4.0 THE BUSINESS-GOVERNMENT NEXUS IN SOUTH KOREA

A close-knitted relationship between the business and government sectors had long existed in South Korea. The relationship was formed since the post-war period in the 1950s. The government needed the business sector for economic growth, whereas the business sector needed the government's favour for loans and financial assistance. The interdependence on each other remained. Businesses have been unusually dependent on government and, even today, still count on government for both subsidies, and, in some cases, specific guidance.

4.1 Post War and Industrial Revolution

People in South Korea were anxious to rebuild their country after war and partition. To obtain quick economic growth, Korea realized the importance of business in helping carrying out government's policies. Korea offered huge rewards, in the form of money, power, and prestige to them. Export policy was adopted and competition was fierce at individual enterprise level and the government ensured that those companies that could not succeed in foreign markets were turned over to other owners.

In Korea, business exists at the pleasure of the government, and, when called upon, is expected to put national development ahead of private greed (Clifford, 1994). The government's policy of building up capital-intensive industry brought to the rise of big business groups, the *chaebol*. With the military taking over South Korea in 1960s, and Park Chung Hee being the President, South Korea had undergone an industrial revolution.

According to Wad (2002), the Korean model evolved during the 1960s and 1970s, created during the Park Chung Hee regime (1961-79). The model rests on three pillars. First, it was a strong state with authoritarian political system and has centralized agencies formulating, implementing, and supervising economic and industrial policy with the purpose of promoting rapid economic growth and industrialization.

Secondly, the financial system was state-controlled. It provided "policy loans" with highly favourable rates, other financial support, and policy guidance to certain sectors, industries, and companies.

Another aspect of the model was the development of big privately owned industrial conglomerates (*chaebols*) with aggressive and diversified investment policies. These conglomerates were developed through state concessions and debt financing, without cross *chaebol* business relations but socially related and coordinated through business associations and informal networks.

According to Clifford (1994), the government lent the *chaebol* money at cheap rates, jailed and blacklisted workers who tried to organize unions, allowed the companies to earn oligopolistic profits in the domestic market, and helped them beg, buy, and steal needed technology from abroad. In return, the government demanded that business put most of its energies into manufacturing, rather than simple zero-sum activities such as real estate speculation, and persuaded businessmen to keep their drinking and carousing discreet enough to convince Koreans that everybody was sacrificing together.

Eventually the government realized that an export-oriented strategy was essential in bringing in foreign exchange. South Korea tried exporting some of its manufacturing products and tasted the sweetness of success. This had gratified Park Chung Hee, the President. However, his aggressive nature did not allow himself to be known as the leader of a nation that flourished by exporting wigs, plywood, cotton fabrics, and knitwear. To Park and those around him, economic development was synonymous with heavy industries like steel and machinery (Clifford, 1994).

President Park Chung Hee had decided to build two major industrial complexes, a refinery at the Ulsan special industrial zone and an iron and steel works in another east coast fishing village, in Pohang. The investment did not look promising because it had far less prospect of earning or saving foreign exchange than did light industries. Light industries earned hard currency more reliably than did heavy industries.

Between the years of 1962 to 1966, most targets were not only met but also exceeded. This had driven Park Chung Hee and his technocrats to continue with intensive planning for further development in the heavy industry sector. Being a nation builder, President Park managed to push South Korea into an era of industrial revolution and become one of the most outstanding countries in East Asia.

In terms of business-government relations, Park forced all businesses, from chemical producers to truck companies, to join associations. The associations were then assigned to appropriate ministries, which then had an easy way to regulate business activities (Clifford, 1994). This structure enabled the government to have extremely effective control over the economy.

The industrial revolution was further enhanced by the Heavy and Chemical Industrialization (HCI) Program. Under the HCI plan, *chaebol* heads who were involved in building heavy industrial projects were granted regular and direct access to the President and his immediate staff. Money to fund expansion flowed freely at subsidized interest rates. Roads, ports, and rail links needed were all built by the government. Business licenses needed to set up other projects were given easily to those who were favourites. Permission to acquire companies (sometimes rivals) was granted to those with the right connections to the President.

Heavy industries in South Korea flourished over the years with the explicit and implicit supports from the government. Businesses that knocked on the right door, too, had the opportunities to expand tremendously at an amazing pace. Therefore, part of the tasks of these business owners was to maintain a good and "healthy" relationship with the government, particularly the president and his immediate staff.

4.2 The Rise of *Chaebols*

The close relationship between government and business resulted in the rise of *chaebols* that were huge and dominating the economy sectors. Like the Japanese *zaibatsu*, ownership and management of the Korean *chaebols* was concentrated in the hands of a small number of families (Wad, 2002).

The adoption of the rapid growth strategy required the *chaebols* to achieve economies of scale. This had caused them to favour huge concentration of productive assets and export of their goods due to the limited size of the domestic market. Their upgrading through sequential selection of more technological complex industries showed that the *chaebols* evolved into huge diversified business groups. However, the pattern of diversification of these *chaebols* was not in related technological and production areas. This was because their growth strategy was conditioned by the rationale of the country or state's industrialization policy.

The state's use of a limited group of companies to promote its industrialization drive, and its requirement that big business be involved in mass production of goods for export had resulted in partnership between the state and *chaebols* as well as concentration of income and asset in the hands of a select minority (Wad, 2002). The top four *chaebols* in South Korea that were noted for their influence on business associations and the political system were Samsung, Hyundai, LG and Daewoo.

According to Clifford (1994), key business groups, particularly Hyundai and Daewoo, were favoured by Park during the 1970s because of their willingness to invest in heavy industries. The founders of these two groups were particularly favourites of President Park because of their commitment to growth and their eagerness to charge into risky ventures.

However, because of scarcity of capital, whom a businessperson knew was an important matter. A businessperson had to be a lobbyist as well. Access to capital and approval from the government for new businesses was essential.

Over the years of 1970s and 1980s, the political power of business expanded. Other than the emergence of large private groups, the organizational capabilities of the private sector increased accordingly. The government formed closer relations with the private sector, which was dominated by the *chaebols*, as part of the strategy of shifting toward more complex, capital intensive and technology intensive industries. This strategy required greater business representation in the policy-making process.

The *chaebol* played an important role in defining the new policy thrust, which further increased the concentration of big business and gave it effective blackmail power over government initiatives (Rhee, 1994; Moon, 1994).

To South Koreans, size meant strength. With sufficient amount of capital, managerial resources, and business skills, the *chaebols* had ventured into a wide range of new areas and subsequently become internationally competitive. Size, coupled with strength, gave the companies the ability to make the inevitable "donations" to the government for various causes ranging from flood relief to political campaigns.

Business groups also had a greater capability to deal with the extraordinary bureaucracy of government that was in every part of the economy. According to a study conducted by the Economic Planning Board, a total of 120 different documents were needed to export a product in the late 1970s.

However, the large *chaebols* continue to grow bigger, with the direct intervention of the president, the HCI plan, the bureaucratic system, and the tight credit situation. It was easier to branch out into a new field of business than it would be for an entrepreneur to start out on his own and struggle in the business.

The relationship between government and business eventually led to corruption and cronyism, when the *chaebols* were competing with one another, trying to defeat the weaker organizations. This was done with the assistance of the government and in return, these *chaebols* contribute to government especially during political campaigns. Having connections in the government made things easier to be accomplished.

4.3 Corruption and Cronyism

The Korean model did not provide much space for mobility between social groups. The two core actors, the state and the *chaebols*, operated as clearly separated social groups. Businessmen seldom ventured into the political arena as high-ranking officers. However, state officials usually took up positions in the financial and corporate sectors after leaving the public sector (Hwang, 1997; Kim, 1998).

However, in the process of democratisation, *chaebols* represented a new challenge to the political leaders. This is due to the fact that these groups had sufficient economic means to influence the mass media via ownership, advertisements, etc (Steinberg, 2000); to bribe politicians and bureaucrats if necessary; to fund political campaigns of political parties; or to establish and sustain their own political party. These capabilities of *chaebols* form their resilience in South Korea until the onset of the crisis in 1997.

This Korean form of political business, popularly referred to as the "politics-economy collusion" or "Jongkyong yuchak" (Kim Y.T., 1998), is a euphemism for widespread corruption, fraud, and bribery (Wad, 2002). Previous studies (Han, 1995; Kim B.S., 1998; Chang K.S., 1999; Yoo, 1997; Steinberg, 2000; cited by Wad, 2002) argued that corruption is part and parcel of the Korean model and is not a recent phenomenon that has emerged with the dismantling of this model.

Clifford (1994) argues that "graft was pervasive" during the Rhee regime, known as the age of political appropriation, where everybody with political connections was stealing what was left after the Japanese occupation. This was also the formative era of many major *chaebols*.

The Park regime was then born in a situation of chaos and pervasive fraud and stealing. "Everybody is in it. Privates steal on foot. Officers steal in jeeps. Generals steal by trucks" (Clifford, 1994). Even though Park was constantly running anti-corruption campaigns to purify his image, but along the way he exploited and subsidized selected businessmen and firms to achieve his aim of rapid economic growth.

During the Chun Doo Hwan era, he also declared war against corruption. However, a scandal was traced back to Chun and his family. His wife, Lee Soon Ja, was a moneylender in the curb market. Her relatives were involved in the same business. The fraud was so enormous that the government had to intervene to rescue the financial market (Clifford, 1994). Eventually, Chun was charged and convicted of corruption.

The next President, Roh Tae Woo, managed to amass 500 billion won (650 million USD) for a personal political slush fund during his presidency (Wad, 2002). The money was most likely "donated" by the *chaebols* in return for licenses, public contracts, tax breaks, credit, etc. Roh was eventually jailed in 1995.

Both the Roh and Kim Young Sam regimes were implicated in the Hanbo scandal, which revealed another aspect of corruption in Korea, which is the funding of politicians by capitalists. Contributions eventually flowed from the *chaebols* to the ruling elite, officially and unofficially. Official donations usually went into the ruling party via the active participation of businessmen in the party's financial committee. However, unofficial contributions often went directly to the President, usually collected in an illegal manner.

It was evident that corruption, particularly that involving the illegal funding of politicians and political parties by big businesses in return for state concessions has remained the norm. The inability of the government to deal with corrupt *chaebol* owners reinforced the extent of these firms' influence over the Korean economy (Wad, 2002). However, with the decentralization of financial institutions since the 1980s and the consolidation of democracy during the Kim Young Sam administration, the political-business collusion had changed in terms of its nature and system.

With the emergence of democracy, more checks and balances in government has been introduced. This is carried out in the hope of helping to reduce corruption as it has become less viable for *chaebols* to seek specific political influence.

4.4 Korea's Plunge in the 1997 Asian Financial Crisis

Prior to the crisis, there were already structural weaknesses that made Korea vulnerable to the financial turbulence in 1997. According to Amsden and Euh (1997), it was the government's decision to allow banks and other financial institutions to borrow and lend without interference that created the current crisis.

In the 1970s, the South Korean government determined the number of financial institutions that could exist and on what they could do. In the 1980s, the world's leading financial institutions expanded internationally. To compete, South Korea had to loosen its rigid controls. In 1995, South Korea agreed to loosen almost all controls on financial institutions (international and domestic), in exchange for membership in the Organization for Economic Cooperation and Development (OECD).

South Korean government also loosens its restrictions on manufacturing companies. They became free to take loans from foreign banks, hence making many of them being overindulged. Large amount of money was borrowed, yet was not turned into sensible long-term investments. The weakening of won during the financial crisis caused the companies trouble because they were unable to pay back both their foreign and local loans.

South Korea's expansion had begun in 1993 and portrayed double-digit growth of exports and investment. Business investment had been high and concentrated in the manufacturing sector. Production capacity in manufacturing had boosted by a full one-fourth from 1994 to 1997. To finance the high level of investment, the total borrowings in the manufacturing sector was raised to about 58% in 1997. As a result, the debt-to-equity ratio, which had been around 300%, soared to almost 400%, more than double the ratios prevailing in other OECD countries (Visco, 1999).

High debts increased the financial burden on Korean firms, which had been having the track record of low profitability, rapid expansion into capital-intensive, high-risk industries by *chaebols* focused on market-share and size. Rates of return had been brought down by the entry of a number of conglomerates into the same industry. Other social problems also followed suit.

The problems in the corporate sector spilled over to the banks. Non-performing loans of commercial banks had risen from less than 4% of their total credit in 1996 to 6% in 1997. Moreover, the lack of transparency in the financial sector caused the loss of investors' confidence in South Korea.

The surge in bankruptcies, the deterioration of banks' balance sheets and the build-up of short-term external debt led to the dramatic outflow of foreign capitals in the second half of 1997. The leaving of portfolio investors further reduced foreign exchange reserves, which already had depleted by the government's decision to intervene in the exchange market. Won was further devalued and the usable reserves in November 1997 had fallen to $7 billion, a small fraction of the short-term external debt. When foreign banks refused to roll over their loans, Korea faced the prospect of defaulting on its foreign debt and was forced in turn to the International Monetary Fund (IMF) for a $57 billion standby agreement (Visco, 1999).

The outbreak of the 1997 financial crisis created an opportunity for the Korean government to trim the power of the mighty *chaebols*. With the support from IMF, the Kim Dae Jung administration embarked on a policy to enforce corporate governance in Korean business (Matthews, 1998). The government, besides delivering the regulatory framework, took charge of the restructuring of both the financial and the corporate sectors.

It is uncertain whether corruption will be reduced. It is hoped that greater transparency, improved legislation and enforcement, a more liberal press, and better-informed citizens (voters) will help to limit corruption. However, the structure of the existing political and economic system is believed to continue to encourage corrupt practices.

With deregulation and internationalisation of the *chaebol* economy, the power relations between the government and the *chaebols* or businesses had changed from one where politicians had hegemony to one where capital secured dominance (Wad, 2002). The *chaebols* were able to promote and lobby for their own interests.

With financial and corporate restructurings taking place, it is now a challenge for the Korean government to reposition itself to form a healthy relationship with the business sector for further development and growth. The government could still form close relationship with businesses, but with a limit and equipped with check and balance, so that a sustained growth could be achieved.