (6/18/1999)

CHAPTER VI

CONCLUSION

GENERAL FINDINGS

This study examined whether different types of business-state nexus are associated with the success or failure of economic transformation in South Korea across different time periods. My historic comparative analysis strongly supports the contention that South Korea's developmental trajectory cannot be understood without reference to the changing patterns of the business-state nexus. A close inquiry into the structural characteristics of business-state interactions is prerequisite to understanding the ups and downs of the Korean economy over time. This study precisely explains how and when the Korean state was able to engineer an equilibrium between the two contradictory conditions of "state autonomy" and "connectedness" in the form of the business-state nexus over time. This study empirically discloses the political/institutional forces and resources which define the dynamics of the business-state nexus. As was seen under the democratic regimes (1988-1997), the delicate equilibrium can be disturbed by various factors: the empowerment of capitalists, the loss of coherent cohesiveness in the policy-making regime and the collapse of development-driven political leadership. Owing to the high potential for the close linkage to deteriorate into a rent-seeking collusion, many political economists cast doubt on the transferability of the Korean developmental model. However, by empirically specifying the forces regulating business-state interactions, this study makes the statist developmental model more transferable to other late-late

developers.

By incorporating the organizational traits of the Korean Chaebol into the “combined developmental model,” this study is superior to the statist approach in the following ways: First of all, the “developmental state model,” which is basically “stationary,” is transformed into a “dynamic developmental model” which can account for both the economic miracles and meltdowns during the various phases of industrialization. Statists do not pay adequate attention to the potential for change in the internal structure of the state over time and thereby overlook the potential downfall of the developmental state at certain phases of economic development or during democratization. The “developmental state” is inherently unstable and changeable over time. It is ironic that successful dense industrialization did not justify the continued existence of the Korean developmental state, but exhausted the political and economic rationale for the survival of the developmental state. Plainly speaking, the developmental state’s original mission to carry out industrialization was accomplished, so that it was supposed to die out. The statist overlooked the downfall embedded in the concept of the “developmental state” at the end of the dense industrialization. This study attempted to make amends for the deficiency of flexibility, adaptability, and dynamism in the statist’s conceptualization by exploring the effects of political and economic change on the internal structure of state.

Another fallacy of the statist approach was that their studies disregarded changes in the role of private partners in the developmental process. Simply speaking, capital rolls bigger and gnaws at the autonomy of the state. The top-down approach centering on the state cannot reveal the overall account of economic development, especially during the post developmental era. As demonstrated in Chapters IV and V, it is not possible to

explain the success or failure of transformative programs without incorporating the organizational characteristics of the Chaebol into the theoretical framework. No longer did private partners remain agents who quietly followed the target policies set by the government, but they turned themselves into powerful distributional coalitions.

Accordingly, their structural characteristics became strongly associated with the success or failure of transformative programs. In short, the combined model was able to delineate the structural changes in the business-state nexus by looking closely at the internal structure of the state and by incorporating the organizational characteristics of the Chaebol. By doing so, the causes of the fluctuations in the Korean economy over time have been fully uncovered.

Second, this model stems the false tide of criticism (which arose after the Asian financial crisis) of the business-state nexus as the original, institutional malady which ought to have been discarded long ago. The close linkage between business and state is neither always inimical to overall economic performance, as is often claimed in current literature, nor is it always conducive to overall economic performance, as was often claimed in early developmental literature. What matters most in the business-state nexus is its structural characteristics. As this study showed, the business-state nexus passed through a series of changes in association with a wide range of variables, including the institutional foundations of the bureaucracy, the policy-making regime and political leadership on the side of the state, and size, diversified power, financing structure, and financial vulnerability on the side of the Chaebol.

During Park's civilian government (1961-1971), the business-state nexus was transformed from the rent-seeking super cartel of the Rhee regime (1948-1960), into an

effective means of rapid industrialization through revolutionary institutional rearrangement. Goal-oriented collaboration for export promotion defined the critical aspects of the business-state nexus during this period. It goes without saying that the phenomenal success of export-driven industrialization was associated with this dramatic turnaround in the nexus. During Park's Bureaucratic-Authoritarian (B-A) regime (1972-1979), the nexus was characterized by the state's thorough and comprehensive dominance over private partners. The B-A regime's extreme concentration of power in the hands of the policy machinery made it possible for the Korean state to carry out the, then, infeasible task of heavy-chemical industrialization. During this period, development-oriented collaboration greatly supported Korea's dramatic transformation from an economy based on light industry to one based on heavy-chemical industry. During the next period (1980-1987), the state no longer thoroughly and comprehensively dominated the nexus, but rather, the nexus became a symbiotic relationship. More specifically, the Korean state maintained its political edge over big business, but lost considerable economic leverage due to the overgrown power of the Chaebol. Despite the state's deepening structural dependency upon big business groups, the coherent policy-making regime and development-oriented political leadership kept the business-state linkage on the right track of constructive collaboration. Thus, the business-state nexus during this period (1980-1987) was depicted by goal-seeking cooperation to repair the fallout of the Heavy-Chemical Industrialization drive and to transform economically into "balanced growth with stability."

However, the structural characteristics of the business-state nexus under the Roh regime (1988-1992) and the Kim Young-sam regime (1993-1997) diverged from those of

the previous periods. The nexus increasingly degenerated into a rent-seeking collusion, due to the fact that the Korean state became a captive of the particular interests of big business. The rising economic power of the Chaebol, the disarray of the policy-making regime, the politicization of core economic agencies (politically-based elite assignments in core economic machinery) and political leadership distracted by electoral politics were significant factors in explaining why the Korean state became captured by the rent-seekers, that is, the Chaebol. Once entrapped in the rent-seeking circle during this period, the Korean state became unable to carry out economic transformation from a state-led to a market-oriented economy. Chaebol reform, the epitome of transformative programs, was much too daunting a task for the Korean state whose internal coherence largely eroded as a consequence of democratization. Thus, the failure of Chaebol reform and the subsequent economic meltdown basically stemmed from the transformation of the nexus into a corrupt rent-seeking device.

Surprisingly enough to those who thought the Korean state no longer played a key role in economic transformation, under Kim Dae-jung's rule (1998-1999), the Korean state quickly and decisively rehabilitated itself as the driving engine of the reform program. The business-state nexus got back on the track of goal-seeking collaboration under the Kim Dae-jung government. The political dynamics of economic crisis allowed the Korean state to reclaim its autonomy from and dominance over private powerholders. The decisive rehabilitation of the Korean state was attributed not only to the institutional rearrangement of the policy-making regime but also to the very characteristics of Korean corporations which were their strengths in times of prosperity, such as weak capital structure and a financing structure which was highly reliant upon external sources. The

Korean state successfully persuaded the Chaebol to enter restructuring programs in the banking and corporate sectors. The Korean state shocked political economists with the dissolution of the Daewoo group, the second largest business group, shattering the myth that they were “too big to fail,” which had fostered the expansionist drive of the Korean Chaebol throughout industrialization. Although friction often seemed more prominent, the goal-seeking collaboration of business-state reduced the cost of restructuring and resulted in quick economic recuperation. But, it remains to be seen whether or not the Korean state’s edge over big business will be upheld even after the liquidity crisis is resolved. In short, the findings of this study contradict the common belief that close business-state connectedness only encourages crony capitalism. The structural characteristics of the business-state nexus vary across different time periods and that variation is strongly associated with the success or failure of transformative programs.

The third contribution of this model is that it carries on and deepens the legacy of the statist developmental model, rather than discarding it as outdated. This study insists that, without a close look at changes in the internal structure of the state, one cannot adequately grasp the overall picture of what happened in the 1997 economic meltdown in South Korea and the relative success of structural adjustment in 1998-1999. The state must remain the central focus in studies of Korean political economy. Thus, this study also helps to correct the deluge of statist-bashing which has been prevalent in recent literature. For instance, Chapter IV points out that the Korean state’s role must go beyond that of simple regulator and/or supervisor. The legacy of state-led development, that is, the existence of the oligopolistic Chaebol in the market, does not allow the Korean state to act as the minimalist state of the Anglo-American model. Rather, the

monopolistic market structure asks the Korean state to intervene directly in the Chaebol, at least until all economic actors become subjugated to the open and transparent rules of competitive market forces. The market mechanism is not enough to regulate and discipline the Chaebol. For instance, market-based control over the Chaebol and economic liberalization during the last years of the Kim Young-sam government (1995-1997) triggered the inflow of huge amounts of foreign capital into the Chaebol, eventually leading to market instability. Without institutional provisions to strengthen the state's regulatory and supervisory role, economic liberalization only resulted in market instability. In short, the "dismantling of the interventionist state" must be carried out alongside the reinforcement of the state's supervisory and regulatory role, even though that sounds contradictory. As a matter of fact, the successful corporate and bank restructuring began with "bringing the state back in" under the Kim Dae-jung government (1998-1999). Without restoration of the ideology that the state must strengthen rather than diminish its role amid deregulation and market opening, it would have been impossible for Kim's government to carry out Chaebol reform programs successfully. Thus, this study shows that marketization does not ask political economists to discard the state as a research focus, but asks us to focus on a different aspect of the state, that is, the "regulatory and supervisory role."

FINDINGS CONCERNING VARIABLES

This study centered on the business-state nexus as a critical institutional device for a long-run developmental strategy. This study looked into a wide scope of variables to delineate this institutional device from 1960 to 1999. These variables were divided into

two broad categories: 1) the internal structure of the state; and 2) the organizational characteristics of the Chaebol. Following is an examination of the extent to which these variables explain business-state interactions.

(1) Internal Structure of the State

(a) Meritocratic Bureaucracy: Recruitment & Reward Systems

There is no question that the meritocratic recruitment and compensation systems laid the foundations for development-oriented collaboration with private partners. The revolutionary turnaround in the nature of the business-state nexus, from “rent-seeking super cartel” to “goal-seeking cooperation,” had its origin in Park’s construction of an open and transparent recruitment system and merit-based promotion system. However, the recruitment system (its openness, transparency, and competitiveness) did not vary much over time, so that it is difficult to directly associate these variables with changes in the structural traits of the business-state nexus. In my comparative historic analysis, the utility of the recruitment variables is quite limited, but, in cross-country studies, these variables are expected to have more explanatory power, owing to the fact that the meritocratic Weberian bureaucracy furnishes the very institutional foundations for the construction of a strong and autonomous state. In any case, meritocratic bureaucracy has remained almost intact in Korea, even after going through political transitions, and this has provided the Korean state with ample institutional resources. The quick, decisive rehabilitation of the Korean state as the driving engine during corporate and bank restructuring under Kim Dae-jung’s rule (1997-1998) is owed, to some degree, to these institutional foundations.

On the other hand, the reward system went through statistically significant changes. The comparability of the overall compensation package for career officeholders (which had been equivalent to their counterparts in the private sector during the developmental state), has gotten worse since the late 1970s. The rapid decline of the reward package, in particular during democratic rule, made it difficult for the Korean state to recruit a quality labor force, eventually resulting in the loss of the state's leadership over private business. As career officeholders' paychecks have fallen farther behind in the 1980s and 1990s, they have increasingly become more susceptible to bribery. More importantly, bureaucratic cohesiveness, built upon developmentalist ideology and social prestige, hardly survived under the mounting impoverishment felt by career bureaucrats. The impact of the relative decline in the reward system on the business-state nexus was substantial. Business became more successful in penetrating into the bureaucratic system and less willing to recognize the state managers' leadership in economic policy-making. The deteriorating reward system was strongly associated with the recent rise of corruption in the business-state nexus.

(b) Policy-Making Regime (Policy Coordination System)

A clear location of decision-making, coherent policy coordination and high autonomy of pilot agencies within the policy-making regime were critical factors in determining whether or not each transformative program was successful. Core economic agencies and the policy coordination system were directly involved in the distribution of two critical resources, that is, credit allocation and business licensing. Accordingly, the breakdown of the policy coordination system and politicization of economic agencies were

strongly linked to the Chaebol's indiscriminate entry into overly crowded industries, eventually resulting in excessive capacity in those industries and widespread pork-barreling between state and business. On the other hand, high institutional autonomy of pilot economic agencies and coherent cohesiveness in the policy coordination system were positively associated with concerted and adequate investment in strategic target industrial sectors. The policy-making regime which was characterized by high institutional autonomy, freedom from political pork-barreling, coherent cooperation, and a clear location of decision-making accounted for the stellar success of the sector-specific industrial promotion during the developmental era. When the business-state nexus was steered by that sort of policy-making regime, the performance of the business-state nexus was outstanding. In contrast, the policy-making regimes which were filled with politicized bureaucrats and disoriented by rising rivalry and conflicts of interest among cabinet ministries resulted in meager performances in terms of economic transformation. It is clear that this sort of policy-making regime was not able to steer the business-state nexus into goal-oriented collaboration.

(c.) Political Leadership (Institutional Autonomy of Economic Agencies)

This study attempted to grasp changes in political aspects of the Korean state by looking closely at the structural traits of political leadership over time. The above-mentioned changes in the internal structure of the state had their origins in changes in political leadership. The political leadership in turn was reconstructed according to each regime's survival strategy. The survival strategies of the chief-executives in particular led to changes in the collective political leadership. The chief-executives showed a strong

tendency to select development-oriented economic technocrats or political proteges for the core economic agencies, depending upon their survival strategies. Accordingly, the type of the collective political leadership, whether it was a developmentalist-driven coalition or a region-based coalition, defined many aspects of the business-state nexus. In particular, the chief-executives who focused on development guaranteed the institutional autonomy of the core economic agencies and thereby kept economic technocrats from being politicized, resulting in policy consistency and the prevalence of economic rationale.

The political leadership variable stood out in its power to explain whether or not the business-state nexus remained on the developmental track. Especially concerning Chaebol reform in the 1990s, the president's stand was a critical factor in determining why some reform programs were carried out and others not. The chief-executive's policy standing swayed alongside popular politics under democratic regimes much more than under authoritarian regimes. When the dynamics of popular politics permitted the political leadership to stick to its original policy standing, the outcome of reform programs turned out well, as in the case of the presidential decree forcing 49 Chaebols to sell their non-business-related real estate in 1990-1992. The relative success of bank and corporate restructuring in 1997-1999 was also largely due to the fact that the political dynamics of economic crisis allowed the chief-executive to stay on the reform track. The popular mandate and consensus for Chaebol reform changed the chief-executive's utility calculation for political survival during Kim Dae-jung's reign (1998-1999). The institutional rearrangement of the financial watchdog and trade watchdog, merit-based elite assignments, and the revival of ideological consensus among economic technocrats concerning Chaebol reform under Kim Dae-jung all helped the Korean state to reclaim its

autonomy from and dominance over the business-state nexus, at least momentarily. In short, the political aspects of the state, to a large extent, defined the structural characteristics of the business-state nexus.

(2) Organizational Characteristics of Big Business Groups

(a) Share of the Chaebol in the National Economy (Share Size, Diversified Power)

The increase in the Chaebol's share of the national economy presented changes in the power balance in the business-state nexus. As capital expanded, the erosion of the Korean state's dominance over and autonomy from its private partners was, to some extent, inevitable. The empowerment of capitalists obviously set the circumstantial conditions under which the state would lose its leadership over the private sector. But the increasing amount of capital in the hands of big business alone did not dictate the detailed changes in the business-state nexus. Rather, the detailed changes were more readily explained by a close look at the changes in the institutional resources held by state and business.

From the early 1980s on, the Chaebol refused to remain a junior partner but claimed equal partnership with the state at the end of the developmental era. Political and economic interdependency characterized the business-state nexus during the post developmental era. The Chaebol's control over capital investments increasingly deprived the Korean state of its traditional autonomy in the 1990s, thus the Korean state's structural dependency upon big capital became pronounced in that decade. However, this historical comparative analysis shows that the Korean state's structural dependency during 1988-1997 stemmed not only from the amassing of capital in the hands of the Chaebol

over time, but also from changes in the internal structure of the state. Electoral politics exhausted the institutional sources of state autonomy with the breakdown of the old rules within the policy-making regime, political coalition structure, and bureaucratic system. The Chaebol accounted for almost the same share of the national economy across three different time periods, but the outcomes of business-state strategic interactions varied greatly across those periods. When the Korean state managed to maintain the coherent cohesiveness of the policy-making regime and the goal-seeking political coalition, as they did, for example, in 1980-1987 and 1997-1999, the Chaebol were not able to brandish the full power of their capital control against the Korean state. The Korean state during these two time periods did not fall captive to the Chaebol. Rather, the Korean state steered the business-state nexus into a reform-driven collaboration. Thus, the effects of the Chaebol's control over capital investments on the economic transformative programs varied in association with political and institutional variables. In other words, this structural variable only worked in the context of the institutional framework. The internal structure of state intermediated and channeled the consequential effects of the Chaebols' control over capital investments.

(b) Financing and Capital Structure of Chaebol

The financing structure of the Chaebol, which was characterized by heavy reliance upon bank borrowing, and its weak capital structure (high debt/equity ratios) weakened the seemingly overpowering Chaebol. In other words, the Chaebol were not as powerful as seemingly portrayed by previous developmental literature. Although the Chaebol's reliance upon external sources, such as bank loans, foreign borrowing, the curb market,

and government loans, steadily diminished during the 1990s, direct fund mobilization from the security and money markets and from internal savings accounted for only half of total business funds. The Chaebol's reliance upon external sources allowed the Korean state to influence the Chaebol's investment decisions quite heavily during the developmental era, and to a lesser extent during the post developmental era. Thus, the Korean state's control over capital resources was an important factor in maintaining the state's dominance over the Chaebol. However, the Chaebol's financing structure steadily improved, resulting in liberation of the Chaebol from government control, especially since the late 1980s, transforming the business-state nexus. In the 1990s, the Chaebol felt much freer in their investment decisions although the government still controlled business licensing. No longer were the Chaebol attentive to the investment directives set by the government during market deepening programs. The Korean state discovered that, without capital resource control, it was difficult to create incentives to entice the Chaebol into reform programs in the 1990s.

The Chaebol's weak capital structure did not substantially reduce the Chaebol's ability to resist governmental pressure during ordinary business cycles. But whenever the Korean economy slid into a deep economic slump, as in 1979-1980 and 1997-1998, this variable played a pivotal role in strategic business-state interactions, mostly reducing the power of the Chaebol. For instance, the 1979-1980 and 1997-1998 economic crises pushed most Chaebol, which were extremely indebted, to the edge of bankruptcy. Big business groups turned to the state for financial rescue. Thus, during financial crisis, the highly indebted Chaebol were very vulnerable to the government's reform pressures and became more attentive to the directives of the government. This variable provides a clue

to why the Korean state so decisively and quickly rehabilitated its autonomy from the Chaebol and effectively carried out reform programs during times of crisis. Overall, financial vulnerability made the private sector more attentive to governmental policy. Big business groups with extremely high debt/equity ratios always looked for preferential credit allocation because of their high financial expenses. In short, the Chaebol's capital and financial structure made it possible for the Korean state to sustain its dominance over the private sector.

POLICY IMPLICATIONS AND PROSPECTS OF THE BUSINESS-STATE NEXUS

How can the business-state nexus be kept on the right track of goal-seeking collaboration in the future? This is a crucial issue for the prospects of the Korean economy, because big business groups and the state are expected to remain pivotal players in the Korean economy at least for the time being. First and foremost, the business-state relationship must come under the open and transparent rules of interactions. To obtain that objective, this study recommends that the business-state channels be more institutionalized and inclusive by incorporating other social groups into the nexus. As in the experiment of the Tripartite Panel of Labor, Capital and State (TPLCS) under the Kim Dae-jung government, inviting other social groups into the business-state nexus would definitely decrease the degree of covert deal-making between private powerholders and power elites within the ruling circle. The establishment of formal and regular meetings at various levels is also strongly recommended as a way of institutionalization. During the Roh and Kim Young-sam administrations, the informal and irregular interconnections

between the public and private sectors were ineffective and vulnerable to bribery, whereas the establishment of open and formal channels at various levels under the Kim Dae-jung government largely curtailed political deal-making within the nexus.

Secondly, securing the institutional autonomy of key economic agencies (e.g., MOEF, BOK, FSC, FTC) is an essential ingredient in maintaining goal-oriented collaboration in the business-state nexus. These key policy agencies are directly associated with private partners. Therefore, their institutional character tends to account for the structural characteristics of business-state interactions. The Federal Reserve and US Treasury enjoy much higher institutional autonomy from politics, as compared with the Korean BOK, MOEF, and FSC. To guarantee the core economic agencies' policy consistency and economic rationale, frequent economic cabinet shuffling and politicization of elite assignments into these agencies must ended. The principle that "the institutional autonomy of key economic agencies must be politically guaranteed" stands out as the primary factor in determining whether or not the business-state nexus remains on the right track of development-driven collaboration.

However, it is readily apparent that the Korean state's outright dominance over private powerholders cannot be sustained over the long run. Big business groups are very likely to become less dependent on the state in terms of capital mobilization in the future, while the decentralization of political power and the involvement of distributional coalitions in the policy-making process will continue to evolve, leading to the further erosion of the Korean state's autonomy from civil society. Thus, goal-oriented collaboration must be manufactured not by the state's despotic power over the private sector but by rule-abiding and consensus-building leadership. To do so, the templates of

internal power structures in both the private and public sectors must be transformed into democratic ones. For instance, the restructuring of the FKI, which had been controlled by top Chaebols, has recently begun, to reflect the broad interests of the business community in their lobbying activities. Government elites should not be given broad discretionary power in regulating and guiding private partners. Rather, open and transparent rules of the game must prevail in business-state interactions.

THE QUESTION OF TRANSFERABILITY OF THE “COMBINED MODEL”

Late-late industrializers, such as South Korea, began their industrialization in an era when the required scale of production had become quite large, and the technological skills of longer-established global competitors had become more difficult to reproduce. Under these circumstances, the state tends to actively promote large-scale firms, and, as a result, the national economy in developing countries is dominated by a handful of big businesses with extensively diversified business lines. But these big business groups turn into market-harming entities, so that big business groups become reform targets during the market deepening process. Transforming big business groups into market-conforming entities was a daunting task for the Korean state amid democratic transition. Other developing countries are expected, sooner or later, to follow the path of the “market deepening battle” between private powerholders and the reform-minded state. Thus, this study sheds some light on the prospects of the business-state nexus in subsequent developers. The obstacles that late-late developers will encounter during market-oriented reform will differ, depending upon the way each state intervenes during industrialization and the degree of economic concentration in the hands of big business. This study

disclosed the political dynamics of the market deepening program and gave some clues to what will happen to other late-late developing countries during the market deepening process, if their big business groups turn out to be market-harming entities at the end of dense industrialization.

It remains to be seen whether or not the variables in this “combined model” are able to account for the strategic interactions of business-state and, thereby, for the economic ups and downs of other late-late developers. Some variables will be difficult to transfer across countries. For instance, it is hard to imagine that the development-driven political leadership or the type of political coalition in South Korea would be readily transferable to other countries. During the developmental era, political leadership in Korea was characterized by a goal-seeking, developmental-drive, mainly due to the imminent security threat from the communist regime in North Korea. But there are only a handful of countries which confront a communist regime and, as a result, whose leadership’s primary concern is national security. Thus, researchers would need to apply these variables to other late-late developers in a creative manner.

A cross-country comparison would definitely improve the combined model. Empirical tests of the combined model against other cases would help sort out which variables are more critical than others in explaining the structural characteristics of the business-state nexus. For instance, further research questions might include an examination of how the Taiwanese state’s strategic choice of small- and medium-sized firms as private partners affected business-state interactions during market-oriented reform. Was the Taiwanese state better able to maintain its autonomy from the private sector due to small size of capital or other characteristics in the internal structure of the

Taiwanese state? Will popular participation in politics always lead to the weakening of state autonomy from private powerholders? Do the organizational characteristics of corporations matter in the context of business-state interactions? Exploring the effects of democratization on the internal structure of the state might help explain why the Korean state stumbled the most among the four Asian dragons during the financial crisis in 1997-1998. In short, contrast and comparison of the Korean case against other countries will enrich the understanding of the role of the business-state nexus in the context of economic development.

APPENDIX

Table A.1
Major Economic Indicators

Year	annual GDP growth rate (%)	per capita GNP (dollars)	growth rate of manufacturing (%)	gross domestic investment ratio (%)	national saving ratio (%)	foreign saving ratio (%)
1962	2.1	87	-	11.8	3.3	10.7
1963	9.1	100	16.1	17.0	8.7	10.4
1964	9.7	103	9.9	13.2	8.7	6.9
1965	5.7	105	20.5	14.1	7.4	6.4
1966	12.2	125	17.3	20.4	11.8	8.5
1967	5.9	142	21.6	20.9	11.4	8.8
1968	11.3	169	27.2	24.9	15.1	11.2
1969	13.8	210	21.6	27.9	18.8	10.6
1970	8.8	253	19.9	24.3	18.3	9.1
1971	9.2	289	18.7	24.8	16.3	10.5
1972	5.9	319	14.0	20.9	17.4	5.1
1973	14.4	396	29.5	25.2	22.9	3.7
1974	7.9	41	17.2	31.8	20.6	12.1
1975	7.1	594	12.4	28.6	18.2	10.1
1976	12.9	802	23.5	26.5	23.7	2.3
1977	10.1	1911	15.3	28.3	26.9	0.6
1978	9.7	1400	22.2	32.5	29.5	3.1
1979	7.6	1647	10.1	35.8	29.0	7.1
1980	-2.2	1597	-1.6	31.9	23.5	11.5
1981	6.7	1741	10.1	29.9	23.5	9.8
1982	7.3	1834	6.9	28.9	24.0	7.0

(Table A.1 continued on next page)

(Table A.1 Continued)

1983	11.8	2104	15.3	29.4	27.9	4.7
1984	10.1	2187	16.9	30.6	30.3	4.0
1985	6.2	2242	6.2	30.3	30.7	3.1
1986	11.6	2568	19.5	29.2	34.7	-2.8
1987	11.5	3218	19.5	30.0	36.2	8.0
1988	11.3	4295	13.8	31.1	38.1	2.3
1989	6.4	5210	4.2	33.8	35.3	0.9
1990	9.5	5886	9.7	37.6	36.0	3.1
1991	9.2	6810	9.5	39.8	36.3	1.5
1992	5.4	7183	5.3	37.3	34.9	0.1
1993	5.5	7811	5.4	35.4	34.9	0.4
1994	8.3	8998	10.8	36.5	35.2	0.5
1995	8.9	10823	11.3	37.3	35.4	1.4
1996	6.8	11380	6.8	38.1	34.8	-
1997	5.5	10307	6.6	34.4	34.6	-
1998	-5.8	6823	-7.2	20.9	-	-

Source: National Statistical Office, *Major Statistics of Korean Economy*, each year.

Table A.2
Variety of Attractions for Promotion of Saving

(Unit: %, index)

Year	Inflation rate of GNP deflator	Interest rate for bank deposits	Interest rate for bank loans	Earning rate of corporate bonds	Composite index of stock prices	Annual percentage increase of land price in major cities	Interest rate for Curb market	Annual %age growth of M2	Export	Machinery 1)	NIF 2)
1961		15.0	13.87	-			-	27.2	13.87		
1962		15.0	13.87	-			-	n/a	9.13		
1963		15.0	13.87	-			52.4	8.8	9.13		
1964		15.0	14.0	-			61.4	14.3	8.0		
1965		30.0	24.0	-			58.8	52.7	6.5		
1966		30.0	24.0	-			58.7	61.0	6.5		
1967		30.0	24.0	-			56.4	61.7	6.0		
1968		25.2	26.0	-			55.9	72.0	6.0		
1969		22.8	24.0	-			51.2	61.4	6.0		
1970		22.8	24.0	-			50.8	27.3	6.0		

(Table A.2 Continued on next page)

Table A.2 Continued

1971		21.3	22.0	-		46.3	20.8	6.0		
1972		12.6	15.5	-		38.9	33.8	6.0		
1973	13.7	12.6	15.5	21.8	308.5	5.8	36.4	7.0	10.0	10.0
1974	31	15	15.5	21	303.3	18.7	24.0	9.0	12.0	12.0
1975	25.7	15	19	20.1	79.9	25.5	28.2	9.0	12.0	12.0
1976	22.5	16.2	18	20.4	97.9	24.9	33.5	8.0	13.0	14.0
1977	16.2	14.4	19	20.1	113.4	50.0	39.7	8.0	13.0	14.0
1978	23.5	18.6	19	21.1	143.7	79.1	35.0	9.0	15.0	16.0
1979	20.2	18.6	19	26.7	120.6	22.0	24.6	9.0	15.0	16.0
1980	24.3	19.5	20	30.1	108.8	17.0	26.9	15.0	20.0	22.0
1981	17.3	16.2	17	24.4	126.3	7.1	25.0	15.0	11.0	16.5
1982	6.8	8	10	17.3	122	5.6	27.0	12.0	10.0	10.0
1983	5.6	8	10	14.2	127.7	31.7	15.2	10.0	10.0	10.0
1984	5.4	10	11.5	14.2	131.9	21.6	7.7	10	10-11.5	10-11.5
1985	4.7	10	11.5	14.2	138.9	7.8	15.6	10.0	10-11.5	10-11.5
1986	4.8	10	11.5	12.8	227.9	6.4	18.4	10.0	10-11.5	10-11.5
1987	6.9	10	11.5	12.6	417.6	13.9	19.1	10.0	10-11.5	10-11.5

(Table A.2 Continued on next page)

Table A.2 Continued

1988	5.3	10	13	14.2	693.1	29.8	22.70	21.5	10.0	10-11.5
1989	10	10	12.5	15.2	918.6	30.5	23.70	19.8	10.0	10-11.5
1990	10.2	10	12.5	16.5	747.0	27.0	20.60	17.2	10.0	10-11.5
1991	10.2	10	12.5	18.9	657.1	13.5		21.9		
1992	6.1	10	12.5	16.2	587.2	-2.6		14.9		
1993	5.1	8.5	12.5	12.6	728.2	-8.1		16.6		
1994	5.4	10	12.5	12.9	965.7	-0.8		18.9		
1995	5.6	10	12.5	13.7	934.9	0.34		15.6		
1996	3.4	9.8	11.0	11.8	833.4	0.84		15.8		
1997	3.9	12.59	15.32	13.4	654.5	0.02		14.1		

Note: 1) Lending rates for the Machinery Promotion Fund

2) Lending rates for the National Investment Fund

Sources: Bank of Korea, *National Accounts*, each year; Office of Statistics, *Major Economic Indicators*, each year.

Table A.3

Comparison of Government Efficiency and Transparency in the 1990s of Asian Countries (Score, rank)

Country	Category	1992	1993	1994	1995	1996	1997	1998
Korea	Government responsiveness	4.2 (34)	4.2 (34)	4.5 (33)	5.3 (22)	4.2 (33)	3.3 (43)	3.7 (39)
	Transparency	3.8 (30)	3.8 (30)	3.7 (37)	4.7 (25)	3.3 (36)	3.1 (38)	3.2 (43)
	Improper Practices	3.0 (32)	3.0 (32)	2.9 (34)	4.6 (26)	4.5 (26)	2.6 (36)	2.5 (33)
	Overall government-effectiveness	3.2	3.2	3.2	4.3	3.7	2.9	2.8
Indonesia	Government responsiveness	6.9 (6)	6.9 (6)	6.3 (9)	5.8 (14)	5.7 (8)	5.5 (20)	4.8 (30)
	Transparency	4.7 (19)	4.7 (19)	4.2 (26)	4.1 (31)	3.6 (32)	4.2 (29)	4.3 (32)
	Improper Practices	2 (39)	2 (39)	2.8 (37)	2.3 (41)	2.0 (42)	2.1 (41)	1.5 (43)
	Overall government-effectiveness	4.1	4.2	4.1	3.9	3.4	3.9	3.3
Malaysia	Government responsiveness	8.1 (2)	8.1 (2)	7.8 (2)	7.6 (2)	7.9 (2)	8.3 (2)	6.6 (6)
	Transparency	6.4 (4)	6.4 (4)	5.3 (1)	6.1 (4)	6.4 (5)	6.1 (8)	6.6 (4)
	Improper Practices	4.4 (27)	4.4 (27)	5.3 (22)	4.8 (24)	4.4 (28)	4.4 (26)	3.6 (25)
	Overall government-effectiveness	6.1	6.1	5.9	5.9	6.0	6.1	5.4

(Table A.3 Continued on next page)

(Table A.3 Continued)

Philippines	Government responsiveness	5.1 (22)	5.1 (22)	5.1 (24)	5.8 (13)	5.1 (18)	7.5 (4)	5.9 (17)
	Transparency	4.2 (23)	4.2 (23)	4.2 (27)	4.1 (32)	4.0 (29)	4.8 (23)	5.3 (19)
	Improper Practices	1.7 (42)	1.7 (42)	1.7 (44)	2.0 (43)	2.2 (40)	1.9 (42)	2.1 (38)
	Overall government-effectiveness	3.2	3.2	3.2	3.5	3.5	4.3	4.1
Singapore	Government Responsiveness	8.6 (1)	8.6 (1)	8.2 (1)	8.6 (1)	8.7 (1)	8.3 (1)	8.4 (1)
	Transparency	7.5 (1)	7.5 (1)	6.0 (5)	6.8 (1)	7.5 (1)	7.4 (2)	7.6 (1)
	Improper Practices	9.6 (1)	9.6 (1)	9.3 (3)	9.4 (2)	9.3 (2)	9.2 (4)	7.9 (9)
	Overall government-effectiveness	8.2	8.2	7.7	8.0	8.2	8.1	7.7
Taiwan	Government Responsiveness	6.3 (9)	6.3 (9)	5.5 (18)	5.8 (10)	5.3 (13)	4.9 (25)	5.7 (18)
	Transparency	5.5 (8)	5.5 (8)	4.6 (24)	5.0 (19)	4.8 (21)	4.7 (24)	5.0 (27)
	Improper Practices	5.8 (22)	5.8 (22)	3.5 (29)	4.4 (27)	4.4 (27)	4.4 (25)	3.9 (24)
	Overall government-effectiveness	5.4	5.4	4.4	5.0	4.2	4.5	4.8
Thailand	Government responsiveness	6.3 (10)	6.3 (10)	5.3 (22)	5.8 (12)	5.2 (16)	4.5 (29)	4.1 (36)
	Transparency	3.9 (29)	3.9 (29)	3.7 (33)	4.4 (30)	3.3 (37)	2.9 (39)	4.4 (31)

(Table A.3 Continued on next page)

(Table A.3 Continued)

	Improper Practices	2.5 (37)	2.5 (37)	2.8 (36)	2.6 (35)	2.2 (41)	2.4 (38)	1.8 (39)
	Overall government-effectiveness	4.1	4.1	3.9	4.1	3.4	3.5	3.3

Source: International Institute for Management Development (IMD), *The World Competitiveness Yearbook*, each year.

Reference: Government responsiveness: Government's ability to quickly adapt policies to new economic realities.

Transparency: The government is transparent towards citizens.

Improper Practices: Improper practices (such as bribing or corruption) prevail in the public sphere.

Overall government-effectiveness: IMD measures "Overall government effectiveness and transparency" using six different areas.

The three above-mentioned areas are included in overall government effectiveness and transparency.

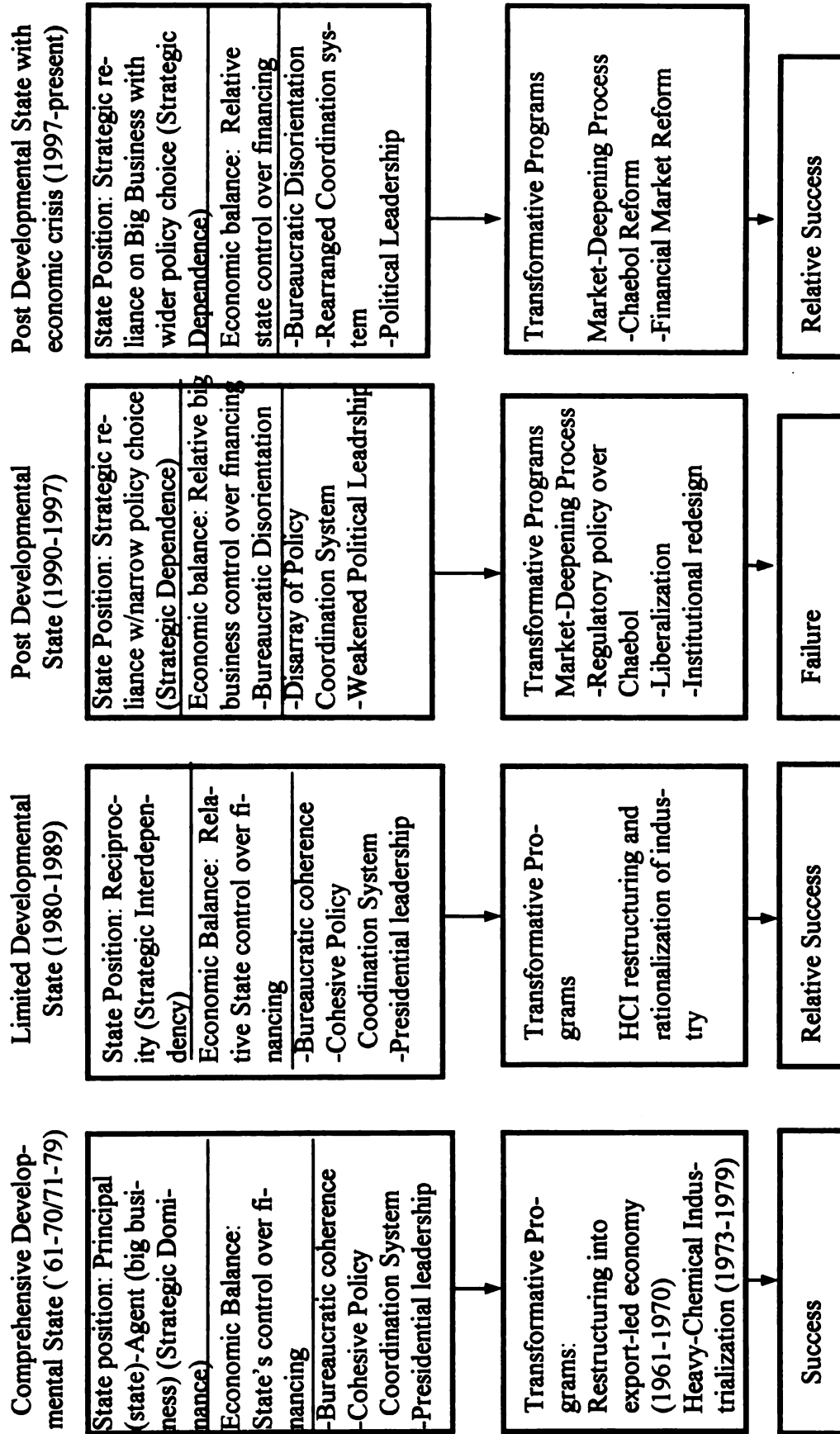
Table A.4
Foreign Borrowing between 1962-1998 (In million dollars)

	Public Loans	Commercial Loans	Financial Institution's Loans	(Bank Loans)	(Foreign Bonds)	Private Foreign Bonds	FDI	Sub- total
'45-61	5	--	--	--	--	--	--	5
1962	3	--	--	--	--	--	1	4
1963	43	24	--	--	--	--	5	72
1964	12	12	--	--	--	--	1	25
1965	5	35	--	--	--	--	6	46
1966	73	110	--	--	--	--	14	197
1967	106	124	--	--	--	--	11	241
1968	70	268	40	40	--	--	19	397
1969	139	410	30	30	--	--	13	592
1970	115	367	25	25	--	--	66	573
1971	303	345	90	90	--	--	43	781
1972	324	326	20	20	--	--	61	731
1973	403	461	49	49	--	--	191	1,104
1974	385	603	218	199	19	--	163	1,369
1975	477	801	200	200	--	--	62	1,540
1976	713	839	131	57	74	--	85	1,768
1977	636	1,241	300	230	70	--	102	2,279
1978	817	1,913	328	272	56	--	101	3,159
1979	1,089	1,578	1,522	1,478	44	--	195	4,384
1980	1,516	1,403	440	393	47	--	131	3,490
1981	1,690	1,247	2,196	2,076	120	43	152	5,328
1982	1,868	914	1,619	1,508	111	--	129	4,530

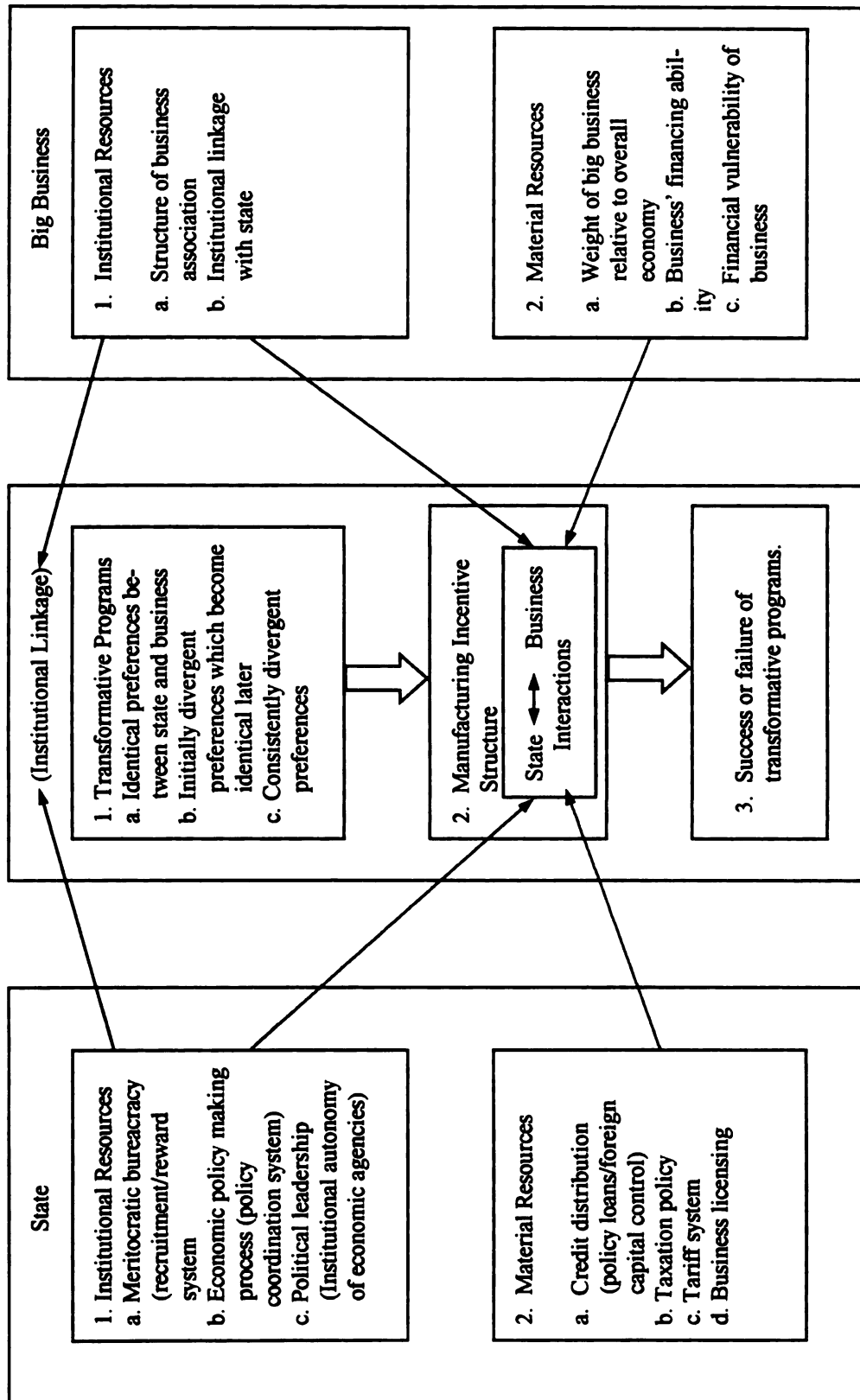
Table A.4 Continued

1983	1,494	973	2,121	1,848	273	113	122	4,823
1984	1,424	858	3,121	2,095	1,026	200	193	5,796
1985	1,024	964	3,862	2,494	1,386	478	235	6,563
1986	880	1,620	1,180	683	497	389	477	4,546
1987	1,109	1,558	777	777	--	315	626	4,385
1988	891	988	9	9	--	110	894	2,892
1989	475	860	208	--	208	50	812	2,405
1990	418	30	1,445	420	1,025	570	895	3,358
1991	429	--	4,450	1,986	2,464	1,165	1,177	7,221
1992	486	150	2,227	443	1,784	1,916	803	5,582
1993	643	--	2,360	560	1,800	1,920	515.7	
1994	742	--	3,580	530	3,050	3,250	757.5	
1995	464	39	7,530	1,050	6,480	3,900	1,940	
1996	387	108	9,570	980	8,590	4,040	3,200	
1997	5395	1302	8,300	1,370	6,930	4,000	6,970	
1998, 6	3267	1914				8,950?	8,850	

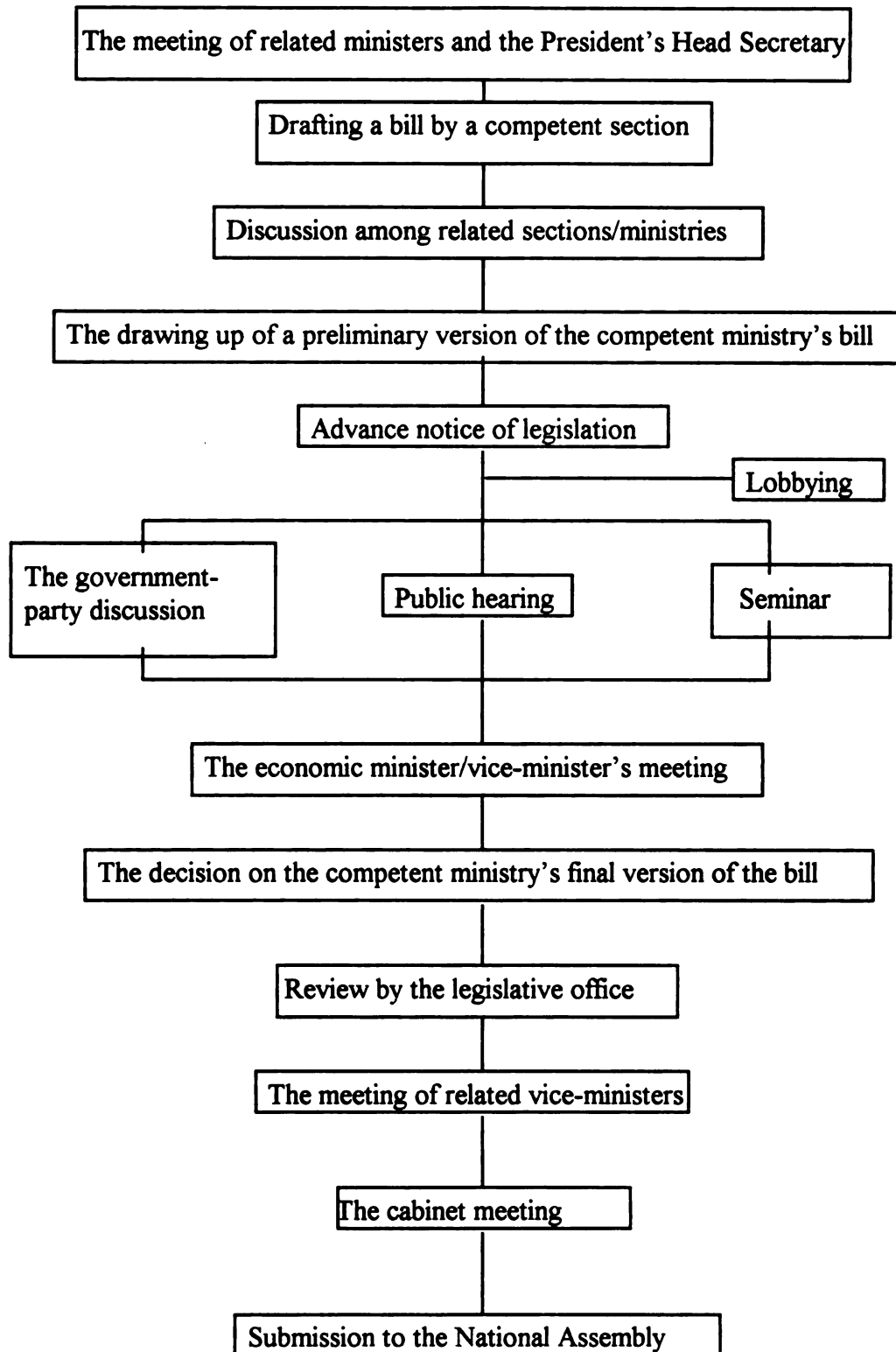
Sources: MOEF, Bureau of International Financial Policy



Changes in Structural Characteristics of Business-State Nexus & Major Economic Transformative Programs
Figure 1.1



Strategic Interactions of Business-State with Institutional and Material Resources
Figure 1.2



Procedure for Drawing up a Bill by the Executive

Figure 2.1

(Lee Yeon-ho 1997:87)

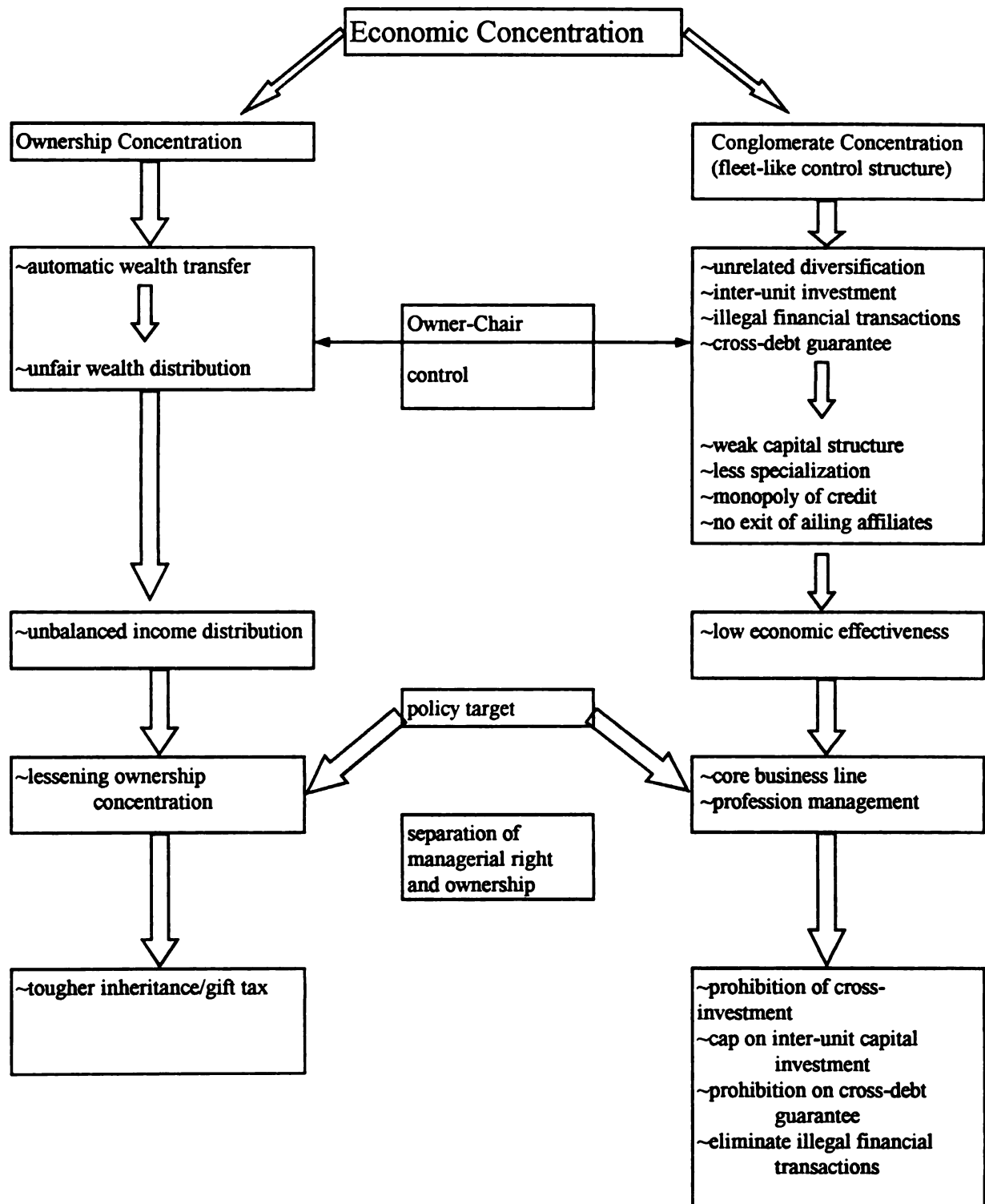
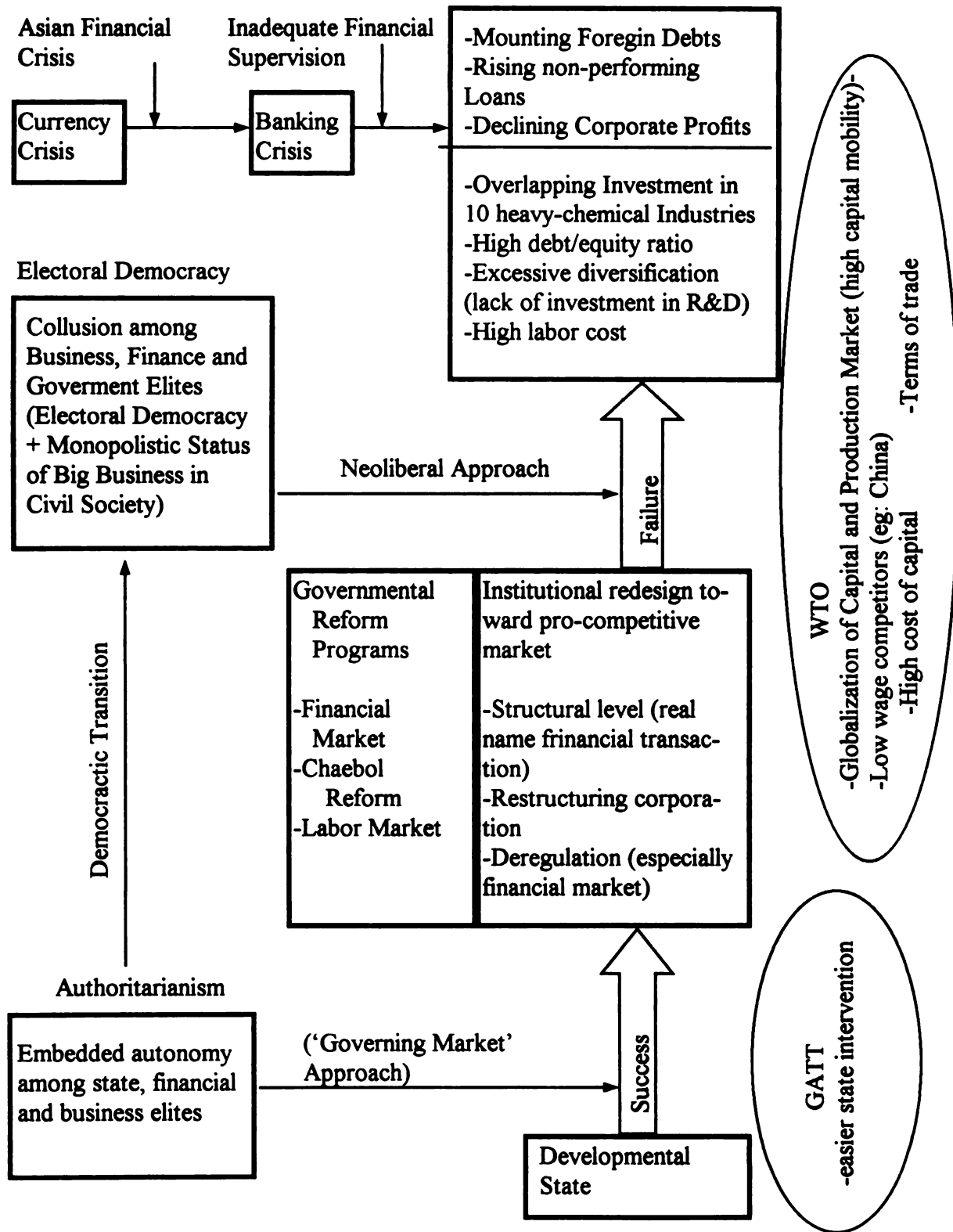


Figure 4.1

Source: FTC, "The real picture of economic concentration and reform in Fair Trade Act," 1994.8.20

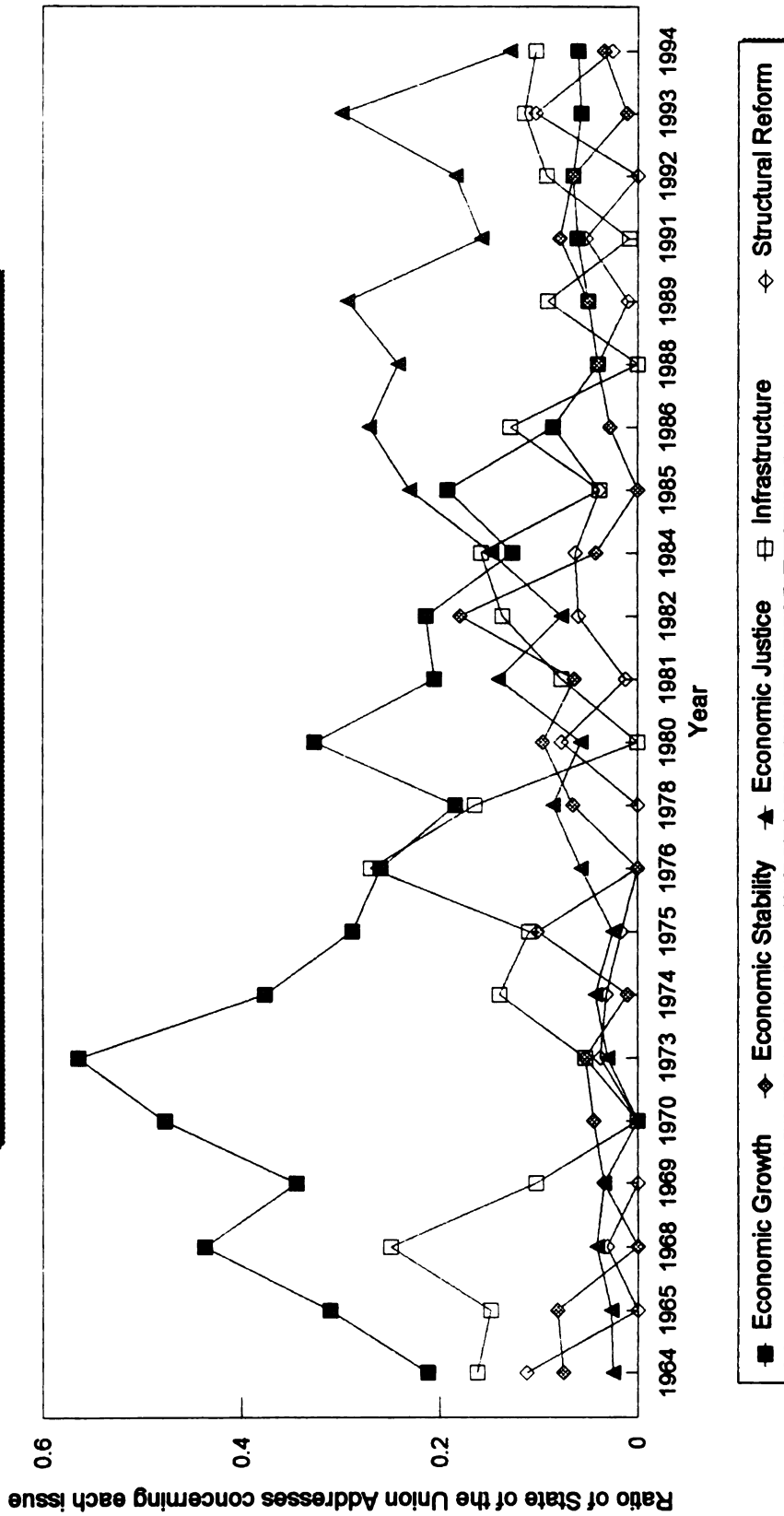


CAUSE OF THE ECONOMIC CRISIS

Figure 4.2

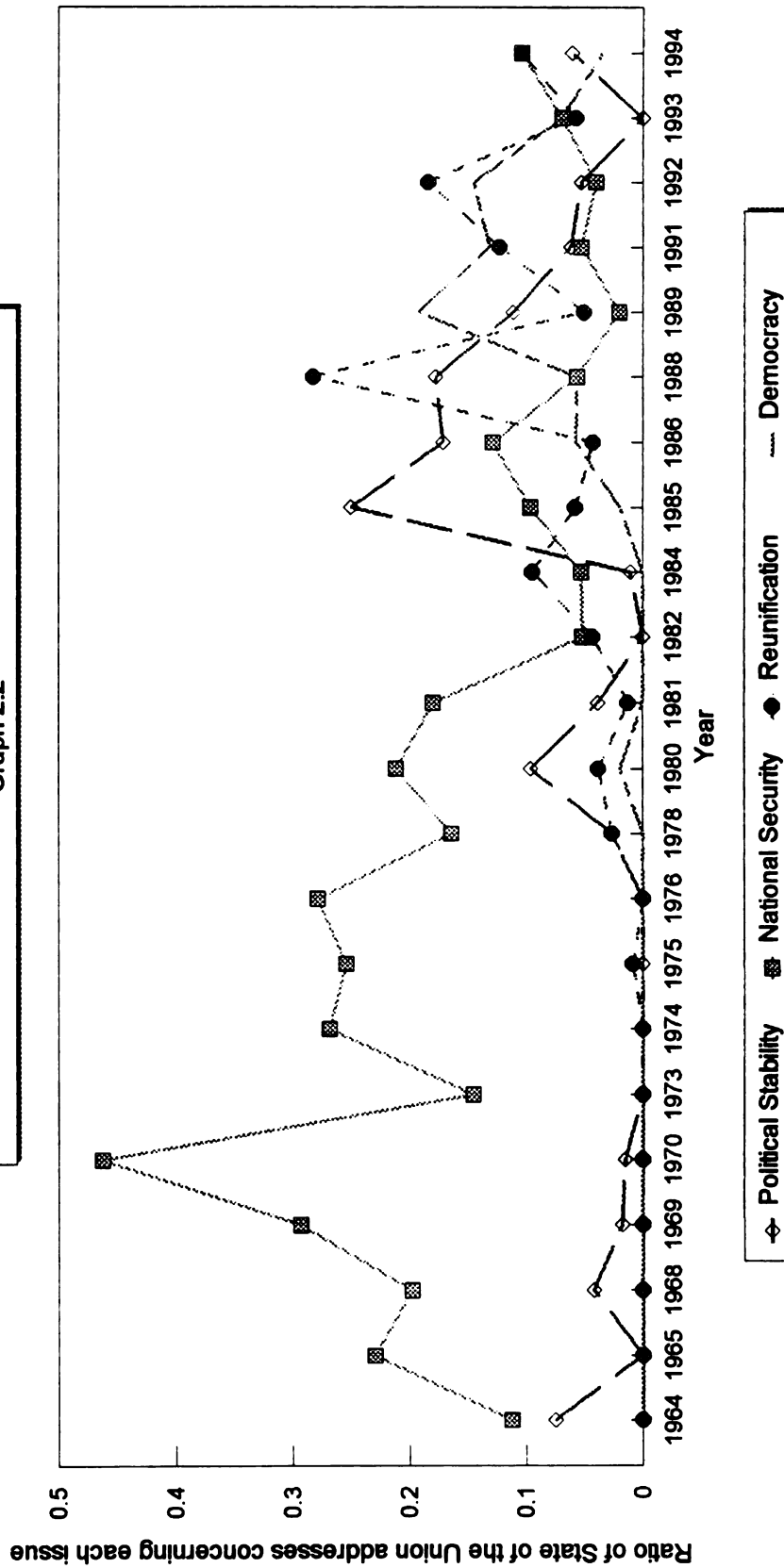
Presidential Speeches on Economic Issues

Graph 2.1

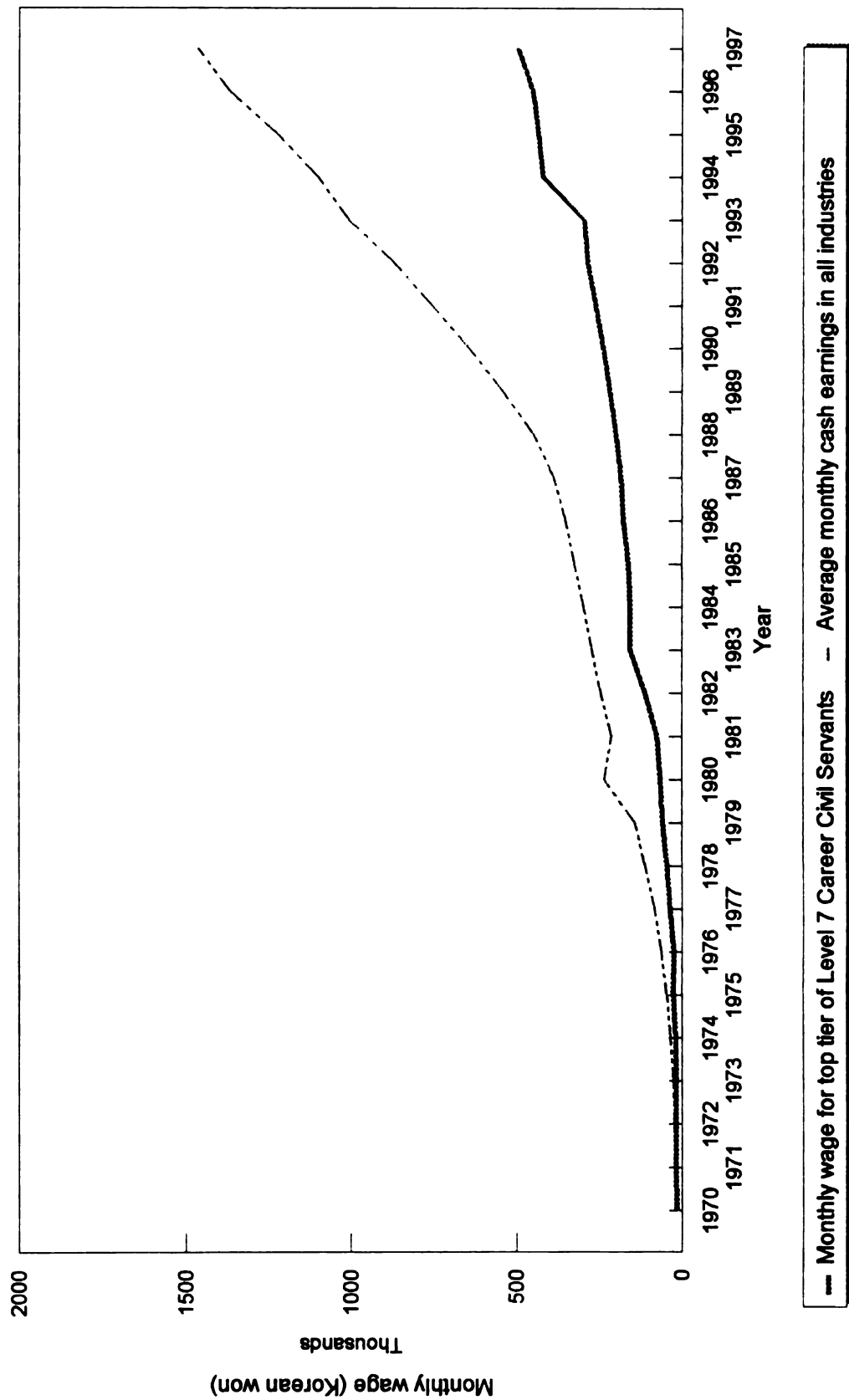


Presidential Speeches on Political Issues

Graph 2.2

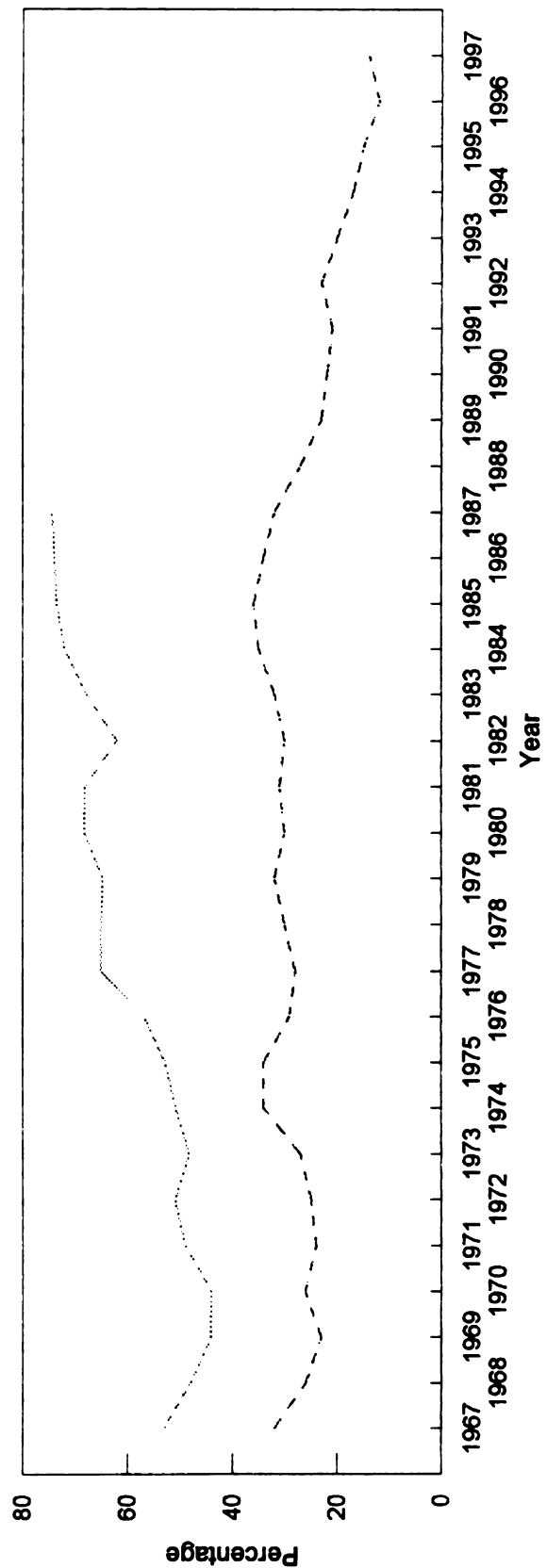


Comparison of Salaries in Government and Private Industry
 Graph 2.3



Ratio of Policy Loans to Total Money Lent

Graph 3.1

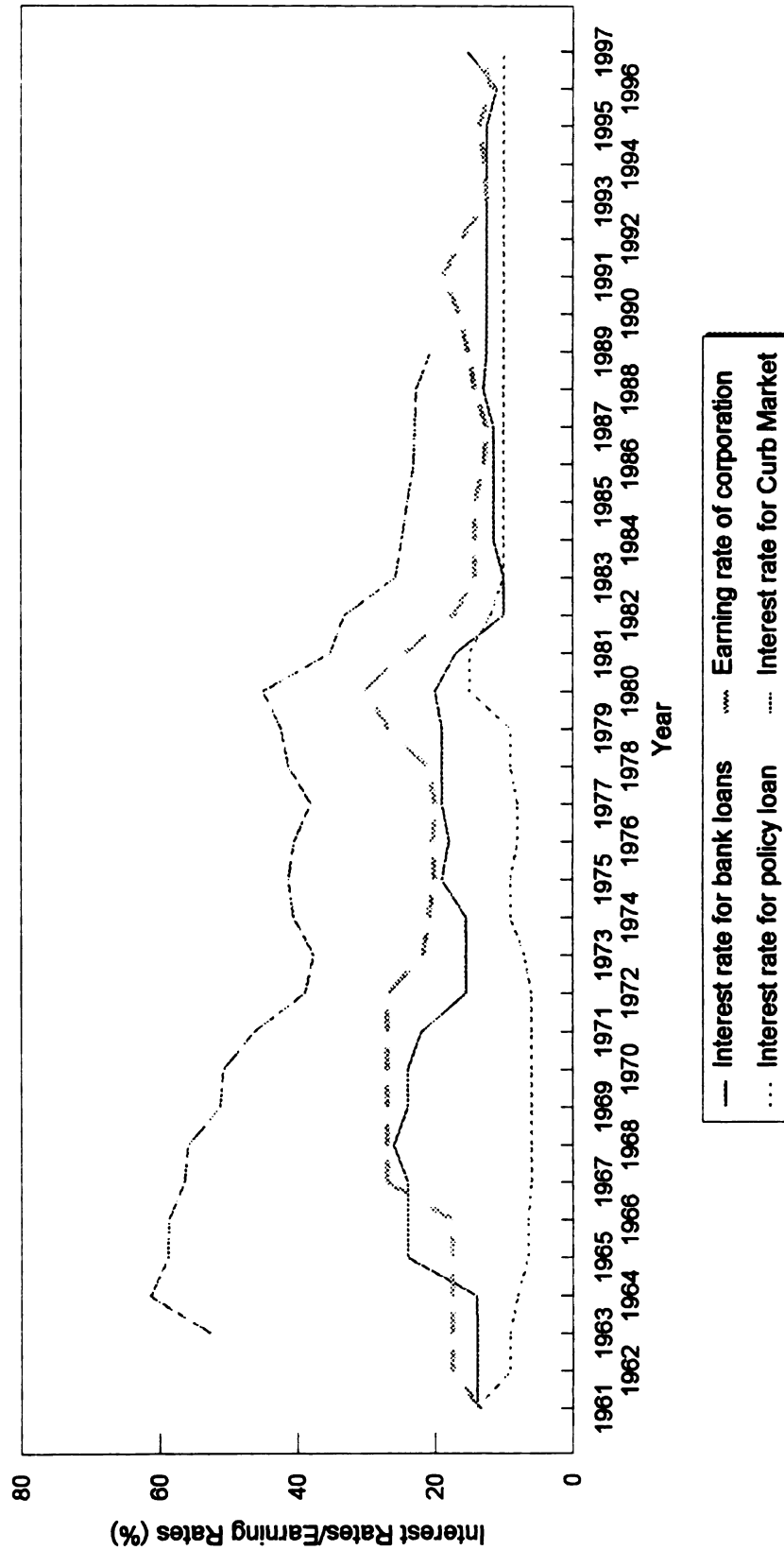


-- Narrow Definition Broad Definition

Many studies use a "broad definition" of policy loans which more accurately portrays reality, but that data was not available for the entire time period. This graph shows data for both the broad and narrow definitions where available.

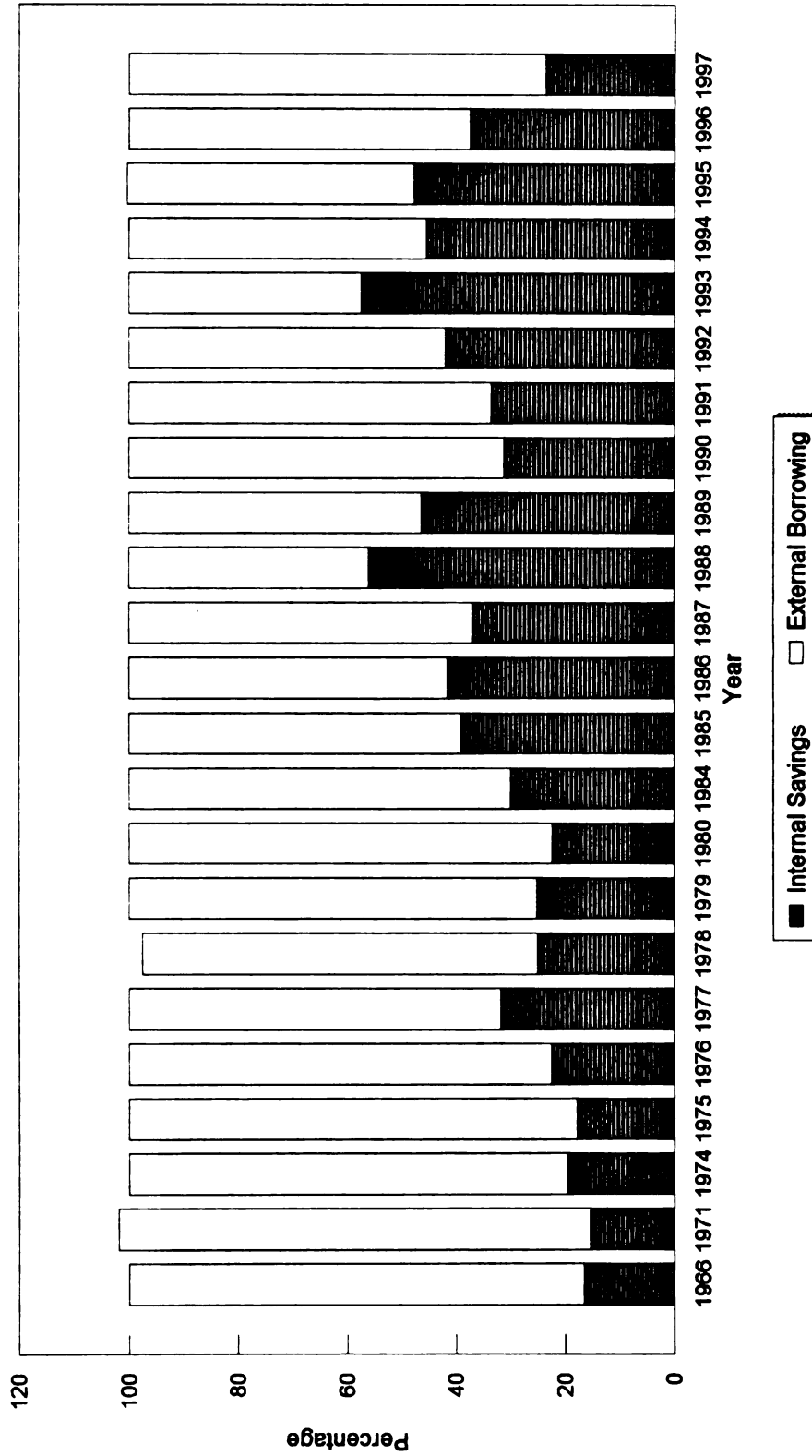
Interest Rates on Various Loans: 1961-1997

Graph 3.2



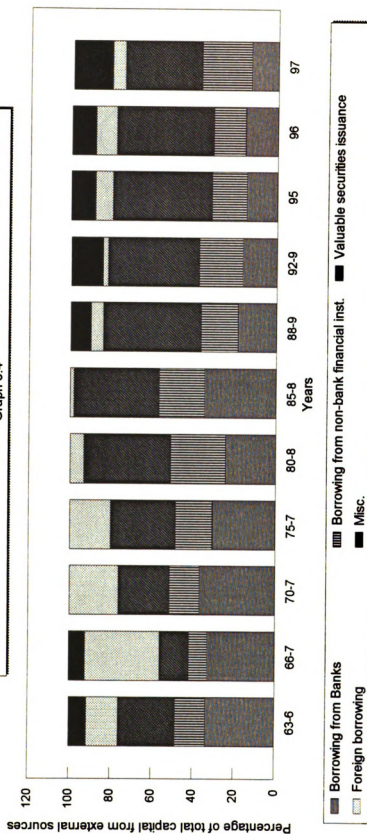
Sources of Corporate Funds in the Manufacturing Sector

Graph 3.3



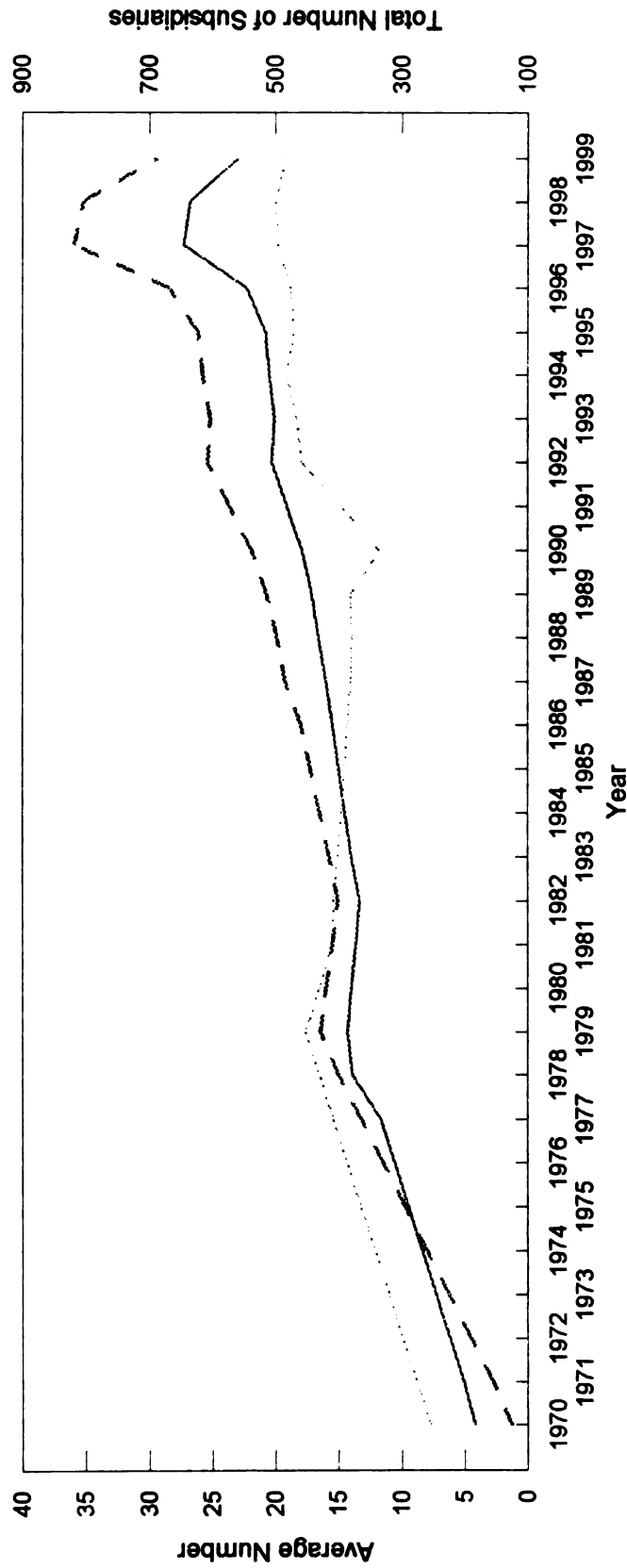
Structure of Capital Mobilization from External Funds

Graph 3.4



Number of Subsidiaries of 30 Largest Chaebols

Graph 3.5

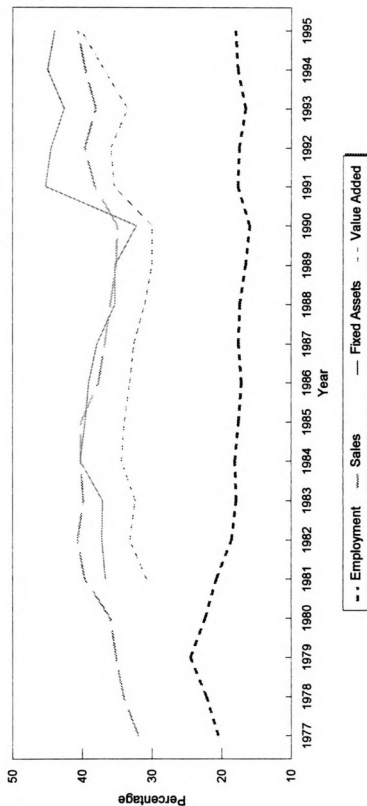


— Ave. No. of Subsidiaries per Chaebol ... Ave. No. of Industries per Chaebol - - No. of Subsidiaries

Data was estimated for the years:
1971-78, 1980-81, 1983-87, 1991

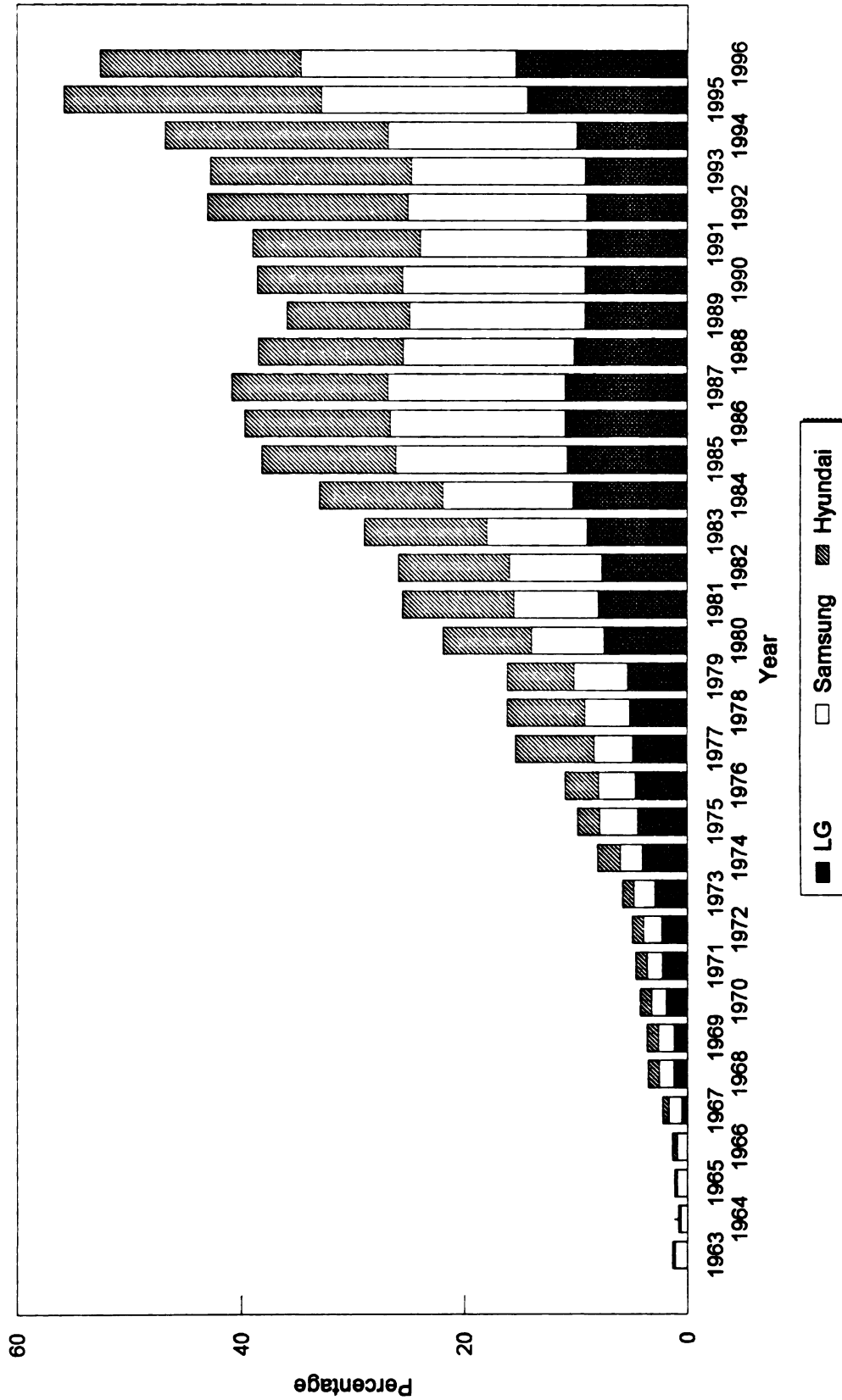
Share of 30 Largest Chaebols in Mining and Manufacturing: 1977-1995

Graph 3.6



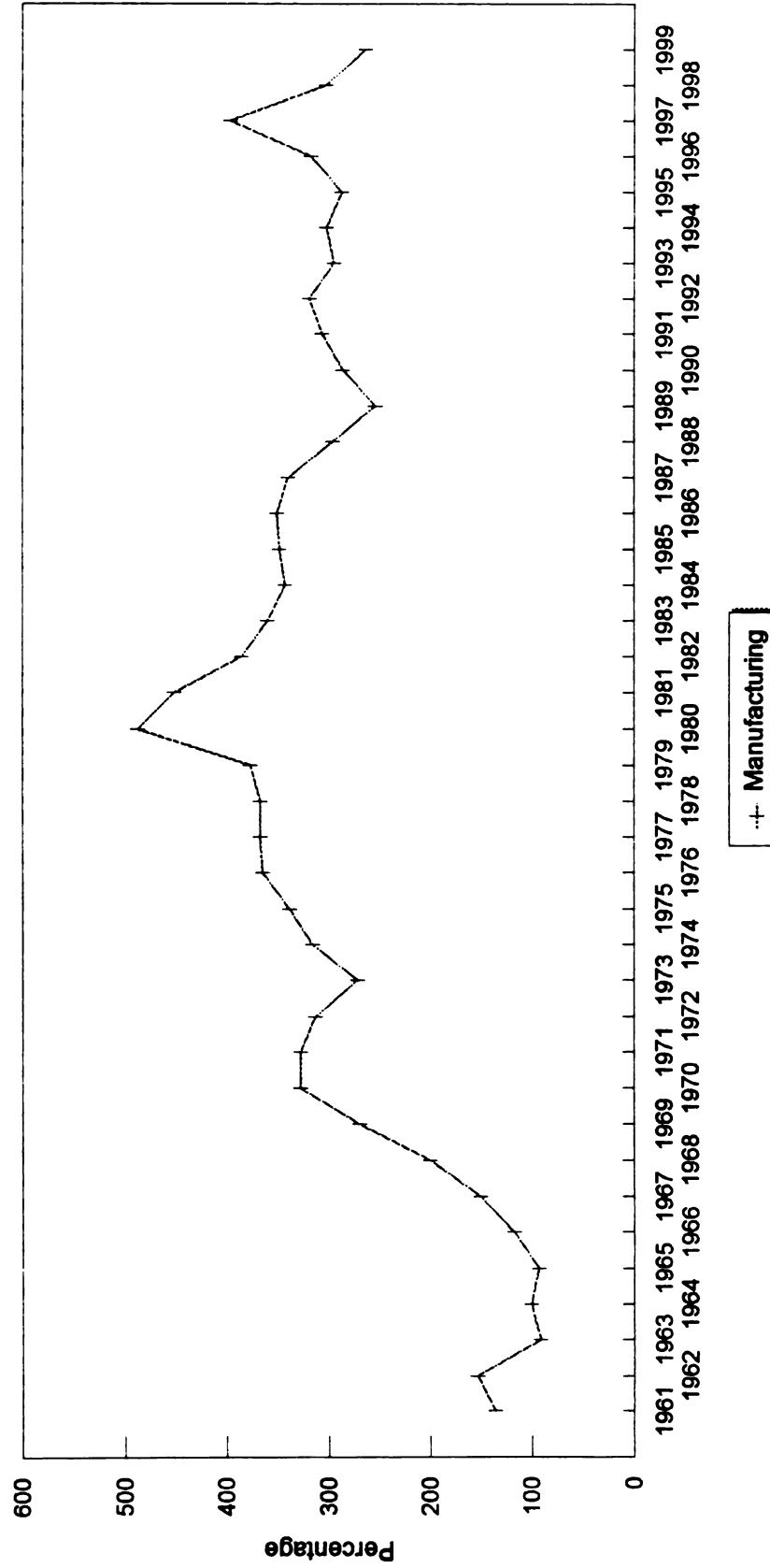
Ratio of Sales by Top 3 Chaebols Relative to GNP: 1963-1996

Graph 3.7



Average Debt/Equity Ratio in Manufacturing: 1961-1997

Graph 3.8



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