

**STRATEGIC ACTIONS AND PUBLIC POLICY CHOICES:  
LEADERSHIP AND INSTITUTIONAL CHANGE IN SOUTH KOREA,  
1960s-1990s**

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## **ABSTRACT**

**South Korea has long been touted as an outstanding model of economic development. Despite poor resource endowment and a large population, a colonial legacy, the devastation following a civil war, persistent political instability, and the lingering military confrontation with her northern neighbour, Korea's role in the international economic system has rapidly increased in importance since the 1950s. For nearly four decades, Korea has achieved a remarkable economic performance that transformed the country from a typical case of a developing nation trapped in a “vicious circle of underdevelopment”, into one of the largest economies in the late 1990s. Several factors account for the Korean economic success, from high levels of domestic investment and savings and a growing volume of exports, to the improvement of the quality of life reflecting decreased poverty levels, longer life expectation and lower fertility rates. Beneath the economic success lays a system of “socialisation of private risk”, a particular mode of organising the market, as the “visible hands” of a strong and developmental state was able to accelerate the pace of economic growth by identifying strategic industrial sectors, making discretionary allocation of resources to those sectors, and minimising the collective action dilemmas pervasive in most developing countries. Yet, how the developmental state's policy goals were designed, negotiated and implemented remains much of a “black box”. This research argues that to understand the policy process in Korea, it is crucial to examine the central role played by Korean leaders and how their policy choices are shaped by the dynamic interaction of institutions, history, context, ideas and coalition politics.**

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## **ROMANIZATION**

**In transliterating Korean names, including my interviews, I follow the received Korean practice of placing surnames first. Exceptions are made for those who opted to write them according to Western practice, such as Syngman Rhee.**

**All references to “Korea” are to the Republic of Korea.**

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## **ABBREVIATIONS**

<b>BOK:</b>	<b>Bank of Korea</b>
<b>CCEJ:</b>	<b>Citizens Coalition for Economic Justice</b>
<b>CNB:</b>	<b>Citizens' National Bank</b>
<b>DPM:</b>	<b>Deputy Prime Minister</b>
<b>DP:</b>	<b>Democratic Party</b>
<b>DRP:</b>	<b>Democratic Republican Party</b>
<b>DJP:</b>	<b>Democratic Justice Party</b>
<b>EMCM:</b>	<b>Economic Minister's Consultation Meeting</b>
<b>EPB:</b>	<b>Economic Planning Board</b>
<b>FKI:</b>	<b>Federation of Korean Industries</b>
<b>FSB:</b>	<b>Financial Supervisory Board</b>
<b>FYDP:</b>	<b>Five-Year Development Plan</b>
<b>GATT:</b>	<b>General Agreement on Tariffs and Trade</b>
<b>GDP:</b>	<b>Gross Domestic Product</b>
<b>HCI:</b>	<b>Heavy and Chemical Industrialisation</b>
<b>HCIPC:</b>	<b>Heavy and Chemical Industries Planning Committee</b>
<b>IMF:</b>	<b>International Monetary Fund</b>
<b>IPDC:</b>	<b>Industrial Policy Deliberation Council</b>
<b>KAB:</b>	<b>Korea Agricultural Bank</b>
<b>KCCI:</b>	<b>Korea Chamber of Commerce and Industry</b>
<b>KCIA:</b>	<b>Korea Central Intelligence Agency</b>
<b>KDB:</b>	<b>Korea Development Bank</b>

<b>KEB:</b>	<b>Korea Exchange Bank</b>
<b>KIST:</b>	<b>Korean Institute of Science and Technology</b>
<b>MCI:</b>	<b>Ministry of Commerce and Industry</b>
<b>MIB:</b>	<b>Medium Industry Bank</b>
<b>MOF:</b>	<b>Ministry of Finance</b>
<b>MSFCs:</b>	<b>Mutual Savings and Finance Companies</b>
<b>NACF:</b>	<b>National Agricultural Cooperative Federation</b>
<b>NBFIs:</b>	<b>Non-Banking Financial Institutions</b>
<b>NCS:</b>	<b>National Construction Service</b>
<b>NDSC:</b>	<b>National Defense Security Command</b>
<b>NDP:</b>	<b>New Democratic Party</b>
<b>NFFC:</b>	<b>National Federation of Fisheries Cooperative</b>
<b>NGO:</b>	<b>Non-governmental organisations</b>
<b>NIF:</b>	<b>National Investment Fund</b>
<b>OBSE:</b>	<b>Office of Bank Supervision and Examination</b>
<b>OECD:</b>	<b>Organisation for Economic Cooperation and Development</b>
<b>ORD:</b>	<b>Office for Rural Development</b>
<b>ONTA:</b>	<b>Office of National Tax Administration</b>
<b>PSPD:</b>	<b>People's Solidarity for Participatory Democracy</b>
<b>RDP:</b>	<b>Reunification Democratic Party</b>
<b>SMEs:</b>	<b>Small-and-Medium Enterprises</b>
<b>SNU:</b>	<b>Seoul National University</b>

**STFCs:** **Short-Term Finance Companies**

**UMNO:** **United Malay National Organization**

**USAID:** **The United States Agency for International Development**

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# **1. CHAPTER ONE - Strategic Actions and Public Policy Choices:**

## **Leadership and Institutional Change in South Korea, 1960s-1990**

### **1.1 Introduction**

**South Korea has long been touted as an outstanding model of economic development.<sup>1</sup> Despite poor resource endowment and a large population, a colonial legacy, the devastation following a civil war, persistent political instability, and the lingering military confrontation with her northern neighbour, Korea's role in the international economic system has rapidly increased in importance since the 1960s. For nearly four decades, Korea has achieved a remarkable economic performance that transformed the country from a typical case of a developing nation trapped in a 'vicious circle of underdevelopment', into one of the largest economies in the late 1990s.<sup>2</sup> Several factors account for the Korean economic success, from high levels of domestic investment and savings and a growing volume of exports, to the improvement of the quality of life reflecting decreased poverty levels, longer life expectancy and lower fertility rates.<sup>3</sup> Beneath the economic success lies a system of socialisation of private risk, a particular mode of organising the market, as the 'visible hands', of a strong and developmental state were able to accelerate the pace of economic growth by identifying strategic industrial sectors, making discretionary allocation of resources to those sectors, and minimising the collective action dilemmas pervasive in most developing countries.<sup>4</sup> Yet, how the developmental state's policy goals**

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<sup>1</sup>Hereafter Korea.

<sup>2</sup>"Vicious circle of underdevelopment" is taken from Il Sakong, one of the country's most prominent economists and a former policymaker. See Il Sakong, *Korea and the World Economy* (Washington: Institute for International Economics, 1993), p.xv. Il Sakong describes the situation of the country in the early 1960s in these terms:

With a per capita GNP of less than \$100 dollars, domestic savings were negligible, and accordingly, foreign aid financed well over 50 percent of the nation's investment. Unemployment and underemployment were widespread; urban unemployment in particular reached as high as 20 percent. Over 40 percent of the nation's population was suffering from absolute poverty. At the same time, as a resource-poor nation, Korea had no significant exports (\$55 million in 1962), and the balance of payments had shown a chronic deficit since 1945.

<sup>3</sup>Sakong, *Korea and the World Economy*, p.7.

<sup>4</sup>See pp.9-10 for a brief introduction to the system of socialisation of private risk and Chapter Two for a more detailed explanation of the economic and political features of this system of "socialisation of private risk".

**were designed, negotiated and implemented remains much of a 'black box'.**

### **1.1.2 Research Focus**

**This research is an attempt to open the Korean developmental state 'black box' and expose the logic behind the state's decision-making process.<sup>5</sup> It combines an institutional and political analysis to explore the dynamics of the policy process behind the Korean developmental state. This thesis is particularly interested in analysing the role of political leaders in inducing institutional change, and how their policy choices are shaped by the interaction of institutions, history, context, ideas and coalition politics.<sup>6</sup> This is expected to advance our understanding of the factors accounting for the behaviour of Korean political leaders that stimulated them to initiate processes of institutional change, the motivations and preferences that led them to favour and reinforce some institutions but not others, and the impact of institutional change on the nature of political interactions in Korea. To accomplish this, I focus on the political dynamics underlying the creation, maintenance and change of the rules embodied in the system of socialisation of private risk:**

- (1) What drove Korean political leaders during the early 1960s to create and develop the system, which became associated with the country's successful economic performance?**

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<sup>5</sup>State is here defined as 'a set of organizations invested with the authority to make binding decisions for people and organizations juridically located in a particular territory and to implement these decisions using, if necessary, force'. See Dietrich Rueschemeyer and Peter Evans, 'The State and Economic Transformation: Toward An Analysis of the Conditions Underlying Effective Intervention', in Peter Evans, Dietrich Rueschemeyer and Theda Skocpol, eds, *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), pp.44-77, pp.46-7.

<sup>6</sup>Policies can be interpreted as 'broad statements of goals, objectives, and means' that are turned into 'action programs' aiming at realizing the specific ends stated in the policies. The intention of these 'action programs' is to eventually produce a change in the policy environment. See Merilee S. Grindle, 'Policy Content and Context in Implementation', in Merilee S. Grindle, ed, *Politics and Policy Implementation in the Third World* (Princeton, NJ: Princeton University Press, 1980), p.6.

- (2) **How did the rules embodied in the system mould the behaviour of the contending groups in Korean state and society, in particular the Korean presidency?**
- (3) **How did these rules influence the distribution of power and with what consequences in terms of policy and political outcomes?**
- (4) **Why and how did the Korean leadership since the early 1990s attempt to transform the rules of the game of the system, and with what consequences?**

**Studies of the Korean and Taiwanese developmental states often reduce their analysis of the state to the examination of an autonomous and capable bureaucracy that selected and implemented policy goals that did not necessarily reflect the demands or interests of the society.<sup>7</sup> In this sense, autonomy was seen as holding the ‘ability to formulate interests of its own, independent of the will of divergent social interests’, while capacity brought ‘the ability to implement strategies to achieve its economic, political, or social goals in society.’<sup>8</sup> The literature on the Korean developmental state, however, by confining its research essentially to the study of the role played by the strong bureaucracy in fostering economic growth and development, fails to capture a complete portrait of the multiple, dynamic and interactive levels within the state strata. Additionally, such literature neglects also interactions between this complex state and society. Hence, there is a need to analyse the state with regard to its several layers: executive leadership, executive-bureaucratic ties, intra-bureaucratic dynamics, executive-society ties and**

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<sup>7</sup>Alice Amsden, *Asia Next Giant: South Korea and Late Industrialization* (Oxford: Oxford University Press, 1989), Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton: Princeton University Press, 1990), Ziya Önis, ‘The Logic of the Developmentalist State’; *Comparative Politics*, 24 (1991), 109-126, and Jung-en Woo, *Race to the Swift: State and Finance in Korean Industrialization* (New York: Columbia University Press, 1991).

<sup>8</sup>Karen Barkey and Sunita Parikh, ‘Comparative Perspectives on the State’; *Annual Review of Sociology*, 17 (1991), 523-549, pp. 525-6.

**bureaucratic-society relations.<sup>9</sup> Ultimately, the capacity of the state to pursue development-oriented public policies relies on ongoing political relationships between these strata, in particular the executive with the other strata.**

**The Korean state, as any other state, is a political realm that encompasses distinct, contending and at times colliding actors. Just as rulers' strategies are subjected to the interference and possible neutralising power of the political society (whether political parties, unions, or interest groups, as well as to the needs of regime survival), the activities of the bureaucracy are bounded by political leaders, competing state ministries or agencies, and their own constituents.<sup>10</sup> Industrial change has the 'policy feedback' of arousing political forces and shaping new political coalitions, and this leads to a new set of constraints and opportunities for rulers and bureaucrats, and ultimately influences the emergence of new institutions and policy reforms.<sup>11</sup> As Hagen Koo points out for Korea:**

**In efforts to highlight the significance of the state as an autonomous actor, analyses conducted in the statist perspective often ignore that the state is embedded in society and draws its essential characteristics from society itself. Both state autonomy and state strength are the products of interactions between the state and society, in which even a weak society finds diverse ways to influence state structure. State strength is neither absolute nor fixed, but rather varies according to social struggles and accommodation in multiple arenas.<sup>12</sup>**

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<sup>9</sup>Chung-in Moon and Rassemi Prasad, 'Beyond the Developmental State: Networks, Politics, and Institutions'; *Governance: An International Journal of Policy and Administration*, 7 (1994), 360-386, p.364.

<sup>10</sup>Political society can be identified as the 'arena where one endeavours to strike a balance in one's political activity between what is desirable and what is possible.' In this arena, political parties, unions or interest groups seek support through the mobilisation of the individual outside his or her 'ascriptive' group, i.e., the group to which one is born such as ethnicity, religion, class and region. Within this arena, the individual's primary 'ascriptive' identity is expected to become subjugated to the collective interests of the political parties, unions, interest groups or elites. See A.H. Somjee, *Political Society in Developing Countries* (London: The Macmillan Press, 1984), pp.1-6 and pp.26-35.

<sup>11</sup>See p.25 for a definition and analysis of 'policy feedback'.

<sup>12</sup>Hagen Koo, 'Introduction: Beyond State-Market Relations', in Hagen Koo, ed, *State and Society in Contemporary Korea* (Ithaca: Cornell University Press, 1993), pp.1-11, pp.5-6.

**This is an important argument because it implies that the strength of the state is not static, but rather changes in accordance with the ability to gain the support of a social base. This scenario of the political fabric within the Korean state is one far from the portrait painted by the developmental state literature that underlines harmonious and stable features. In view of this dissonant and dynamic nature of the Korean state, political leadership cannot be assured, and like all other social actors, political leaders have also to protect their political interests. The developmental state literature, by equating state with bureaucracy, neglects the key role of those who control and direct the activities of the state.<sup>13</sup> In fact, the developmental state literature has little to say about leadership, and about what stands at the 'heart of a politics of economic growth': 'rulers and would be rulers calculations, that is, how they attempt to secure support, by what mix of policies, designed to appeal to which groups, with what political success, and at what economic cost.'<sup>14</sup> Policy choices and implementation rest on the strategies designed by the rulers to boost their political legitimacy, to strengthen their power, and to guarantee regime survival.**

**Strategies are not only a product of institutional opportunities and constraints, but also of history, context, coalition politics and ideological templates involving the actors at the time of action. The magnitude of political struggle is affected not only by economic institutions, whether property rights laws, industrial organisation - legal rules on contracting or competition, and firm structures - or other forms of economic regulative measures, but also by political institutions. These can include rules about**

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<sup>13</sup>William Liddle, 'The Politics of Development Policy'; *World Development*, 20 (1992), 793-807.

<sup>14</sup>Robert Wade, 'East Asia's Economic Success: Conflicting Perspectives, Partial Insights, Shaky Evidence'; *World Politics*, 44 (1992), 270-320, p.309. See also Wade, *Governing the Market*, pp.228-255. In his seminal work on Taiwan, however, Robert Wade fails exactly to undertake such analysis. In relation to Taiwan's developmental state, Robert Wade argues that 'if we want to know the source of state power and autonomy, we have to understand the organisation of the Nationalist Party and its strategy to rule.' Yet, while the analysis is rich in the way the party interacted with the society, Wade rarely looks at the workings and politics of the party's hierarchy. He neglects in particular the role of the party chairman who also happened to be the island's president. In this sense, the analysis does not acknowledge that control over policymaking rested in the hands of the top party leadership, and that this control was delegated not to formal bureaucracies but to a few trusted individuals with personal ties to the leadership. On the role of political leadership in Taiwan, see Gregory Noble, *Collective Action in East Asia: How Ruling Parties Shape Industrial Policy* (Ithaca: Cornell University Press, 1998), p.35.

**executive-legislative ties which vary depending on the type of political system (parliamentary, presidential, or semi-presidential), rules comprising regime type such as state or social corporatism or government under multiparty coalitions, rules of electoral competition, or judicial rulings. In sum, state domination over society is far from being a fixed condition in Korea. It varies over time and space, subjected to institutions, history, context, ideas and coalition politics and how they shape policy choices undertaken by political leaders. Thus, the developmental state literature on the Korean state needs to be redesigned to start accounting for these variances and what impact they have on the policy process.**

**This chapter first looks at the main features of the system of socialisation of private risk, at the core of the Korean developmental state. It then challenges accusations that this system had bred crony capitalism which ultimately led to the IMF crisis in 1997, by showing how recent research has exposed how the widespread practice of rent-seeking in East and Southeast Asia contributed to rapid economic growth. Instead, the origins of the crisis need to be assessed in terms of the weakening role of the state. However, the tendency to emphasise the role played by external pressures in weakening the capacity of the Korean state, fails to demonstrate how these exogenous forces interact with domestic politics to produce institutional change. The chapter proposes an alternative interpretation of the system of socialisation of private risk based on a polished version of historical institutionalism centred on the role of political actors in inducing institutional change, and how their choices are arbitrated by institutions, history, context, ideas and coalition politics.**

## **1.2 Socialisation of Private Risk: State Finance, Chaebol and Industrial Development in Korea**

### **1.2.1 Bureaucratic Guidance, Industrial Policy and Financial Control**

**Korea is usually portrayed by the developmental state school as an exemplary case of successful state-led economic and industrial development.<sup>15</sup> Specifically, this school posits that government control over banks in the Korean credit-based system was the critical tool to guide and discipline the business sector towards an effective industrial policy.<sup>16</sup> In accordance with this view, the Korean state, following the five-year economic development plans prepared by the Economic Planning Board (EPB), selected several export-oriented industrial sectors as priority sectors (such as automobiles, steel, shipbuilding, machinery and electronics) and provided them with massive aid, notably in terms of financial benefits.<sup>17</sup> The chosen ones would have preferential access to rationed and subsidised credit, foreign exchange, state investment funds, tax advantages, as well as other supportive mechanisms such as import protection and sectoral entry restrictions. But on the other side, through so-called 'administrative guidance', the government would steer these industries in terms of acquisition and deployment of technology, capacity expansion, and prices.**

**The ultimate consequence of this economic interchange between state and business was the institutionalisation of a system of socialisation of private risk in which the state sustained the potential risks associated with private investments.<sup>18</sup> This socialised risk would take such forms as deposit insurance, lender-of-last-resort, state guarantees, or subsidies to banks that become critically exposed to firms in financial difficulties. In the case of Korea, the state raised capital on**

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<sup>15</sup> Amsden, *Asia Next Giant*, Wade, *Governing the Market*, and Önis, 'The Logic of the Developmentalist State'.

<sup>16</sup> See, in particular, Woo, *Race to the Swift*.

<sup>17</sup> Ha-joon Chang, 'The Political Economy of Industrial Policy in Korea'; *Cambridge Journal of Economics*, 17 (1993), 131-157.

<sup>18</sup> Wade, *Governing the Market*, p.366.

**the international markets and allocated the financial resources to private firms, a policy which Wonhyuk Lim described to have had the effect of 'contracting out the provision of goods and services to the private sector under a system of government monitoring as well as a guarantee on loans.'**<sup>19</sup>

**For the developmental state literature what seems to have distinguished Korea from most other late industrialising countries was the discipline exerted by the state over private firms through its control of capital flows.<sup>20</sup> Thus, in the fast-growing economy of Korea, subsidies were provided under the principle of reciprocity, i.e., the recipient of subsidies had to obey certain performance standards in terms of output, product quality, investments in training, research development, and in particular, export targets. Export performance emerged as the state's main benchmark to allocate credit to private firms. While the system of socialisation of private risk encouraged private investment, the Korean state, through direct monitoring and a market test based on export performance, contained the potential costs of 'moral hazard' that could be created by state-guaranteed debt financing.<sup>21</sup> Discipline in Korea took mainly two forms: (1) rationalisation of industries which succumbed to overexpansion; (2) and bankruptcy of badly managed firms in otherwise healthy industries.<sup>22</sup>**

### **1.2.2 The IMF Crisis, 'Crony Capitalism' and Value-Enhancing Rent-Seeking**

**In the wake of the financial crisis in 1997, this system of socialisation of private risk which had nurtured what was once regarded as 'alliance capitalism' was overnight blamed for fostering 'crony capitalism', i.e., "the network of businessmen who gained access to**

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<sup>19</sup>Wonhyuk Lim, 'The Origin and Evolution of the Korean Economic System'; *KDI Policy Study 2000-03* (Seoul: Korea Development Institute, 2000), pp.25-6.

<sup>20</sup>Amsden, *Asia Next Giant*, p.14 and Woo, *Race to the Swift*, p.2.

<sup>21</sup>Lim, 'The Origin and Evolution of the Korean Economic System', p.26. The concept of moral hazard derives from the insurance literature and describes borrowing situations in which borrowers will have the propensity to be less cautious with borrowed money than if it's their own money.

<sup>22</sup>Amsden, *Asia Next Giant*, pp.14-6.

**wealth through their connections to the president and channelled it largely into non-productive personal fortunes at home and abroad".<sup>23</sup> Empirical evidence in the developmental East Asian states such as Korea reveals however, that corruption, patronage, kickbacks and other forms of rent-seeking were not only common but also widespread practices during the years of high economic growth in the region. What seems to have differentiated East Asian developmental states from other late industrialising nations was not the absence of state-business corruption networks, but instead the fact that rents were predominantly used to achieve productive goals rather than embezzled for private consumption.**

**State-centric analysts like Peter Evans acknowledge the existence of corruption, inefficiency, nepotism and favouritism in Korea, arguing that such 'deformities were simply more successfully contained than those in less well developed bureaucracies'.<sup>24</sup> Alice Amsden adds that bailouts of failing firms were not absent in Korea and when they occurred would be highly politicized as the state picked close friends to take over the troubled firms. But she also stresses that what kept the authority of the disciplinary process intact was the state's ability to ensure that its close friends would generally perform well.<sup>25</sup> However, the recognition by these authors that rents were widely used in Korea is not complemented with an explanation of why this exchange for favours was successfully contained so as not to deteriorate into full rent-seeking and corruption which would put at risk economic growth. The issues of rent-seeking and corruption are particularly relevant, not only due to the claims that they were the cause of the 1997 financial crisis in Asia, but also because it has**

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<sup>23</sup>For the origins of the term and a critique of this labelling, see James Putzel, 'Developmental States and Crony Capitalists', in Pietro Masina, ed, *Rethinking Development in East Asia: From Illusory Miracle to Economic Crisis* (Richmond, Surrey: Curzon Press, 2002), pp.161-188, p.162. See also Ha-Joon Chang, 'The hazard of moral hazard', *Financial Times*, 8 October 1998, p.7.

<sup>24</sup>Peter Evans, 'State Structures, Government-Business Relations, and Economic Transformation', in Sylvia Maxfield and Ben Ross Schneider, eds, *Business and the State in Developing Countries* (Ithaca: Cornell University Press, 1997), pp.63-87, p.72, fn.11.

<sup>25</sup>Amsden, *Asia Next Giant*, p.16.

**become commonly accepted that these practices are conducive to poor economic performance.**

**But for Mushtaq Khan, the conflation of widespread rent-seeking activities with high economic growth patterns in Asia requires a new understanding of the different types of rents that exist in any given economy, as well as an analysis of the institutional and political variables underpinning these economic exchange.<sup>26</sup> Khan contrasts the development patterns of South Asia (Indian subcontinent) with East Asia (Korea) and Southeast Asia (Malaysia and Thailand) until the late 1990s. He contends that, despite their differences, Korea, Malaysia and Thailand show that rent-outcomes of the rent-seeking process were conducive to productive investments and high economic growth. In face of the evidence, Khan argues that rents can be seen not only as value-reducing but also as value-enhancing. These value-enhancing rents are nonetheless expected to occur only under certain political and institutional conditions. Once these conditions alter, there is the possibility that the nature of the rents can also change and turn into value-reducing rents.<sup>27</sup>**

**Patron-client relations are here seen as the crucial political element behind the process of rent-seeking, and a necessary explanation for the variance in rent-outcomes. Khan argues that the distribution of organisational power within the patron-client networks involved in the rent-seeking exchange in the four case studies analysed provides the explanation for their variance in economic performance. While in the case of the Indian subcontinent, resources were allocated to non-capitalists ('intermediate' or 'middle' classes), in East and Southeast Asia, they were mainly routed to the business sector. The Korean rent system was one**

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<sup>26</sup>Mushtaq H. Khan and Jomo K.S., 'Introduction', Mushtaq H. Khan, 'Rents, Efficiency and Growth', and 'Rent-Seeking as Process', in Mushtaq H. Khan and Jomo K.S., eds, *Rents, Rent-Seeking and Economic Development: Theory and Evidence in Asia* (Cambridge, UK: Cambridge University Press, 2000), pp.1-20, pp.21-69, and pp.70-144, respectively. Rent-seeking is understood as the 'activities which seek to create, maintain or change the rights and institutions on which particular rents are based', while rents are defined as 'excess incomes' or incomes higher than the minimum someone would have received, the minimum being usually defined as the income on his or her next-best opportunity.

<sup>27</sup>Khan and Jomo, 'Introduction', p.24.

**characterised by the greater political power of the state vis-à-vis the weak organisational power of intermediate groups, in a way that strengthened the capacity of the state to create, maintain or transfer rents and rights in accordance with its own economic agenda. In Malaysia and Thailand, although intermediate groups were not as organisationally weak as in Korea, productive investment and rapid growth was not affected. The distinct feature of the Malaysian rent system was what Khan names 'centralised clientelism' in which the rents paid by the Malay-Chinese capitalists were redistributed in a centralised way to the Malay intermediate groups, the political basis of the country's ruling coalition, UMNO (the United Malay National Organization). The strength of UMNO rested then in its success in using rents to bring together competing Malay clientelist groups in a unified political movement.<sup>28</sup> In Thailand, on the other hand, what was in place was a 'capitalist-led decentralised clientelism', i.e., redistributive rents were essentially sought by Thai capitalist groups committed to primitive accumulation and therefore in developing their business interests.<sup>29</sup>**

**The contribution by Khan is significant because he offers a valid and alternative economic understanding of rent-seeking that goes beyond the general view focusing on its negative social costs and eschewing its potential use to create value-enhancing rents and rights.<sup>30</sup> Khan does this by underlining the need to understand the political and institutional context under which 'good' or 'bad' rent-seeking processes take place. This analysis of rent-seeking and corruption and how they coexisted with fast economic growth in Korea defies a much-voiced view by neo-liberals blaming fundamentally 'crony capitalism' for the crisis in 1997.<sup>31</sup> The work of Ha-joon Chang, Hong-Jae Park and Chul Gyue Yoo appear to strengthen the arguments postulated by Khan as they illustrate how policy reforms**

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<sup>28</sup>Khan, 'Rent-Seeking as Process', pp.98-101.

<sup>29</sup>Khan, 'Rent-Seeking as Process', pp.101-4.

<sup>30</sup>See for example, Anne O. Krueger, 'The Political Economy of the Rent-Seeking Society'; *The American Economic Review*, 64 (1974), 291-303.

<sup>31</sup>For an overview of the neo-liberal explanations for the crisis, see Mark Beeson and Richard Robison, 'Introduction: Interpreting the crisis', in Richard Robison et al., eds, *Politics and Markets in the Wake of the Asian Crisis* (London: Routledge, 2000), pp.3-24, pp.19-20.

**that weakened the Korean state's capacity to create, maintain or transfer rents and rights ultimately contributed to the crisis.<sup>32</sup>**

### **1.2.3 From Strong State to Weak State**

**For Ha-joon Chang, Hong-Jae Park and Chul Gyue Yoo, the crisis was caused mainly by the dismantling of the planning economy undertaken at a rapid pace during the presidency of Kim Young Sam (1993-1997). These authors claim that ill-designed financial liberalisation and further weakening of industrial policy undertaken during Kim Young Sam's presidency negatively affected the country's economic conditions. First, the process of designing five-year development plans came to an end, despite the fact that it had been a useful framework to co-ordinate investments since 1962. Together with the merger of the Economic Planning Board (EPB) and the Ministry of Finance (MOF) in 1993, to create the Ministry of Finance and Economy (MOFE), these policy and organisational changes represented the symbolic 'demise of (indicative) 'planning' in Korea'. Secondly, the government led by Kim Young Sam hastened the dismantling of selective industrial policy which had begun in the late 1980s. This policy had been a crucial mechanism to check 'excessive competition', therefore its termination led to over-investment.**

**As government proceeded with financial liberalisation, the loosening of financial regulations further aided over-investment. With financial deregulation taking place, restrictions on foreign borrowing by conglomerates was reduced and foreign debt grew rapidly from US\$44 billion in 1993 to US\$120 billion in September 1997. The share of short-term debt (which is defined as debt with less than a year's maturity) in total external debt, however, rose from 43.2 percent in 1992 to 57.6 percent in 1997.<sup>33</sup> This placed the country in a position sensitive to fluctuations in foreign confidence over the soundness of the Korean**

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<sup>32</sup>Ha-Joon Chang, Hong-Jae Park and Chul Gyue Yoo, 'Interpreting the Korean crisis: financial liberalisation, industrial policy and corporate governance'; *Cambridge Journal of Economics*, 22 (1998), 735-746.

<sup>33</sup>Asian Development Bank, *Rising to the Challenges in Asia: A Study of Financial Markets, Volume 7: Republic of Korea* (Manila: Asian Development Bank, 1999), p.11 (table 4).

economy. For Chang et al. it was not only the scope of the liberalisation, 'but also its design that contributed to the crisis, as it gave the incentive to borrowers to contract short-term loans and allowed poor asset-liability management to go unchecked.'<sup>34</sup> While Chang, Park and Yoo's approach offer a compelling analysis of the impact of the transformations engineered by the Korean state during the presidency of Kim Young Sam, two puzzles are nonetheless left unanswered:

- (1) If industrial policy and financial regulation underpinned the success of Korean development, why did the state since the early 1990s move to transform the system of socialisation of private risk?
- (2) If successful development in Korea was a product of a strong and disciplinarian state, why then did the state fail to supervise the financial and corporate sectors as was expected within the system of socialisation of private risk?

For Robert Wade, the dismantling of the rules of the game that had, for almost two decades, underpinned the capacity of the Korean developmental state was greatly determined by U.S. pressure in the early 1990s.<sup>35</sup> He argues that under intense demands from the U.S. Treasury, Korea not only allowed 'higher ceilings on foreign participation in the Korean stock market, guaranteed entry for some type of foreign financial institutions, higher ceilings for foreign ownership of Korean companies', but also introduced two major policy changes that would directly lead to the crisis: Korean conglomerates were given freedom to borrow in international markets and; the establishment of new merchant banks as well as their capability to borrow abroad were liberalised. This changing policy environment contributed to weakening the state's ability to

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<sup>34</sup> Chang, Park and Yoo, *Interpreting the Korean crisis*, pp.738-9.

<sup>35</sup> Robert Wade, 'International Institutions and the US Role in the Long Asian Crisis of 1990-2000', paper presented at the conference, *New Institutional Economics, Institutional Reform and Poverty Reduction*, Development Studies Institute, London School of Economics and Political Science, London, 7-8 September 2000.

**supervise the financial and corporate sector. In sum, the 'dismantling' of what were regarded as the pillars of the system of socialisation of private risk – industrial policy and strict financial regulation – are indicated as major causes contributing to the crisis that hit Korea in 1997.**

**However, the role played by external pressures, in particular from the U.S., on Korea's policy choices is not sufficient to explain the policy reforms that ultimately caused the crisis. As Wade acknowledges, this argument 'does not pin down the importance of this external pressure relative to the wishes of segments of the Korean policy-making elite; nor does it say where the Korean government gets its policy 'preferences' from.'**<sup>36</sup>**Furthermore, preferences matter little if the policy elites cannot carry out the policies they choose.**<sup>37</sup> **Policy elites need to have the capacity to implement policies, not only through an effective administrative apparatus that can resort to taxation or coercion, but also by mobilising or retaining support in the society.**<sup>38</sup> **Thus, explanations of the causes that led to the transformation of the capacity of the Korean state since the early 1990s calls for an understanding of the perceptions, preferences and strategies of the Korean political leaders that led them to pursue institutional change. Additionally, it is also necessary to comprehend the political dynamics involved in this process, in particular the building of a supporting coalition and its degree of political success and economic costs.**

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<sup>36</sup>Wade, 'International Institutions and the US Role in the Long Asian Crisis of 1990-2000', p.17.

<sup>37</sup>Barbara Geddes, *Politician's Dilemma: Building State Capacity in Latin America* (Berkeley, CA: University of California Press, 1996), p.14. Policy elites can be defined as "those who have official positions in government and whose responsibilities include making or participating in making and implementing authoritative decisions for society". See Merilee Grindle and John W. Thomas, *Public Choices and Policy Change: The Political Economy of Reform in Developing Countries* (Baltimore: The John Hopkins University Press, 1991), pp.59-67. The composition of the policy elites (heads of state, bureaucracy, legislators, etc) will vary depending on the particular policy under consideration.

<sup>38</sup>Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca: Cornell University Press, 1986), p.238.

## **1.3 Investigating “Socialisation of Private Risk” In Korea: An Alternative Interpretation**

### **1.3.1 Beneath the Veneer of the State: Historical Institutionalism and the Politics of Policy Process**

**Studies of the Korean developmental state often build a static model of the state emphasising the role of the bureaucracy, and its strength vis-à-vis a ‘weak’ society (in particular the business sector). Yet, by continuing to base their analysis of the nature of the Korean state on these terms, the studies fail to grasp the manifold and dynamic interactions within the state strata and between this complex state and society, in particular the role played by Korean Presidents vis-à-vis other concerned actors, during the processes of policy choices. Analysts operating within historical institutionalism have sought to go beyond the dichotomy of state-society, which forms the basis of the developmental state literature, to focus instead on the dynamic interactions between political and economic actors in the policy process.<sup>39</sup> As Peter Hall, one of the main exponents of this school, emphasises, historical institutionalism looks at ‘the institutional relationships, both formal and conventional binding the components of state together and [which] structure its relations with society. While those relationships are subject to incremental change, and more radical change at critical conjunctures, they provide the context in which normal politics is conducted.<sup>40</sup>**

**Institutions, in particular intermediate institutions, matter. Not only do institutions determine the capacity of governments to enact laws and implement policies, they also mould the perceptions, preferences and actions of individuals or groups, and structure power relations between**

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<sup>39</sup>Kathleen Thelen and Sven Steinmo, ‘Historical Institutionalism in Comparative Politics’ in Kathleen Thelen, Sven Steinmo, and Frank Longstreth, eds, *Structuring Politics: Historical Institutionalism in Comparative Analysis* (Cambridge: Cambridge University Press, 1992), pp.1-32, p.7. For a similar approach to the historical institutionalist school, see Ha-Joon Chang, ‘Breaking the mould: an institutionalist political economy alternative to the neo-liberal theory of the market and the state’; *Cambridge Journal of Economics*, 26 (2002), 539-559.

<sup>40</sup>Peter Hall, *Governing the Economy: The Politics of State Intervention in Britain and France* (Cambridge: Polity Press, 1986), p.19.

**contending individuals or groups in society. Institutions are here defined as the ‘formal rules and informal procedures, routines, norms and conventions embedded in the organisational structure of the polity or political economy.’<sup>41</sup> Historical institutionalists consider examples of intermediate institutions to be: constitutional rules, bureaucratic standards operations, property rights laws, industrial organisation, conventions that govern trade unions or business association activities, as well as bank-firm ties. Most of these rules tend to be explicit, well-defined, usually written and are deliberately created and established by the state to apply, at least in principle, to all political actors. Others, however, are not written, but rather developed as codes of behaviour.**

**Historical institutionalists, in general, do not regard individuals or groups as all utility maximisers when they pursue their preferences, but instead more as rule-following ‘satisficers’.<sup>42</sup> This approach sees the perceptions, preferences and actions as defined and confined by the institutional reality in which individuals or groups interact with each other. The question of how individuals or groups forge their perceptions, preferences and actions is regarded as problematic, since they are influenced by the institutional context. Historical institutionalists also tend to look at the institutional environment as shaping the power relations between the contending individuals or groups in society as it favours access to the process of policymaking to some but not others. These analytical foundations emphasise the role played by institutions in structuring politics. Historical institutionalists tend to conceptualise institutions as path-dependent, i.e., ‘decisions at one point in time can restrict future possibilities by sending policy off onto particular tracks,**

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<sup>41</sup> Peter Hall and Rosemary C.R Taylor, ‘Political Science and the Three New Institutionalisms’; *Political Studies*, 24 (1996), p.938. The concept of institutions here employed is usually associated with historical institutionalism. For an overview of other institutionalisms, new institutionalism economics (NIE), rational choice and sociological institutionalism, see Douglas C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990), and ‘The New Institutional Economics and Third World Development’, in John Harriss, Janet Hunter and Colin Lewis, eds, *The New Institutional Economics and Third World Development* (London: Routledge, 1995), pp.17-26, Thomas Koelbe, ‘The New Institutionalism in Political Science and Sociology’; *Comparative Politics*, 27 (January 1995), 231-243, and Junko Kato, ‘Review Article: Institutions and Rationality in Politics – Three Varieties of Neo-Institutionalists’; *British Journal of Political Science*, 4 (1996), 553-582.

<sup>42</sup> Thelen and Steinmo, ‘Historical Institutionalism in Comparative Politics’, p.8.

**along which ideas and interests develop and institutions and strategies adapt.<sup>43</sup> Institutions are thus seen as relatively enduring features which have played a crucial role in driving historical development along a particular set of paths.**

**By focusing analysis on how the institutional setting influences state-society interactions, i.e., the politics of the policy process, historical institutionalism emerges as the most adequate and useful theoretical platform to look carefully beneath the veneer of the Korean developmental state and advance our knowledge of the logic behind the policy process, in particular the workings of the system of socialisation of private risk.**

**Three main themes within historical institutionalism distinguish it from other institutionalisms (as illustrated in Table One) to offer a more adequate and comprehensive analysis of the political economy of growth and development in Korea:**

- 1) Recognising the limitations of human rationality, historical institutionalism does not necessarily see the preferences, goals and actions of individuals and groups as oriented towards utility maximisation as in rational choice institutionalism. Instead, preferences, goals and actions are the product of particular historical developments, and are developed and sustained by a particular set of norms, rules, structures and ideas;**
- 2) For historical institutionalists, processes of politics and policymaking within a specified institutional setting can be best understood if we develop a contextual perspective to trace what political actors are trying to achieve and why they emphasise certain preferences and actions over others. For historical institutionalism, unlike new**

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<sup>43</sup>Margaret Weir, 'Ideas and the politics of bounded innovation', in Thelen, Steinmo, and Longstreth, eds, *Structuring Politics*, pp.188-216, p.192.

**institutional economics and rational choice institutionalism, causality is regarded as being contextual, i.e., it sees particular policy decisions as being a product of highly complex constellation of factors at a certain point in time. This school has rejected the view that the same operative forces will lead to the same political outcomes everywhere. Instead, the effects of such forces will be mediated by the context of a specific situation, often a legacy from the past.<sup>44</sup>**

**3) Finally, historical institutionalists focus on the ‘contingencies of history’, i.e., they highlight the irregularities rather than the regularities of history to demonstrate the limitations of universal causal models. Ultimately, this allows the analysis of multiple and diverse types of development experiences beyond what have been the common objects of study within this approach: industrialised Western nations.<sup>45</sup> As Ellen Immergut puts it:**

**Our understanding of particular events and developments is constrained by the large role played by chance. Quirks of fate are responsible for accidental combinations of factors that nevertheless have lasting effects. In addition, self-conscious political actors, reflecting on their pasts and futures can divert the supposedly ineluctable march of progress onto unexpected paths. Such contingent developments stand beyond logic and can only be grasped through historical analysis.<sup>46</sup>**

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<sup>44</sup>While institutions play a crucial role in shaping the behaviour of political actors, historical institutionalists, nonetheless, agree that it is the interplay between institutions and other contextual factors such as class, public philosophies, historical circumstances, elite and public preferences that fabricate peculiar policy outcomes which in turn, will become areas of future political and institutional strife. See Thelen and Steinmo, ‘Historical Institutionalism in Comparative Politics’, p.27. See also Hall and Taylor, ‘Political Science and the Three New Institutionalisms’, p.941.

<sup>45</sup>Ellen Immergut, ‘The Theoretical Core of the New Institutionalism’; *Politics & Society*, 26 (1998), 5-34.

<sup>46</sup>Immergut, ‘The Theoretical Core of the New Institutionalism’, p.19.

**Table One - Types of Institutionalisms: Similarities and Differences**

Dimensions	New Institutional Economics	Rational Choice Institutionalism	Historical Institutionalism
<b>Institutions</b>	<b>Set of humanly devised rules that constrain human interaction in society (ex: property rights, formal rules and regulations)</b>	<b>Set of incentives and constraints that mould the rational behaviour of self-interested individuals (ex.: constitutions, legislatures, executives, courts or elections)</b>	<b>Set of formal and informal rules and conventions that structure and shape individuals, (ex.: constitutional rules, bureaucratic standard operations, industrial organisation, or conventions governing bank-firm ties)</b>
<b>Actor's preferences and behaviour</b>	<b>Individuals' preferences are constrained by their mental models which are partly culturally derived and partly acquired by experience. Individual action is based on incomplete information and limited mental capacity.</b>	<b>Individuals' preferences are given, fixed and they manoeuvre and act strategically to attain and maximise their personal utilities. Individual action is regarded as an optimal adaptation to the institutional environment.</b>	<b>Individuals' preferences are self-reflective, defined and confined by history, norms, rules, structures and ideas within a particular context. Individual action is determined by the institutional reality and context at the point in time.</b>
<b>Political Process</b>	<b>Institutions determine the performance of the economy by their constraining effect on exchange processes in terms of transaction and production costs.</b>	<b>Institutions are the strategic arena, i.e., the rules of the game that do not allow every conceivable political choice to be considered and within which the preferences of self-interested individuals are pursued.</b>	<b>Institutions offer an ordered and structured environment in which some actions might be appropriate but others not. Institutions manipulate and constrain perceptions, expectations, the calculation of interests and formation of goals.</b>
<b>Power Relations</b>	<b>Institutions reflect interest group politics and are influenced by the transaction costs of bargaining, measurement and</b>	<b>Individuals have the ability to act unilaterally and institutions are not analysed in terms of whether or not they</b>	<b>Institutions are not neutral. Institutions bias policymaking toward some types of interests and</b>

	enforcement.	privilege particular interests.	away from others because they channel participation in particular directions.
<b>Institutional Change</b>	<b>Institutional change is an ongoing, incremental process. Change is a consequence of exogenous pressures or learning by individuals or organisations that choose to modify the terms of the exchanges because they believe that they could be better off.</b>	<b>Institutional change is usually evolutionary and a product of exogenous pressures. Change is a conscious process and occurs when the existing institution has failed to meet the requirements for which it was formed.</b>	<b>Institutional change is essentially an outcome of the pressure by exogenous elements as they "punctuate" what was regarded as a durable institutional setting.</b>

### **1.3.2 Individuals, Institutions and Historical Institutionalism: Debating Ontological and Epistemological Issues**

**Historical institutionalism shows a way forward to examine how institutions structure political interactions in the policy process over time, but it is less obvious how and why these institutions change. This is not to say that historical institutionalism does not deal with institutional change: 'institutions are characterised by long periods of stability, periodically 'punctuated' by 'critical junctures', i.e., when substantial institutional change occurs thereby creating a 'branching point' from which historical development moves onto a new path.'<sup>47</sup> Change is essentially an outcome of the pressure by exogenous elements such as economic crisis or military conflict ('critical junctures'), as they 'punctuate' what was regarded as a durable institutional setting. While**

<sup>47</sup>Hall and Taylor, 'Political Science and the Three New Institutionalisms', p.942, and Thelen and Steinmo, 'Historical Institutionalism in Comparative Politics', pp.16-7. 'Critical junctures' are defined as 'points of departure from established patterns'. See Thelen and Steinmo, 'Historical Institutionalism in Comparative Politics', p.27. A concept that is widely accepted within the historical institutionalist school is of 'punctuated equilibrium' first introduced by Stephen Krasner, and borrowed from evolutionary biology, and which he described as 'an imagery that expects short bursts of rapid institutional change followed by long period of stasis.' In this model, institutional crises usually arise from external pressures. These crises lead to the breakdown of the old institutions to generate political conflict over the configuration of the new institutional framework. See Stephen Krasner, 'Approaches to the State: Alternative Conceptions and Historical Dynamics'; *Comparative Politics*, 16 (1984), 223-246.

**this ‘punctuation’ can be a sufficient explanation after the occurrence of the fact, this can also come close to being tautological. How are we to know that this fact was sufficient to alter the institutional equilibrium? There seems to be no a priori criteria to learn when there may be enough political or contextual force to produce change.<sup>48</sup> In general, historical institutionalists do not seem to have elaborated a clear response to explain what triggers ‘critical junctures’ that ultimately alter the institutional equilibrium and inertia.<sup>49</sup>**

**This resides in the fact that historical institutionalism ambiguously addresses a recurrent ontological discussion in social science, i.e., the nature of the exchange between institutions and individuals.<sup>50</sup> For historical institutionalists, political behaviour takes place within a stable institutional framework that offers an ordered and structured environment and which might be appropriate for certain actions but not others. Institutions are seen as essentially manipulating and constraining preferences and actions. Historical institutionalists are eclectic in the sense that they use either a ‘calculus approach’ or a ‘cultural approach’ to explain how institutions affect the behaviour of individuals or groups.<sup>51</sup> The ‘calculus approach’ assumes that institutions influence the behaviour by providing ‘greater or lesser degrees of certainty about the present and future behaviour of other actors.’ They affect individual behaviour by changing the expectations an actor has about the conduct that other actors are likely to take in reaction to or at the same time with his own action. The “cultural approach” presumes that individuals or groups derive moral and cognitive guidelines for interpretation of reality and behaviour from the institutional setting they are embedded in. Here, the course of action decided by individuals will depend on the way they interpret the context rather than on merely instrumental calculation.**

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<sup>48</sup>Guy Peters, *Institutional Theory in Political Science* (London: Pinter, 1999), pp.68-9.

<sup>49</sup>Even historical institutionalists such as Peter Hall and Rosemary Taylor acknowledge this limitation of the approach. See Hall and Taylor, ‘Political Science and the Three New Institutionalisms’, p.942.

<sup>50</sup>Peters, *Institutional Theory in Political Science*, pp.71-2.

<sup>51</sup>Hall and Taylor, ‘Political Science and the Three New Institutionalisms’, pp.939.-940.

**Nevertheless, historical institutionalists recognise that institutions are ‘themselves also the outcome (conscious or unintended) of deliberate political strategies, of political conflicts, and of choice.’<sup>52</sup> In this sense, political actors can be as Kathleen Thelen and Sven Steinmo emphasise ‘subjects and agents of historical change.’<sup>53</sup> Despite the empirical evidence showing that political actors should be taken seriously in the analysis of processes of institutional change, analysing how actors become agents or architects of institutional change remains a vague project within historical institutionalism.<sup>54</sup> Colin Hay and Daniel Wincott’s interpretation of how the dynamic interaction between political actors and institutions may yield institutional change is here seen as a potential approach to attend to this ontological issue.<sup>55</sup> These authors claim that historical institutionalism is prone to fall into a ‘latent structuralism’ by postulating, that whether through the ‘calculus approach’ or ‘cultural approach’, political behaviour is essentially circumscribed by institutions.**

**For historical institutionalism to overcome this limitation, Hay and Wincott contend that it needs to be founded on a distinctive social ontology. Such social ontology would then affirm a stronger conception of the strategic role played by political agency in political outcomes and acknowledge the ‘mutually constitutive’ nature of the relationship between institutions and agents and how they affect institutional fabrication, dynamics and transformation. For Hay and Wincott, institutions do not only impose constraints, they also offer opportunities**

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<sup>52</sup>Thelen and Steinmo, ‘Historical Institutionalism in Comparative Politics’, p.10.

<sup>53</sup>Thelen and Steinmo, ‘Historical Institutionalism in Comparative Politics’, p.10.

<sup>54</sup>For studies on the role played in particular by political leaders, in nurturing institutional change and policy reform, see Joan N. Nelson, ed, *Economic Crisis and Policy Choice: The Politics of Economic Adjustment in the Third World* (Princeton, NJ: Princeton University Press, 1990), Grindle and Thomas, *Public Choices and Policy Change*, John Williamson, ed, *The Political Economy of Policy Reform* (Washington: Institute for International Economics, 1994), Merilee Grindle, ‘New Rules of the Game: Theory, Practice and Poverty’, paper presented at the conference *New Institutional Economics, Institutional Reform and Poverty Reduction*, Development Studies Institute, London School of Economics and Political Science, London, 7-8 September 2000, Merilee Grindle, ‘Designing Reform: Problems, Solutions, and Politics’; *KSG Faculty Research Working Papers Series RWP01-020* (Cambridge: Harvard University, 2000), and Merilee Grindle, *Audacious Reforms: Institutional Invention and Democracy in Latin America* (Baltimore: The John Hopkins University Press, 2000).

<sup>55</sup>Colin Hay and Daniel Wincott, ‘Structure, Agency and Historical Institutionalism’; *Political Studies*, 46 (1998), 951-7. For a debate on structure and agency, see Colin Hay, ‘Structure and Agency’, in David Marsh and Gerry Stoker, eds, *Theory and Methods in Political Science* (London: Macmillan Press Ltd, 1995), pp.189-206. For a reply to Hay and Wincott, see Peter Hall and Rosemary C.R. Taylor, ‘The Potential of Historical Institutionalism: A Response to Hay and Wincott’; *Political Studies*, 46 (1998), 958-962.

**for political behaviour. The premises for these strategies must rely upon judgements of the institutional framework which are at best partial and which may turn out to be erroneous after carrying out the strategic plan. "Within this formulation, strategy plays an important role in the analysis of change, which is expected to comprise of, the examination of the calculations of the actors, the actions based on such calculations, the institutional context within which the actions occur and the sculpture of the perceptions of the institutional context in which the strategy is devised. Ultimately, Hay and Wincott argue that strategic action produces two outcomes, whether intended or unintended:**

**(1) direct effects upon the institutional and institutionalised contexts within which it takes place and which future action occurs – producing a partial transformation of that institutional environment (though not necessarily as anticipated) and altering the course of its temporal unfolding (however marginally); (2) strategic learning on the part of the actors involved – as they revise their perceptions of what is feasible, possible and indeed desirable in the light of their assessments of their own ability to realise prior goals (and that of others), as they assimilate 'new information' (from whatever external source), and as they reorient future strategies in the light of such 'empirical' and mediated knowledge of the context as a structured terrain of opportunity and constraint."<sup>57</sup>**

**Finally, within this formulation, ideas tend also to perform an important role as 'cognitive filters'. The perceptions, preferences and strategic actions of political actors are moulded not only by the institutional environment in which they are situated but also by ideas."<sup>58</sup> Ideas are then 'mental constructs, views or political beliefs**

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<sup>56</sup>Hay and Wincott, 'Structure, Agency and Historical Institutionalism', p.954.

<sup>57</sup>Hay and Wincott, 'Structure, Agency and Historical Institutionalism', p.956.

<sup>58</sup>Hay and Wincott, 'Structure, Agency and Historical Institutionalism', pp.956-7. Ideas, however, have not been absent from the historical institutionalist analysis. Ideas, in fact, tend to be regarded as a significant variable in the historical institutionalists' examinations of processes of policy-making. See Thelen and Steinmo, 'Historical Institutionalism in Comparative Politics', pp.22-6. Yet, ideas themselves rarely emerge as the unique forces determining political outcomes, and there is a tendency to treat them instrumentally and functionally. Ideas are seen more as, in the words of Mark Blyth, 'catch-all concepts to explain variance', and no efforts are made to analyse ideas per se, or their independent impact on the institutional setting. See Mark Blyth, 'Any More Bright

**political actors have about some aspect of the world around them' and they matter in the sense that as they remain significant over time, they become institutionalised to form what is known as culture, i.e., a 'set of ideas or beliefs that are institutionalized, persist over time and are associated with a particular community.'<sup>59</sup> The analysis of ideas and cultures are particularly important because they might account not only for continuity but also change, i.e., how individuals, groups, societies succeed in swapping or merge old beliefs and cultural patterns with new ones.**

**In the face of this need to seek a stronger conception of the role played by agency in political outcomes, acknowledgement that agents and institutions are mutually constitutive, and explanation on how this mutual constitution emerges and how it produces institutional change, the research strategy employed by historical Institutionalists needs to be rearranged epistemologically. The work of Merilee Grindle and John W. Thomas is significant by offering the empirical guidelines and a *priori* criteria that can be used to trace how political actors, in particular elites, act strategically to initiate and implement reform.<sup>60</sup> According to the framework designed by Grindle and Thomas, the confluence of three key factors are crucial to understand reform processes: (1) the environmental background influencing the perceptions, preferences and actions of the policy elites; (2) the specific political conditions affecting policy choices and; (3) the political dynamics that emerge during the implementation process.**

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Ideas? The Ideational Turn of Comparative Political Economy'; *Comparative Politics*, 29 (1997), 229-250, p.231. Peter Hall and Rosemary C.R. Taylor, seem to have taken this criticism seriously, stressing that historical institutionalism has the potential to offer a more sophisticated understanding of the relationship between structures and agents by postulating that exposure to new ideas 'can alter the basic, as well as the strategic preferences of actors' to the point that ideas could be seen more as building blocks of actions than 'cognitive filters', as presented by Hay and Wincott. See Hall and Taylor, 'Political Science and the Three New Institutionalisms', pp.961-2.

<sup>59</sup>See Sheri Berman, 'Ideas and Culture in Political Analysis', paper presented at workshop *Ideas, Culture and Political Analysis Workshop*, Princeton University, 15-16 May 1998, p.1.

<sup>60</sup>Grindle and Thomas, *Public Choices and Policy Change*.

**Within this framework, there are four main 'lenses', or a *priori* 'decisional criteria', through which policy elites may filter their policy options:<sup>61</sup> (1) technical recommendations; (2) the effects of their choices on bureaucratic exchanges; (3) the implications in terms of political stability and political support and<sup>62</sup> (4) the impact on ties with international actors. These four criteria are seen as aiding the policy elites to evaluate the risks and gains that can derive from the several options under analysis. The consideration of these criteria, however, will necessarily reflect the orientation of policy elites - values, ideas, expertise, experiences, power and loyalties - and the historical circumstances, international conditions, domestic political and economic contexts, and institutional environments within which they seek to accomplish their goals. The importance of the criteria will vary over time and depend on the different set of contextual conditions.<sup>63</sup>**

**The process of decision-making is relevant to discern: who gets involved in the process of policymaking; what may be the issues and problems under consideration and; when and how reform may begin. However, it is the implementation phase that often settles the nature and success of the initiative. Implementation is regarded as an 'interactive' and 'ongoing' process of policy making in the sense that policy elites need to take into consideration the viability of the choices in terms of: coalition support and opposition to change; what stakes they have in the pursuit of reform and; the political and bureaucratic resources they hold to maintain such reform initiatives. " There are, however, three important considerations to make concerning this framework.**

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<sup>61</sup>Grindle and Thomas, *Public Choices and Policy Change*, pp.96-104. Unlike the model of politics designed by Warren Ilchman and Norman Uphoff in which the main concern of statesmen in developing countries is to gain and maintain power when making policy choices, the model offered by Grindle and Thomas goes beyond the 'power-as-overriding motive' assumption and in this way provides a more comprehensive and approximate view of the reality in relation to what may actually be the motivations and preferences of decision makers. See Warren F. Ilchman and Norman Thomas Uphoff, *The Political Economy of Change* (Berkeley: University of California Press, 1969).

<sup>62</sup>This, with the understanding that social actors hold in different degrees a set of political and economic resources from votes, political allegiance and support, to economic goods and services, information or money.

<sup>63</sup>Grindle and Thomas, *Public Choices and Policy Change*, p.96.

<sup>64</sup>Grindle and Thomas, *Public Choices and Policy Change*, p.125. Political resources are assessed in terms of their significance for regime legitimacy, political stability, governmental autonomy, nature of the reforms and

First, Grindle and Thomas point out that, technical recommendations are often imbued by an ideological content on how the path of development ought to be. However, this interpretation intertwining technical advice and ideas makes it difficult to understand why and how ideas *per se* become politically significant to inspire political leaders to seek reforms.<sup>65</sup> As put by Mark Blyth, ideas can, not only redefine existing preferences and the creation of new ones, but also assist the occurrence of radical policy change and are a prerequisite for it.<sup>66</sup>

Secondly, the implementation process not only tends to set the nature and success of the reform initiative, but also has political outcomes that ultimately may break the institutional equilibrium and generate change. Institutions mould policies and politics, but policies and politics ultimately may generate institutional change. This is what Paul Pierson calls 'policy feedback'.<sup>67</sup> As stated by Sven Steinmo, 'political institutions are not neutral. They bias policy making toward some types of interests and away from others because they channel participation in particular directions'.<sup>68</sup> For example, public policies usually direct 'spoils' to certain groups but not others and in doing so they offer a strong incentive for the beneficiaries to mobilise to keep the 'spoils' or even expand them. Public policies and the allocation of state resources are then turned into no more than 'objects of perpetual conflicts'.<sup>69</sup> Adam Przeworski identifies three types of conflict: (1) between state actors; (2) between state actors and the interests negatively affected by the public policies; and (3) between state actors, exclusively, or between them and other non-state actors in the definition of the goals underpinning public

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elite consensus. Bureaucratic resources, on the other hand, take three forms: financial strength, management skills and technical capacity.

<sup>65</sup> Grindle and Thomas, *Public Choices and Policy Change*, p.97.

<sup>66</sup> Blyth, 'Any More Bright Ideas?', p.246.

<sup>67</sup> Paul Pierson, 'When Effect Becomes Cause: Policy Feedback and Political Change'; *World Politics*, 45 (1993), pp.595-628. See also Liddle, 'The Politics of Development Policy', pp.793-807.

<sup>68</sup> Sven Steinmo, *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State* (New Haven: Yale University Press 1993), p.7.

<sup>69</sup> Adam Przeworski, *The State and the Economy under Capitalism* (Chur: Harwood Academic Publishers, 1990), pp. 50-1.

**policies. The nature of the conflicts is then a significant factor to understand how they may change the configuration of the institutional environment.<sup>70</sup>**

**Finally, this framework regards politics as a means through which 'windows of opportunities' are recognised and taken on by policy elites to produce reform. However, insights on the configuration of the political dynamics embedded in a specific institutional environment need to take into account that interactions, especially between a complex state and society, are not always formal, visible and traceable.<sup>71</sup> In fact, these interactions may be informal. Thus, this thesis will refer to politics as 'who gets what, when, how, and at whose expense', in the sense that politics is about 'the distribution not only of the benefits derived from the use or consumption of goods and services, but also the costs required for their production and supply.'<sup>72</sup> This interpretation of politics allows for the inclusion of both formal and informal processes of politics. Formal politics relates to the type of politics governed by explicit, well-defined and written rules that usually emanate from the state. Informal politics involves the customs, informal norms and codes of behaviour guiding relationships between individuals and groups in any given society which are not deliberately created by an established authority.<sup>73</sup> Unlike formal politics, that can be described as operating within the realm of the rule of law to achieve legitimate public ends, informal politics are conducted through the use of means that owe their legitimacy essentially to the**

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<sup>70</sup>Peter Hall, for example, emphasises the role played by ideas and power for the policy paradigm shift that took place in Britain as the country abandoned a Keynesian mode of policymaking to one based on monetarist economic theory in the late 1970s. See Peter A. Hall, 'Policy Paradigms, Social Learning and the State: The Case of Economic Policymaking in Britain'; *Comparative Politics*, 25 (1993), 275-296. Jonas Pontusson, on the other hand, focuses, for example, on the role played by changing interests of economic actors caused by transformations in the characteristics of the marketplace and how this led to institutional realignments. See Jonas Pontusson, 'From Comparative Public Policy to Political Economy: Putting Institutions in Their Place and Taking Interest Seriously'; *Comparative Political Studies*, 28 (1995), 117-147.

<sup>71</sup>Merilee Grindle and John W. Thomas recognise that in developing countries due to the close nature of the state and the elite-centred politics, it was not uncommon to see informal and non-public channels trying to influence the process of policymaking, but they fail to show how formal and informal politics interact in the policy process. See Grindle and Thomas, *Public Choices and Policy Change*, p.63.

<sup>72</sup>Haruhiro Fukui, 'Introduction: On the Significance of Informal Politics', in Lowell Dittmer, Haruhiro Fukui, Peter N.S. Lee, eds, *Informal Politics in East Asia* (Cambridge, UK: Cambridge University Press, 2000), pp.1-19, pp.1-3.

<sup>73</sup>Robert Scalapino, 'Informal Politics in East Asia: Introduction'; *Asian Survey*, 36 (1996), 227-9, p.227.

**individuals involved in the policy process. The relationship between formal and informal politics is one of functional interdependence. As Lowell Dittmer states:**

**Formal politics serves two functions for informal politics: spiritual and mundane. On the one hand, the formal hierarchy supplies the offices, status, and perquisites of power that political actors seek. But informal groupings do not merely plunder the hierarchy for these ends, but also use it to confer legitimacy on the policies that they enact, not only for themselves but on behalf of mass constituencies, perhaps even (if coincidentally) the 'public' at large. Thus formal politics is both a 'feeding trough' and a 'temple' for the practice of informal politics.<sup>74</sup>**

**The main problem of informal politics, however, rests precisely on the possibility that individuals may stop legitimising their occurrence. For example, while informal politics will usually operate within a secretive, private and businesslike approach (here a good example would be situations of 'pork barrel politics', i.e., resource transfers to one's constituency), it can develop into "crisis politics" when it is subjected to public enquiry (such as major financial scandals or corruption ties) and by doing so it may lead to institutional change and policy reforms.<sup>75</sup>**

**Korea is a good case to analyse to what degree ideas, political conflicts generated by policy feedback, and informal networks interact to influence the choices of political leaders. During the 1960s and 1970s, under the leadership of Park Chung Hee, who was deeply committed to a 'growth-first' ideological paradigm, Korea established and consolidated a system of socialisation of private risk. The state nurtured the**

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<sup>74</sup>Lowell Dittmer, 'Conclusion: East Asian Informal Politics in Comparative Perspective', in Dittmer, Fukui, Lee, eds, *Informal Politics in East Asia*, pp.290-308, p.295. See also Patricio Abinales, *Making Mindanao: Cotabato and Davao in the Formation of the Philippine Nation-State* (Manila: Ateneo de Manila University Press, 2000), p.11. Focusing on the debate strong society versus a weak state, Abinales argues that this division between state and society fails to notice that a significant characteristic of postcolonial weak states is a 'considerable blurring of what is official and what is not and how the lack of a clear divide weakens state capabilities'. He adds that 'in reality it is difficult to distinguish between citizen and bureaucrat, party official and local warlord, police officer and local smuggling kingpin'.

<sup>75</sup>Dittmer, 'Conclusion', p.303.

**development of domestic business groups through a set of resources, including capital, technology and industrial policies.<sup>76</sup> The assassination of Park Chung Hee in 1979, and the emergence of a new authoritarian regime under Chun Doo Hwan (1980-1987), led, however, to a re-assessment of the system of socialisation of private risk which ultimately led to changes in the equilibrium sustaining this system, in particular the cooperative ties between the state and the private sector.<sup>77</sup> Cooperative ties in Korea would not only occur through the participation of the private sector in government-led deliberation councils or other official arrangements, but also in a less visible and informal manner. As in many other political settings, the legitimacy of political leaders and their actions were far from being secured due to the weak tradition of the rule of law and the tendency to disrespect administrative regulations in Korea. In a process that became progressively entrenched during Park Chung Hee's reign in the 1960s, policy deliberations became an ideal terrain to build supporting groups, usually based on school, family or/and regional ties, as a way to tackle the likely vulnerability of the regime. Thus, natives of the south-eastern region of Kyongsang and graduates from Seoul National University have dominated the country's political and economic elites for the past 50 years.<sup>78</sup> Nevertheless, this may not be a guarantee for continuing exchange of political and economic trade-offs. Since the 1980s, and despite the school or regional ties, the preferences of the new leadership and economic actors began to diverge. Furthermore, the tendency to privilege these ties, in particular the regional, came under strong social condemnation with the democratisation of Korean society.**

**The new economic policies undertaken by President Chun Doo Hwan, and later continued by Roh Tae Woo (1988-1992) and Kim Young Sam (1993-1997), involved not only changes in the 'spoils' system created by Park Chung Hee, but also a re-evaluation of the policy outcomes of the**

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<sup>76</sup>See Chapters Three and Four for the "growth-first" ideological paradigm.

<sup>77</sup>Chung-in Moon, 'Changing Patterns of Business-Government Relations in South Korea', in Andrew McIntyre, ed, *Business and Government in Industrializing Asia* (Ithaca: Cornell University Press, 1994), pp.142-166.

<sup>78</sup>See Chapter Two for more details.

**previous development strategy that culminated in an ideological paradigm shift from ‘growth-first’ to ‘fairness of wealth distribution’, which implied mainly the reduction of the *chaebol*’s economic concentration.<sup>79</sup> Yet, by this time, the legacy of the past, i.e., the system of socialisation of private risk that had consolidated the economic power of big business groups made the project of institutional change more difficult to achieve. With the *chaebol* increasingly under control of their own financial resources and know-how, the private sector not only started to challenge the capacity of the state to perform certain services, but also resisted the ending of the ‘spoils’. This is what Eun Mee Kim calls the contradictions of institution and autonomy of the developmental state. Such contradictions ultimately contribute to the weakening of the state’s power and influence in the workings of the economy: ‘the contradictions are paradoxical, since it is success in attaining the goal (economic development) that becomes the catalyst for the state’s decline and transformation.<sup>80</sup>**

**In sum, a modified version of historical institutionalism that seriously considers the strategic role played by political agency in promoting institutional change and how the blending of ideas, political conflicts generated by policy feedback and informal networks drive policy strategies is presented here as an alternative interpretative framework to investigate the system of socialisation of private risk in Korea.**

#### **1.4 Polished Historical Institutionalism and Institutional Change In Korea**

**This thesis introduces a polished version of historical institutionalism as a useful theoretical platform to improve our knowledge of the logic of decision-making in the Korean developmental state, in particular through an investigation of the impact of political dynamics on the changing configuration of the system of socialisation of private risk**

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<sup>79</sup>See Chapters Five and Six for the “fairness of wealth distribution” ideological paradigm.

<sup>80</sup>Eun Mee Kim, *Big Business, Strong State: Collusion and Conflict in South Korean Development, 1960-1990* (Albany: State University of New York Press, 1997), p.43.

**since the 1980s. The research rests on five propositions to understand institutional change in Korea: (1) institutions matter not only because they impose constraints but also because they open opportunities for political behaviour; (2) political actors are both subjects and agents of historical change, in the sense that they can act strategically to define, pursue and achieve institutional change; (3) political strategy is shaped by the institutional setting in which actors are embedded, as well as by ideas and the specific historical context within which the action takes place; (4) policies are sources of political make-up that ultimately may generate institutional change; (5) and the interaction of formal and informal politics is relevant to the understanding not only of 'who gets what, when, how, at whose expense', but also how these patterns of political behaviour influence the patterns of institutional change. In comparison with previous studies on the Korean developmental state, historical institutionalism has the potential to offer a thicker analytical narrative of processes of institutional change in Korea.**

**As in any other country, policy choices in the Korean state are hammered out by political leaders. In Korea, the President and his staff at the Blue House have reigned over the process of decision-making. For the past forty years, the single most enduring feature of Korean politics has been the concentration of power in the presidency. Institutional checks and balances based on the principle of separation of powers do exist, on paper. However, they are rarely enforced.<sup>81</sup> Korean presidents are expected to be active players in the process of decision-making through their involvement in the design, negotiation, implementation and screening of public policies, yet their role in inducing institutional change continues to be understudied.<sup>82</sup> Furthermore, while the Korean presidency is usually regarded as an 'imperial presidency', Korean leaders are far**

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<sup>81</sup>Sung Chul Yang, *The North and South Korean Political Systems: A Comparative System* (Seoul: Seoul Press, 1994), p.463.

<sup>82</sup>A few exceptions are Sung Deuk Hahn and L. Christopher Plein, *After Development: The Transformation of the Korean Presidency and Bureaucracy* (Washington: Georgetown University Press, 1997) and Yeon-ho Lee, *The State, Society and Big Business in South Korea* (London: Routledge, 1997). However, they both fall into the same pattern of analysing the Korean presidency from a perspective of an autonomous and capable actor vis-à-vis a weak society.

**from autonomous.<sup>83</sup> They do not live in an institutional, political, economic, social, ideological or historical vacuum as their policy choices are unequivocally influenced by a myriad of intertwined factors. For any chosen policy to take effect, political leaders need to mobilise or retain support in the society. This research, by attempting to fill in the gaps in the existing literature through the examination of the intervening role of Korean political leadership in advancing institutional change, aims to contribute to a better understanding of the Korean developmental state and the country's economic performance.**

#### **1.4.1 Methodology**

**In an analysis of economic adjustment policies during the 1980s, Joan Nelson points out that the combination of dedicated leadership and a high degree of centralised control and authority are important to explain the resolute and effective implementation of stabilisation and structural change programs. This type of control and authority results either from military rule, or from political institutions that grant the chief executive dominant power, as well as from more temporary circumstances such as successful popular election and /or momentarily suspended or weak opposition.<sup>84</sup> In the same vein, one of the conclusions of a number of studies of economic reform programs around the world organised by the Washington-based Institute for International Economics in the 1990s reveals that most of the cases of successful reform involved leadership from executives strongly committed to institutional change.<sup>85</sup>**

**Despite the fact that East Asia, in particular the cases of Korea and Taiwan, formed (and continue to maintain to a certain extent even after the democratic overture in the late 1980s) political regimes in which control and authority are concentrated in the hands of the executive,**

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<sup>83</sup>The term 'imperial presidency' is taken from Chung-in Moon and Jongryn Mo, *Economic Crisis and Structural Reforms in South Korea* (Washington: The Economic Strategy Institute, 2000), p.23.

<sup>84</sup>Nelson, 'Introduction: the politics of Economic Adjustment in Developing Nations' and 'Conclusion' in *Economic Crisis and Policy Choice*, pp.3-32, p.25 and pp.321-361, p.341, respectively.

<sup>85</sup>John Williamson and Stephan Haggard, 'The Political Conditions for Economic Reform', in Williamson, ed, *The Political Economy of Policy Reform*, pp.525-596.

**literature on the developmental state has instead preferred to analyse the role of the bureaucracy as the leading actor behind the development process. But in choosing such a framework it overlooks the ‘nitty-gritty’ of the policy process, and hence its failure to clearly understand the nature and organisation of the state and the involvement of political leaders in the policy process and how this changed over time. In this sense, this thesis attempts to open the ‘black box’ of the East Asian developmental state through an analysis of Korea as a case study by exploring and investigating how Korean Presidents filter their policy options in terms of the complex interaction of institutional constraints and opportunities, history, context, ideas, and coalition politics.**

#### **1.4.2 Research Strategy**

**This thesis aims to provide an understanding of the role played by Korean leaders in the policy process and their efforts to bring about institutional change. In this sense, the research examines how the perceptions, incentives, motivations and preferences of Korean leaders moulded by a particular institutional, historical, contextual and political environment help define policy choices. The research looks at two major periods as critical points where Korean Presidents are considered in terms of their role in ‘punctuating’ the institutional equilibrium to pursue and implement institutional change.<sup>86</sup> The first period covers the presidency of Park Chung Hee (1961-1979) and the second encompasses the presidency of Kim Young Sam (1993-1997). The two periods here selected comprise what I regard to be key moments of institutional change with a major impact on Korea’s economic growth and development. The analytical narrative undertaken to examine these two periods intends to clearly illustrate the strategic actions and policy decisions pursued by Korean presidents in the process leading to the creation, maintenance and transformation of the system of socialisation of private risk. The actions and policy decisions taken up by Park Chung**

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<sup>86</sup>See footnote 46.

**Hee and Kim Young Sam are examined in further detail in two case studies on policy reforms, the heavy and chemical industrialisation in the 1970s and the real name financial transaction system in 1993.**

**In assessing the usefulness of the five propositions mentioned above to explain institutional change in Korea, this thesis first investigates why and how President Park Chung Hee built and consolidated a system of socialisation of private risk in the 1960s and 1970s. The identification of this period as a crucial instance of institutional change is explained by the fact that it is during Park's leadership that Korea experienced a successful turnaround in the country's economic record. The discussion of the pre-1980s period is also important to underline the significant institutional path dependencies inherited from Park's regime and how their existence moulded the choices of the succeeding Korean leadership.**

**In the aftermath of the country's major financial crisis in 1997, it became apparent that policy choices undertaken during the presidency of Kim Young Sam had played a significant role in the country's economic meltdown by changing important rules underpinning the system of socialisation of private risk. While previous governments led by Chun Doo Hwan (1980-1987) and Roh Tae Woo (1988-1992) had already attempted to alter the rules of the game, it was only with Kim Young Sam that the dismantling of the two pillars of the system- industrial policy and strict financial regulation – became a reality. These policy choices are indicated as major causes contributing to the collapse of Korean corporate and financial sectors in 1997. Subsequently, and having identified this period as another moment of critical institutional change in Korea's political economy, this thesis investigates why and how President Kim Young Sam after 1993 chose to radically transform the rules of the game originally embodied in the system of socialisation of private risk and with what degree of success.**

**Case studies are powerful tools to analyse the political dynamics involved in processes of institutional change.<sup>87</sup> The use of the process-tracing technique in case studies allows us to look closely at the way a decision was designed, negotiated and implemented. As Andrew Bennett and Alexander L. George point out, 'process tracing is an attempt to trace empirically the temporal and possibly causal sequences of events within a case that intervene between independent variables and observed outcomes.'<sup>88</sup> In this way, case studies provide the answers for the following questions: how and when did issues of institutional change surface? Who were the main actors involved in the process of institutional change? What reasons account for why these actors defended or disputed institutional change? How did these actors seek to define the trajectory of the process of institutional change? How were the proposals adopted and legitimised? How did the actors react in face of new rules of the game?<sup>89</sup>**

#### **1.4.3 Data Collection**

**Since this research aims at exploring the logic behind the Korean state's decision-making process, the thesis is particularly interested in analysing how policy choices undertaken by Korean leaders are shaped by the interaction of institutions, history, context, ideas and coalition politics. Memoirs, speeches, newspaper articles, publications of Korean think tanks, unpublished PhD dissertations and other secondary data, supplemented by a number of first-person interviews are the main research instruments employed to understand Korean leaders' preferences, perceptions, motivations, incentives, evaluation of alternatives, as well as the information they hold, the expectations they develop, the strategies they**

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<sup>87</sup>Pierson, 'When Effect Becomes Cause', p.596.

<sup>88</sup>Andrew Bennett and Alexander L. George, 'Case Studies and Process Tracing in History and Political Science: Similar Strokes for Different Foci', in Colin Elman and Miriam Fendius Elman, eds, *Bridges and Boundaries: Historians, Political Scientists, and the Study of International Relations* (Cambridge, MA: MIT Press, 2001), pp.137-166, p.144.

<sup>89</sup>Berman, 'Ideas and Culture in Political Analysis', p.11 and Grindle, *Audacious Reforms*, p.11.

**adopt, and the constraints and opportunities that define the parameters of their actions.**

**Field research in Korea was undertaken in two different periods totalling around 13 months (January-June 2000 and January-July 2001). During the field research, I carried out extensive research in newspaper archives in the library of the National Assembly and Yonsei University, a comprehensive search for papers from Korean journals, and publications from Korean think tanks (in particular the Korean Development Institute and Korea Institute of Finance) and conducted fourteen interviews. Several problems were encountered in the research process.**

**I originally planned to follow Merilee Grindle and John W. Thomas with regard to establishing an interview schedule of relevant policy elites: heads of state, bureaucrats, legislators, societal interests, business interests, religious elites, military, organised labour and media.<sup>90</sup> However, a detailed examination of how a decision was designed, negotiated and implemented in Korea poses significant challenges due to the relatively closed, informal and secretive elite-centred decision-making process.<sup>91</sup> Hence, the identification of whom to interview became an issue from the beginning. In order to identify who should be interviewed, I engaged in an extensive cross reading of newspaper archives, other secondary data (academic papers, articles in Korean journals and reports by think tanks and leading Korean policymakers) which described or even briefly mentioned the two particular case studies under examination, and resorted to informal conversations with Korean academics and bureaucrats. Through this method, I traced the sequence in which events emerged and developed, identifying, when possible, those involved in the policy process. The review covered the 1970s for the first case study and 1982 to 1993 for the second case study.**

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<sup>90</sup>Grindle and Thomas, *Public Choices and Policy Change*, p.63.

<sup>91</sup>Tu-jen Cheng and Brantly Womack, 'General Reflections on Informal Politics in East Asia'; *Asian Survey*, 34 (1996), 320-337, p.327. See also Grindle and Thomas, *Public Choices and Policy Change*, p. 63.

**A second problem that emerged was the access to the country's policy elites as well as their availability for interviews. In Korea, where human relations are strongly based on school, regional or family ties, personal contacts are usually an important means to gain access for interviews. While I succeeded in obtaining some interviews through local connections, most of them had to be pursued personally as my contacts were not always available to help me. The final list of cited interviews includes a senior journalist at one of the leading business magazines in Asia, bureaucrats in the Ministry of Finance and Economy (MOFE) and Bank of Korea (BOK), former members of the government, academics, researchers at the country's main business lobby group, the Federation for Korean Industries (FKI) and members of two of the country's most prestigious non-governmental organisations, the Citizen's Coalition for Economic Justice (CCEJ) and People's Solidarity for Participatory Democracy (PSDP).**

**Elite interviewing is usually aimed not at the compilation of pre-determined data but at the collection of information to assist the interviewer in his/her efforts to reconstruct some episodes or distinguish a pattern of specific behaviours.<sup>92</sup> This methodological approach can be regarded as a great opportunity to learn from the respondents' experiences and to obtain unexpected and valuable information that otherwise would not be accessible in written documents or reports and that can actually offer new ways to disentangle the particularities of the object of study. Thus, in this thesis, interviews were essentially unstructured though underpinning them all was a common line, i.e., the search for answers regarding the role played by Korean leaders in the country's policy process and to understand policy choices leading to reform in general and specifically during two historical periods under examination, 1961-1979 and 1993-1997. As Paul Thompson points out, 'in the broadest sense, all testimonies normally carry within them a triple potential: to explore and**

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<sup>92</sup>Jarol B. Manheim and Richard C. Rich, *Empirical Political Analysis: Research Methods in Political Science* (New York: Longman Publishers, 1995), p.162.

**develop new interpretations, to establish or confirm an interpretation of past patterns of change, and to express what it felt like.<sup>93</sup> The interviews were recorded and later fully transcribed and citations made as faithfully as possible to ensure both the character and the meaning of the original.**

**Elite interviewing, nonetheless, entails some risky scientific issues. By employing as sources those who were or are deeply engaged in the policy process, elite interviewing can mould the researcher's view of the process itself. According to Jarol Manheim and Richard Rich, there are four main risks in terms of reliability involved in elite interviewing, as the respondents may: (1) have a limited view of the events under analysis which leads them not to recognize which aspects are important to explain the events; (2) have imprecise information on the events (either because of misperception of the episodes or because they have forgotten important details); (3) have convinced themselves that their perception of things was the 'valid one' when in fact it was not; (4) have deliberately lie in order to protect themselves or others.<sup>94</sup> As with any other source, the transcripts of the interview needed to be tested to search for internal consistency, cross-checked to compare details with other sources, and evaluated by placing the evidence in a wider context.<sup>95</sup>**

**Interviews for this thesis lasted between one to two hours each and served to provide relevant information, regarded not as factual data but simply as data, on the workings of the policy process pertaining to the two case studies under examination. Data gathered during the interviews was cross-checked by comparing it with other sources, including materials collected during the archival research. Most of the interviews were conducted in English, with the exception of the ones involving members of non-governmental organisations. Though I undertook a six-month language course in Korea, I found my language skills insufficient to conduct these interviews on my own and therefore had the assistance of an interpreter, a**

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<sup>93</sup>Paul Thompson, *The Voice of the Past: Oral History* (Oxford: Oxford University Press, 2000), p.265.

<sup>94</sup>Manheim and Rich, *Empirical Political Analysis*, pp.162-3.

<sup>95</sup>Thompson, *The Voice of the Past*, p.153.

**master student at Yonsei University in Seoul and with previous experience as an interpreter. Additionally, the interpreter also assisted me in the research and translation of some Korean-language newspaper articles, related to the two case studies under examination.**

**The developmental state literature tends to analyse Korean economic growth and development by looking at a static, excessively abstract and too often aggregated state under the rule of bureaucrats, instead of those who *de facto* control and direct the activities of state agencies, i.e., the political leadership. Furthermore, research on the Korean developmental state does not tell us much about how public policy problems first become defined and solutions developed by the country's political leadership within the national policy agenda. In this sense, this thesis seeks to examine how the perceptions, motivations, incentives and preferences of Korean leaders interacting with particular institutional constraints and opportunities, history, context, ideas, and coalition politics led to the creation, sustainability and transformation of the system of “socialisation of private risk.”**

**Drawing from a polished version of historical institutionalism its theoretical underpinnings and supporting its arguments through an empirical examination of two case studies based on primary and secondary data, this thesis offers a re-interpretation of the Korean developmental state that emphasises the crucial role of Korean leadership in the policy process. Additionally, and, in comparison with previous studies on Korean development, the thesis offers a ‘thicker’ analytical narrative of processes of institutional change in Korea. Finally, and concerning the text, I have decided not to present tabular data since the data I employ in my argument is easily available in published form. Instead I refer to this data in the text and cite the sources.**

#### **1.4.4 Organisation**

**The thesis is composed of seven chapters. This chapter has set out the thesis project, the research focus, the general background, and the theoretical and methodological considerations. Chapter Two analyses the limitations of the existent literature on the developmental state by reassessing what is at the core of the Korean developmental state, the system of socialisation of private risk and its political and economic foundations: strong state, industrial policy and financial control. I re-evaluate the three-level causation the developmental state literature claims to be behind Korea's economic performance. The developmental state literature aims to explain successful economic performance. In doing so, this literature tends to reify the role played by a strong and efficient bureaucratic state in producing this outcome. I propose, however, that any attempt to understand economic performance in Korea needs necessarily to go beyond a rigid conceptualisation of a strong and efficient bureaucratic state and instead start accounting for the multiple and interactive levels within the state and between this complex state and society and how their exchanges influence policy choices and implementation. This facilitates opening the Korean developmental state "black box" and revealing the logic behind the state's decision-making process. I suggest that the strength of the Korean state to choose, implement, and enforce public policy should not be seen as statically persisting over time and space. Instead the strength of the state is subjected to variation and this depends essentially on the role played by Korean Presidents and how they filtered their policy options in terms of institutions, history, context, ideas and coalition politics.**

**Chapters Three and Four investigate the formation and consolidation of the system of socialisation of private risk during the presidency of Park Chung Hee (1961-1979). Chapter Three analyses the role of President Park in selecting and favouring this system and how his choices were mediated by historical circumstances, institutional legacies, the domestic**

**political situation, the country's economic conditions, international pressures, and ideologies. Chapter Four examines in detail a particular instance of policy reform, the heavy and chemical industrialisation in the 1970s, as a way to explain why and how President Park behaved strategically to protect the system and with what political and economic consequences.**

**Chapters Five and Six explore the efforts to transform the rules of the game embodied in the system of socialisation of private risk that have been undertaken since the early 1990s. Chapter Five analyses the role of President Kim Young Sam (1993-1997) and his government in their attempts to change the workings of the system right before the IMF crisis. In doing so, I investigate why and how such choices were pursued and implemented, and under what particular institutional, international and domestic environment. Chapter Six investigates in-depth a specific policy reform, the real name financial transaction system in 1993, to understand why and how President Kim strategically acted to alter an important feature of the system of socialisation of private risk and with what political and economic outcomes.**

**Chapter Seven first makes a comparative assessment of presidential policy choices during the two periods, 1961-1979 and 1993-1997, and then, drawing from the different policy outcomes derived from the case studies presents conclusions on the politics of policy choices in Korea. I end with suggestions for further research.**

## **2. CHAPTER TWO - Beyond the Limitations of the Developmental State Literature: The Korean Case**

### **2.1 Introduction**

**The literature on Korean development patterns offers compelling evidence of the interventionist role played by the state in fostering rapid and economic growth since the 1960s. Behind this economic success, it argues, rests a strong developmental state, usually equated with bureaucracy, which defines and pursues efficient economic policies reflecting national interests. Yet, the process of decision-making within the Korean developmental state has largely remained a “black box”. While the literature concentrates on how the state has intervened in the organisation of the market, and how the country’s successful economic performance is correlated with this state intervention, it does not say much about the political dynamics affecting the decision-making process, i.e., how policies are discussed, agreed, implemented, assessed and enforced. This chapter first summarises the economic and political foundations of the system of “socialisation of private risk”: strong state, industrial policy and financial control. This system is usually regarded to be at the core of the East Asian developmental state. I then reassess the three-level causation the developmental state literature claims to be behind the Korea’s economic performance. Predominantly, developmental state literature concerned with finding explanations for successful economic performance, tends to reify the role played by what it considers to be a strong and efficient bureaucratic state.**

**I propose that any attempt to more clearly comprehend economic performance in Korea has to temper this tendency to emphasise the image of a strong and efficient state. Instead, it needs to acknowledge the existence of dynamic exchanges between multiple and interactive levels within the state and between this complex state and the society. Additionally, it should recognise how these exchanges have an effect on**

**policy choices, policy implementation and economic performance. I then suggest an alternative interpretation of the Korean developmental state in which the strength of the state to choose, implement, and enforce public policy should not be seen as statically persisting over time and space. Conversely, it is subjected to variation. This variation depends essentially on the role played by Korean Presidents and how they filtered their policy options in terms of institutions, history, context, ideas and coalition politics.**

## **2.2 Explaining the East Asian Developmental State and Economic Success**

### **2.2.1 Industrial Policy and Financial Control**

**In the past forty years, the fast growing economies of East Asia have led to a rethink of the genesis of development. In a time when development theory and policy were dominated by the idea of a 'minimal state' as the best solution for economic growth, the East Asian high economic performance offered new insights into the role played by the state in the process of national development. Several scholars sought to explain the successful economic performance of East Asia by looking at the interventionist and leading role played by the state.<sup>96</sup> Analysing the Japanese case, Chalmers Johnson introduced the concept of the 'developmental capitalist state' as one which seeks economic development through high rates of growth, productivity and competitiveness. Six main policy features are regarded as crucial to explain the performance of the East Asian developmental states: (1) redistributive land reform; (2) state-controlled financial system; (3) macroeconomic stability to nurture long-term investment; (4) industrial policy that favoured simultaneously import substitution and export production; (5) protection and investment in the agricultural sector as well as improvement of rural livelihoods; (6) and income policies that**

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<sup>96</sup>See for example, Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford: Stanford University Press, 1982), Amsden, *Asia Next Giant*, Wade, *Governing the Market*, Önis, 'The Logic of the Developmentalist State', and Woo, *Race to the Swift*.

produced a more equitable income distribution and higher living standards.<sup>97</sup>

**As a whole, all these policies are correlated with the East Asian successful economic performance. However, industrial policy and financial control, in particular, stand at the core of the East Asian developmental states' peculiar way of organising the market. According to developmental state literature, the economic performance of East Asia is strongly associated with a series of key mechanisms devised by the interventionist state to organise the financial system and define the blueprint for industrial development.<sup>98</sup> These key features make up what is known as the system of socialisation of private risk:**

- (1) In a closely regulated bank-based system as in Korea or Taiwan, enterprises were inclined to make better investment decisions, because they were offered the opportunity to develop long-term strategies. As this relationship strengthened over time, and as long as firms' investments followed long-term plans, loans were rolled over even if the returns were not as immediate as thought;**
- (2) The bank-based system allowed for a faster allocation of capital to strategic industrial sectors and granted the state the capacity to control the financial flows;**
- (3) Close relations between banks and firms improved collection and the processing of information, allowed the monitoring of management performance, and eased restructuring of firms undergoing difficulties; and**

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<sup>97</sup>Putzel, 'Developmental States and Crony Capitalists', pp.163-8.

<sup>98</sup>Wade, *Governing the Market*, pp.364-8.

(4) **Control over the financial system offered the state the political leverage to build up the coalitions necessary to implement the industrial and development strategies. In this sense, the public-private co-operation usually present in East Asia was far from being an outcome of voluntary compliance by the business groups as they were discouraged from opposing the state under threat of possible loss of access to credit.<sup>99</sup>**

**Additionally, this literature claims that this cooperative system between state, banks and firms succeeded because it obeyed certain 'imperatives':**

(1) **The state sustained the risks involved in the investments. This socialised risk took the form of: deposit insurance, lender-of-last-resort, subsidies to banks dangerously exposed to loan losses and firms in financial difficulties, banks' shareholding in firms, or state-owned banks;**

(2) **The creditor was involved in the firm management, and did not pull out when the company was under distress showing instead commitment with the restructuring of its management;**

(3) **The state and the banks were able to distinguish between 'responsible' and 'irresponsible' borrowings, and disciplined the latter. This capacity allowed the state to avoid bailing out firms and moral hazard. Simultaneously, the government was also careful to monitor the activities of the financial intermediaries to impede them, for example, from hiding non-performing loans (NPLs);**

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<sup>99</sup>Wade, *Governing the Market*, pp.364-5.

- (4) **The existence of a 'central guiding agency' was crucial to complement market signals with its own signals as to which sectors will be most profitable;**
- (5) **Finally, the state regulated international capital flows which granted it the capacity to control money supply and the cost of capital to domestic firms as well as to set and manage the development of strategic industrial sectors.<sup>100</sup>**

## **2.2.2 The Strong Bureaucratic State and the System of Socialisation of Private Risk**

**Underneath the East Asian system of socialisation of private risk** are 'hard states', i.e., states that are 'able not only to resist private demands but actively to shape the economy and society.'<sup>101</sup> A competent bureaucracy usually led by a pilot agency in charge of formulating and implementing economic policies is the leading actor in the process of economic change and development. It is this bureaucracy that in fact 'guided' the market, and implemented the consistent, coherent, and rational system of socialisation of private risk. As Robert Wade puts it, 'in this kind of political regime, the bureaucracy can more easily demonstrate competence and remain 'clean', because it is neither caught between and penetrated by struggling interest groups nor subverted from above by the politics of rulers' survival.'<sup>102</sup>

**In tandem, ongoing organisational and institutional linkages between the government and the private sector eased the stream of information exchange, facilitated co-operation, policy coordination, implementation and goal consensus.<sup>103</sup> Thus, the developmental state is**

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<sup>100</sup>Wade, *Governing the Market*, pp.366-8.

<sup>101</sup>Wade, *Governing the Market*, p.337.

<sup>102</sup>Wade, *Governing the Market*, p.339.

<sup>103</sup>Daniel Okimoto, *Between MITI and the Market: Japanese Industrial Policy for High Technology* (Stanford: Stanford University Press, 1989), p.226. For another example of relationships between state and the private

**basically one where the autonomy of the bureaucracy is complemented by an unusual degree of private-public co-operation.<sup>104</sup> The difference between East Asia and other late industrialising economies did not rest in the invention of industrial policy and financial control mechanisms as 'many other nations have at one time or another tried most of the policy tools used in East Asia.'<sup>105</sup> For Alice Amsden, what distinguished East Asia was the willingness of these bureaucratic states to behave as 'disciplinarian agents, imposing performance standards while allocating subsidies for industrial development.'<sup>106</sup>**

### **2.3 Three-Level Causation and The Korean Economic Performance**

**According to developmental state literature, the Korean successful economic performance during more than three decades starting in the 1960s is essentially the product of a three-level causation process.<sup>107</sup> At the first level of causation, economic performance was the outcome of high levels of productive investment, strategic allocation of financial resources in key industries, and selective exposure of domestic industries to international competition.**

**At a second level of causation, these proximate causes, as put by Robert Wade, were themselves the policy outcomes of a system of socialisation of private risk combining industrial policy and financial control that empowered the state with the capacity to stimulate, guide and control industrial production and investment, as well to discipline the private sector whenever it failed to comply with performance standards.**

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sector as an ongoing negotiation or strategic co-operation, see Richard Samuels, *The Business of the Japanese State* (Ithaca: Cornell University Press, 1987).

<sup>104</sup> For an overview of the developmental state, see Önis, 'The Logic of the Developmentalist State'. For Robert Wade, however, while Taiwan fits the developmental state's image of bureaucratic autonomy, the same cannot be said in terms of public-private cooperation. See Wade, *Governing the Market*, p.256. For a comparative analysis of the bureaucracy and the relations between government and business in Taiwan and Korea, see Tu-jen Cheng, Stephan Haggard and David Kang, *Institutions, Economic Policy and Growth in the Republic of Korea and Taiwan Province of China* (Geneva: United Nations Conference on Trade and Development, 1996).

<sup>105</sup> Wade, *Governing the Market*, p.343.

<sup>106</sup> Alice Amsden, 'A Theory of Government Intervention in Late Industrialization', in Louis Putterman and Dietrich Rueschemeyer, eds, *State and Market in Development: Synergy or Rivalry?* (Boulder: Lynne Rienner Publishers, 1992), pp.53-84, p.61.

<sup>107</sup> Wade, *Governing the Market*, pp.26-9.

**Hence, the Korean state actively intervened in the market to pick the strategic industries to be developed, guided the use of investment resources, and regulated investment rates through its control of the country's financial resources. Additionally, the state selectively distributed business licences (i.e., determining who could enter certain sectors of the economy) and regulated monopolistic and unfair trade practices. It also controlled prices and wages (which involved the repression of labour unions), supported private business with tax benefits, financial incentives and market information, and sustained an efficient taxation.<sup>108</sup>**

**Finally, at the third level of causation, the system was maintained and enforced by a 'hard' bureaucratic state. The Korean state has been regarded as an 'essentially' Weberian state, i.e., a state with the autonomy and capacity to formulate and implement economic choices free from the influence of private interests. Two crucial features are the basis of the East Asian developmental states: bureaucratic autonomy and public-private co-operation. It is 'the coexistence of these two conditions that allows the state and the bureaucratic elites to develop independent national goals and, in the subsequent state, to translate these broad national goals into effective policy action. The coexistence of these two conditions is critical.'**<sup>109</sup>

**The state in Korea is usually equated with a strong and autonomous bureaucracy seen as a product of Confucian heritage and Japanese colonialism.<sup>110</sup> The recruitment of bureaucrats developed along a meritocratic line, and the highly competitive entrance examination tended to attract the best national students. Among bureaucrats there was a**

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<sup>108</sup> Jung Ku-Hyun, 'Business-Government Relations in the Growth of Korean Business Groups'; *Korean Social Science Journal*, 14 (1988), 67-82, pp.68-9. See Amsden, *Asia Next Giant*, pp.16-8.

<sup>109</sup> Önis, 'The Logic of the Developmentalist State', p.114.

<sup>110</sup> Meredith Woo-Cumings, 'The Korean Bureaucratic State; Historical Legacies and Comparative Perspectives', in James Cotton, ed, *Politics and Policy in the New Korean State: From Roh Tae-woo and Kim Young-sam* (Melbourne: Longman Australia Pty Ltd, 1995), pp.141-169. See also Atul Kohli, 'Where Do High Growth Political Economies Come From? The Japanese Lineage of Korea's Developmental State'; *World Development*, 22 (1994), 1269-1293.

**tendency to generate a sense of unity and common identity offering the image of a corporate actor that delivered coherent, consistent and rational policies aimed at achieving long-term national development goals. This, however, was only possible as long as the bureaucracy was insulated from pressures by any interest groups or distributional coalitions.<sup>111</sup> Consequently, the Korean developmental state has been described as a state where 'bureaucrats rule while politicians reign'.<sup>112</sup> The other major feature of the Korean developmental state lies in the type of relationship built between the state and business sector. State and businesses have developed cooperative ties bounded by the system of socialisation of private risk.**

**Two concepts were introduced to describe the nature of state-business relations in Korea within this system: the 'quasi-internal organisation' and 'embedded autonomy'. Chung-Hee Lee proposes that the government and large private enterprises in South Korea should be considered as a 'quasi-internal organisation'.<sup>113</sup> Under the control of the Korean state, the country's financial system functioned as an internal capital market by providing credit to selected business groups. In Korea, where the government was committed to fast economic development via export growth, export targets became closely tied to the allocation of subsidised credit. Lee argues that the 'quasi-internal organisation' contributed to economic development in South Korea because it helped solve market imperfections through 'extended bounded rationality, reduced opportunism and uncertainty, reduced small-number indeterminacies, better information and a group-oriented atmosphere.'**

**Peter Evans, on the other hand, suggests the concept of 'embedded**

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<sup>111</sup>Peter Evans, *Embedded Autonomy. States & Industrial Transformation* (Princeton: Princeton University Press, 1995), p.30.

<sup>112</sup>Onis, 'The Logic of the Developmentalist State', p.115. This interpretation of the relationship between bureaucrats and politicians in the developmental state first emerged in the work carried by Chalmers Johnson on Japan's Ministry of International Trade and Industry (MITI) in 1982 and later extended to the cases of Korea and Taiwan. For the latter cases, see Chalmers Johnson, 'Political institutions and economic performance: the government-business relationship in Japan, South Korea, and Taiwan', in Frederic C. Deyo, ed, *The Political Economy of the New Asian Industrialism* (Ithaca: Cornell University Press, 1987), pp.136-164.

<sup>113</sup>Chung-Hee Lee, 'The Government, Financial System, and Large Private Enterprises in the Economic Development of South Korea'; *World Development*, 20 (1992), 187-197.

autonomy' to describe relations between government officials and business actors, and to explain the high economic performance in Korea.<sup>114</sup> For Evans, state officials in Korea were well organised in a coherent structure as they aimed at pursuing collective goals, with the state playing the role of 'midwife'.<sup>115</sup> By this he means that the state, connected with the business community, helped the growth of entrepreneurial groups and induced existing ones to take on new and challenging industrial ventures by reducing the risk and uncertainty of such endeavours. For connectedness to take the path of growth-oriented projects, however, state officials should remain autonomous in the process of policy formulation.

Interestingly, in the aftermath of the Korean financial crisis in 1997, the synergetic and closed ties between the state and business groups that were once regarded as an important feature accounting for the successful economic performance of Korea, soon were identified as 'crony capitalism' and accused to be the cause of the crisis. Yet, as Mushtaq Khan points out, rent-seeking has not only been a pervasive feature of the Korean political economy, but it has also been associated with productive investments and high economic growth.<sup>116</sup> Khan claims that rent-seeking generates not only value-reducing rents but also value-enhancing rents. In his analysis, patron-client networks and the distribution of power within them are the crucial independent variable determining whether or not rent-seeking generate value-enhancing rents. Khan argues that in the case of Korea, it was the presence of a strong state vis-à-vis a weak society that bolstered the creation and maintenance of value-enhancing rents. A careful examination of this strong state perspective, however, reveals some significant drawbacks in its interpretation of the causes behind the successful Korean economic performance.

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<sup>114</sup> Evans, 'State Structures, Government-Business Relations, and Economic Transformation', p.78.

<sup>115</sup> Evans, *Embedded Autonomy*, pp.78-81.

<sup>116</sup> Khan, 'Rents, Efficiency and Growth, and Rent-Seeking as Process'.

## **2.4 Reassessing the Korean Economic Performance: A Critique of the Three-Level Causation**

### **2.4.1 Challenging the First-Level Causation**

**At the first-level causation, high levels of productive investment, allocation of resources to strategic industries and exposure of domestic industries to international competition seemed to have played an important role in the country's industrialisation. However, it is difficult to say to what degree calculated government intervention is sufficient to explain Korean economic performance in isolation from, or without relating it, to a particular context at the time. Contingent events, which are beyond the control of the state, such as unanticipated international political and economic circumstances and which might have a significant impact over a country's pattern of economic performance need to be taken seriously.<sup>117</sup> The economic impact of the Vietnam War in the 1960s and the Middle East oil boom in the 1970s are two significant cases of how unexpected 'contingencies of history' should be taken into consideration for a better understanding of the Korean economic performance during the leadership of Park Chung Hee (1961-1979).**

**From 1965 to March 1973, over 300,000 South Korean soldiers fought in Vietnam, to make it the largest U.S. allied military contingent after the South Vietnamese.<sup>118</sup> South Korea's involvement in the Vietnam War was seen as a move by President Park Chung Hee not only to guarantee the maintenance of the US military presence in the Korean peninsula in face of the continuing threat by North Korea, but also to keep US support for his regime and to win financial support and economic**

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<sup>117</sup> Moon and Prasad, 'Beyond the Developmental State', p.370.

<sup>118</sup> On the impact of the Vietnam War on Korea, see Seiji Naya, 'The Vietnam War and Some Aspects of Its Economic Impact on Asian Countries'; *The Developing Economies*, 9 (1971), 31-57, Sungjoo Han, 'South Korea's Participation in The Vietnam Conflict: An Analysis of the U.S.-Korean Alliance'; *Orbis*, 21 (1978), 893-912, Woo, *Race to the Swift*, pp.93-7, and John Lie, *Han Unbound: The Political Economy of South Korea* (Stanford, CA: Stanford University Press, 1998), pp.62-7.

**benefits.<sup>119</sup> Park Chung Hee, as well as other Korean officials and businessmen, seemed to have been conscious of the impact the Korean War had had on the revival of the Japanese economy in the early 1950s. This consciousness seems to have led the Korean elite to draw a parallel conclusion that the Vietnam War would be an opportunity for the Korean economy. The income generated by Korea from what was known as the Vietnam War boom totalled over one billion US dollars between 1965 and 1972.<sup>120</sup> As Sungjoo Han argues, ‘the Vietnam earnings became available during a critical stage in Korea’s economic development, when large amounts of international liquidity were needed for the rapid expansion of export industries.<sup>121</sup>**

**South Korean business groups working in Vietnam generated a total income estimated at 233 million US dollars from 1966 to 1972.<sup>122</sup> The conflict represented the first opportunity for an international venture for some of the country’s major business groups.<sup>123</sup> Hyundai won its first international contracts from the US government for projects in Southeast Asia, and Hanjin, that a few years later would purchase the country’s major airline KAL, signed a 7.9 million US dollars contract to supply transportation to the U.S. Air Force. The war-related income was particularly important in terms of remittances from Koreans, both military and civilian workers, stationed in Vietnam.<sup>124</sup> But the impact of the war**

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<sup>119</sup> For the opinions emerging in Korea concerning the potential political and economic benefits related to an involvement in the Vietnam War, see Lie, *Han Unbound*, p.63. See also Han, ‘South Korea’s Participation in the Vietnam Conflict’, p.894. He argues that Korea became first involved in the conflict to prevent the withdrawal or weakening of the U.S. security commitments with the country.

<sup>120</sup> Lie, *Han Unbound*, p.64.

<sup>121</sup> Han, ‘South Korea’s Participation in the Vietnam Conflict’, p.898.

<sup>122</sup> Lie, *Han Unbound*, p.64.

<sup>123</sup> Woo, *Race to the Swift*, pp.96-7. See Seok Ki Kim, *Business Concentration and Government Policy: A Study of the Phenomenon of Business Groups in Korea, 1945-1985*, Doctoral dissertation, Harvard University, 1987, p.131.

<sup>124</sup> David Cole and Princeton N. Lyman, *Korean Development: The Interplay of Politics and Economics* (Cambridge, MA: Harvard University Press, 1971), p.135. See also Lie, *Han Unbound*, p.64. As he puts it: ‘Remittances of South Korean soldiers, technicians, and workers not only benefited individuals but the government as well. The revenue generated during the Vietnam War in large part financed the construction of the main South Korean artery, the Kyongbu Highway connecting Seoul and Pusan, which was built between 1968 and 1970.’ The importance of these revenues for the building of this major highway should not be underestimated. For Chung-yum Kim, Chief of Staff of President Park during the 1970s, the construction of the expressways was crucial for Korean economic development. It increased the incomes of farmers by allowing the cultivation of vegetables and fruits in greenhouses along the expressways that could easily reach major cities in one day year round. At the same time, it helped the emergence of industrial parks that benefited from lower production costs as a result of lower wages in the countryside and reduced transportation time and costs. For the

**went further, as it corresponded to a turning point in terms of industrial patterns as Korea began to ship to Vietnam new industrial products such as steel, transportation equipment and non-electric equipment.<sup>125</sup>As Jung-en Woo points out:**

**The Vietnam War was not only a cornucopia of huge invisible earnings and immense U.S assistance, but an incubator of new industries before testing the fires of international competition. The phenomenon whereby a foreign market is turned into a laboratory for infant industries is, in other words, often political and, therefore, foreign to the assumptions underlying neoclassical trade theories. Nonetheless, it is one of the ways in which a mercantilist state engineers a movement upward in the industrial product cycle.<sup>126</sup>**

**The Middle East oil boom in the 1970s is another relevant 'contingency of history' that tends to be overlooked in terms of its impact on the performance of the Korean economy.<sup>127</sup>Benefiting from increasing oil revenues in the aftermath of the first oil crisis in 1973, from 1974 Middle East countries pursued major construction projects as part of their development plans. Pushed by President Pak Chung Hee who seemed to be worried with the rapidly growing account deficits derived from the high cost of oil imports, Korean construction companies began to look for new business opportunities in the Middle East with the help of the government.<sup>128</sup>As it had earlier happened with the Vietnam War, the**

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process leading to the construction of the country's network of expressways, see Chung-yum Kim, *Policymaking on the Front Lines: Memoirs of a Korean Practitioner, 1945-1979*, EDI Retrospectives in Policymaking (Washington: The World Bank, 1994), pp.103-114.

<sup>125</sup>Naya, 'The Vietnam War and Some Aspects of Its Economic Impact on Asian Countries', p.47. As Naya puts it: 'The Vietnam conflict has provided Taiwan and Korea a greater learning effect in producing and exporting new industrial products than would have occurred under normal conditions.'

<sup>126</sup>Woo, *Race to the Swift*, p.97.

<sup>127</sup>For economic relations between South Korea and the Middle East during the 1970s, see Nigel Disney, 'Korea and the Middle East', in Gavan McCormack and Mark Selden, eds, *Korea North and South: The Deepening Crisis* (New York: Monthly Review Press, 1978), pp.199- 206, and Jae Kyu Park, 'Korea and the Third World', in Youngnok Koo and Sung-joo Han, eds, *The Foreign Policy of the Republic of Korea* (New York: Columbia University Press, 1985), pp.219-261. For government policies to support construction firms in the Middle East, see Chung Hoon Lee, 'Promotion Measures for Construction Service Exports to the Middle East (1975)', in Lee-Jay Cho and Yoon Hyung Kim, eds, *Economic Development in the Republic of Korea: A Policy Perspective* (Honolulu: University of Hawaii Press, 1991), pp.527-549.

<sup>128</sup>Lee, 'Promotion Measures for Construction Service Exports to the Middle East (1975)', p.539. The South Korean government played an active role in promoting business expansion into the Middle East. For example,

**impact on the Korean economy was particularly significant. As Nam Duck Woo, Deputy Prime Minister and Minister of Economic Planning at the time, puts it:**

**The construction activities in the Middle East had far reaching effects on the Korean economy. In addition to improving Korea's balance of payments with the region, they provided opportunities for Korean engineers and workers to learn new skills and gain expertise in large project management in a foreign environment. Through this experience Koreans acquired new comparative advantage in development projects in the Third World.<sup>129</sup>**

**The importance of the construction activities in the Middle East for the Korean economy in the 1970s can be seen by looking at their share and value in the country's total merchandise exports.<sup>130</sup> Between 1965 and 1973, the value of merchandise exports was approximately 8.6 billion US dollars with the construction service exports to the Middle East reaching a mere 24 million US dollars, or 0.3 percent of the total value of merchandise exports. But over the next eight-year period, from 1974 to 1981, the value of construction service exports to the Middle East became one of the major components of Korea's external trade, as it grew to represent 44 percent of the value of merchandise exports, or 41 billion US dollars of a total of 94 billion US dollars. At the same time, from 1977 to 1979, approximately 292,000 Korean workers went to the Middle East, or around 27 percent of the country's male manufacturing work force.<sup>131</sup> The remittance of their wages as well as of business profits, in conjunction with exports of machinery, equipment, and materials related**

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the Korea Trade Promotion Corporation set in 1962 to help promoting the country's exports, had opened eight centres in the Middle East during the 1970s, and in 1975, President Park Chung Hee founded the Korea Foundation for Middle East Studies (KFMES) aimed at advising firms on trade opportunities in the Middle East. See Disney, 'Korea and the Middle East', p.202.

<sup>129</sup>Nam Duck Woo, *Korea's Economic Growth in a Changing World* (Seoul: Samsung Economic Research Institute, 1997), p.106.

<sup>130</sup>Lee, 'Promotion Measures for Construction Service Exports to the Middle East (1975)', pp.527-58.

<sup>131</sup>Amsden, *Asia Next Giant*, p.100.

**to the construction activities provided the country with much needed foreign exchange earnings.<sup>132</sup>**

**What these two ‘contingencies of history’ tell us is that they had a significant impact on the performance of the Korean economy in the 1960s and 1970s and had they not occurred the country’s pattern of development might have had a different outcome. These two events, however, should not be seen as sufficient to explain the performance pattern of the Korean economy, as the economic and political benefits related to them cannot be dissociated from the government initiative to intervene and take advantage of the international economic context. In both cases, the leadership of Park Chung Hee played the necessary role of managing the system of socialisation of private risk to swiftly intervene and maximise the opportunities and the potential windfalls presented by these two events. This was done by offering financial incentives, administrative guidance and risk insurance to Korean firms willing to get involved in business projects related to the Vietnam War and the Middle East construction boom.**

#### **2.4.2 Challenging the Second-Level Causation**

**At the second-level causation, the developmental state literature argues that high levels of productive investment, strategic allocation of financial resources in key industries, and selective exposure of domestic industries to international competition are the policy outcomes of a system of socialisation of private risk. This system empowers the state vis-à-vis the private sector with the capacity to guide levels of industrial production and investment through its control of financial flows. Policy choices are expected to obey principles of economic rationality, including disciplinarian measures against those in the private sector that fail to achieve the targets set by the state-designed development plans. An**

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<sup>132</sup>Lee, ‘Promotion Measures for Construction Service Exports to the Middle East (1975)’, p.527 and Lie, *Han Unbound*, p.88. See also Disney, ‘Korea and the Middle East’, p.201. The increase in foreign exchange earnings in turn increased the domestic money supply, which, along with the increase in national income had important consequences for the economy that will be discussed in Chapter Five. See Amsden, *Asia Next Giant*, pp.100-1.

**assessment of the system of socialisation of private risk, however, shows a more complex picture.**

**First, the strong state literature claims that the system of socialisation of private risk has been protected from the influence of interest pressures. This literature posits that it was the depoliticisation of this system and its respect for principles of economic rationality, even within a scenario of customary rent-seeking that strongly contributed to Korean economic performance.<sup>133</sup> Yet, policies are rarely undertaken only to realise an economic rationale as they are usually attempts to 'politicise' the market. As Chung-in Moon and Rashemi Prasad point out, 'regardless of regime type, economic policies are destined to be politicised. Depoliticisation of the economy is equivalent to the neoclassical assumption of perfect market.'<sup>134</sup> For instance, the Korean's government decision to pursue heavy and chemical industrialisation in the 1970s was expected not only to move the country's industrial production to high-valued products (economic rationale), but also to address the country's growing security concerns by building an indigenous defence industry (security rationale) and necessary to bestow legitimacy on the new *Yushin* regime and guarantee the political survival of President Park Chung Hee (political rationale).<sup>135</sup> Economic concerns seem to have been only one of the several variables influencing the policy process.**

**The same politicised policymaking pattern surfaced in the 1980s during the military and authoritarian regime of Chun Doo Hwan (1980-1987) with the implementation of the Industrial Rationalisation Program.<sup>136</sup> This program was formally aimed at building a more efficient allocation of state-controlled credit. It involved the re-organisation of six**

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<sup>133</sup>Khan, 'Rent-Seeking as Process', p.128. As Khan puts it: 'The less important economic rationality is for state officials, the less likely it is that value-maximizing rights and rents will be created by autonomously acting states.'

<sup>134</sup>Moon and Prasad, 'Beyond the Developmental State', p.368.

<sup>135</sup>See Chapter Four.

<sup>136</sup>Moon, 'Changing Patters of Business-Government Relations in South Korea', pp.147-8.

**problematic industries, especially power-generating equipment and automobiles, with serious surplus capacity stemming from excessive investment and poor planning and co-ordination. The policy favoured mergers between whole business lines, the delegation of particular products to specific firms and the attraction of foreign investment.<sup>137</sup> Here, the government faced a dilemma. The rescue of ailing industries and insolvent firms could imply not only very high costs, but also the surrender of the government's recent adoption of market values, but forsaking them could on the other hand generate economic chaos and subsequently political distress. The solution found was to persuade healthier firms to take over the troubled firms by offering them highly generous financial benefits, such as concessional loans at low interest rates and payable over 5-30 years, or money to offset the estimated loss from the acquisition of the insolvent firms.**

**Between 1985 and 1988, some 78 firms were restructured under this program.<sup>138</sup> Paradoxically, and given the fact that the reform was to move towards a more market-oriented approach, the government sought the restructuring through discretionary industry-specific and firm-specific state intervention. In fact, there were no guidelines concerning the identification of industries eligible for government-initiated restructuring.<sup>139</sup> Politics again seemed to have dominated the economic agenda of the Korean government. As James Schopf argues, the executive led by Chun Doo Hwan 'did not use the effective economic bureaucracy available to him simply to implement plan-rational industrial policy. Instead, Chun selected firms to receive rents and used the bureaucracy to advise these politically motivated decisions, thus foregoing maximization of efficiency and basing his decisions not on firms' economic performance so much as on the owners' political**

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<sup>137</sup>The Daewoo Heavy Industries of the Daewoo Business Group, for example, was expected to merge its Okpo Integrated Machinery Plants with the Changwon and Goonpo factories of Hyundai International in the power generating equipment and heavy construction equipment sectors. See Jong-Chang Rhee, *The State and Industry in South Korea: The limits of the authoritarian state* (London: Routledge, 1994), p.161.

<sup>138</sup>Moon, 'Changing Patterns of Business-Government Relations in South Korea', p.149.

<sup>139</sup>Sang-Woo Nam, 'Korea's Financial Reform Since The Early 1980s'; *KDI Working Paper* No.9027 (Seoul: Korea Development Institute, 1992), p.34.

**contributions and family ties.<sup>140</sup> The collapse of the Kukje conglomerate in 1985 (at the time the seventh-largest *chaebol*, or business conglomerate) is usually presented as a good case revealing the willingness of the state to punish a poorly managed business group.<sup>141</sup>**

**The president of the conglomerate, Yang Chong-mo, however, claimed that because of its support of the opposition, and his refusal to contribute to a private foundation created by Chun Doo Hwan, the government decided to cut the financial support.<sup>142</sup> The process that followed to dissolve and resell the group's 23 subsidiaries proved to be influenced by political considerations as the selected firms to acquire Kukje's assets all had close ties with the country's leadership. The main beneficiaries of the whole process were Dongkook Steel Group, Hanil Synthetic Fiber Group and the Kukdong Construction Group, a group of firms that had built strong informal ties with the leadership of the Fifth Republic through political contributions and family connections. Hanil, Kukdong and Dongkook contributed respectively eight, five, and four times more per asset than Hyundai, the largest *chaebol*, and the favours received from Chun Doo Hwan corresponded to their order and scale of contribution.**

**Additionally, the second and fourth sons of the owner of Hanil, Kim Han-Soo, married the daughters of Choi Nam-sun and Kim Bok-dong, two Korean Military Academy (KMA) presidents from the core supporting group of Chun Doo Hwan, the KMA's 11<sup>th</sup> graduating class. Furthermore, Choi Nam-sun's son-in-law, Lee Jae-woo, was a member of parliament for Chun's Democratic Justice Party (DJP), while Kim's son-in-law was Roh**

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<sup>140</sup>James C. Schopf, 'An Explanation For the End of Political Bank Robbery In the Republic of Korea'; *Asian Survey*, 41 (2001), 693-715, p.694.Under Korea's new Freedom of Information Act, Schopf had access to previously sealed documents that detailed the exchange of kickbacks under the Fifth Republic led by Chun Doo Hwan.

<sup>141</sup>Amsden, *Asia Next Giant*, p.15.

<sup>142</sup>On the collapse of Kukje Corporation, see Kim, *Big Business, Strong State*, pp.200-3. See also Mark Clifford, *Troubled Tiger: Businessmen, Bureaucrats, and Generals in South Korea* (New York: M.E.Sharpe Inc.,1998), p.222. In an interview with Mark Clifford, Kim Mahn Je, president of the Korean Development Institute during the regime of Park Chung Hee, and Minister of Finance during Chun Doo Hwan, admitted that politics were involved in bringing down Kukje.

**Tae Woo's (close associate of Chun and later Korean president from 1988 to 1992) right hand-man.<sup>143</sup> The two cases presented here show clearly that policy choices have not been depoliticised in Korea. Instead, policies have been selected to satisfy the political interests of the regime. The latter case shows clearly that the disciplinarian process has not been immune to political considerations cultivated through formal and informal ties between politicians, businessmen and the military leadership.**

**Furthermore, strong statist analyses tend to stress how the system of socialisation of private risk provided the Korean state with the capacity to push the private sector to follow strategic industrial strategies and policies. Consequently, the private sector is regarded as a passive and assenting actor that does not do more than follow state choices. An example, however, of the entrepreneurial initiative demonstrated by private firms and its impact on the industrial transformation of Korea can be traced to the early drive in the 1960s to develop export-oriented manufacturing industries.<sup>144</sup> Empirical evidence has illustrated well the crucial role played by the Korean state in the promotion of exports through financial reforms, incentive schemes and setting an administrative support system.<sup>145</sup> Yet, the initial success of Korea's export-oriented industrialisation seems to be less related with the first state-designed development plans and more with the ingenuity revealed by the Korean private sector in allying themselves with Japanese companies to seize international business opportunities.**

**Korea's first-five year development plan (1962-1966) gave scant attention to exports, in particular to manufactured exports. Youngil Lim**

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<sup>143</sup>Schopf, 'An Explanation For the End of Political Bank Robbery In the Republic of Korea',pp.707-8.

<sup>144</sup>For a study on the entrepreneurial role of Korean business groups as an important factor determining the country's economic performance, see In-Young Kim, *The Political Economy of a Chaebol's Capital Accumulation in South Korea: The Case of Samsung, 1938-1987*, Doctoral dissertation, University of Hawaii, 1996.

<sup>145</sup>Choong Yong Ahn and Joo-Hoon Kim, 'The Outward-Looking Trade Policy and the Industrial Development of South Korea', in Cha Dong-se et al, eds, *The Korean Economy 1945-1995: Performance and Vision for the 21<sup>st</sup> Century* (Seoul: Korea Development Institute, 1997), pp.339-382, pp.344-350, and Young Sae Lee and Woojin Youn, 'Export Promotion in Asia: The Korean Experience'; *KIET Occasional Paper No.29* (Seoul: Korea Institute for Industrial Economics and Trade, 1999).

points out that the plan unveiled by the government 'did not clearly envisage adopting export-led growth based on the unskilled labour-intensive manufactures,' that would later become the country's major export items.<sup>146</sup> In fact, one of the sections of the development plan that examined how to expand exports was initially deleted by members of the military junta at the time for 'they saw little hope for growth'.<sup>147</sup> The plan put into effect in January 1962 focused primarily on export of primary goods, such as pigs, rice, seaweed, fresh fish, frozen marine products, dried cuttlefish, silk yarn, iron ore, graphite, or skins and hides. For the industrial sector, the plan emphasised import-substitution industries like cement, fertilizer, industrial machinery, oil refinement, machine and heavy chemical industries. Such industrial policy was to be financed with the foreign exchange gained through the exports of primary goods.<sup>148</sup> However, by the end of the first year of implementation, the plan had failed to reach its goals and underwent major revision which included changing the target for average annual growth rate from 7.1 percent to 5 percent. The initial targets were abandoned and a new plan was devised with more modest goals.<sup>149</sup>

By the end of the (revised) first five-year development plan, 1966, the composition of actual exports was surprisingly different from what had been planned originally by the government. Textiles, clothing, plywood, wigs, footwear, and electronic components emerged as the major foreign exchange earners.<sup>150</sup> While the government expected manufactured goods to represent only 33.2 percent of the total exports in the first five-year development plan, the actual figure was 61.8 percent. Furthermore, as a result of the higher percentage of exports of manufacturing goods, the value of actual exports greatly surpassed the

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<sup>146</sup>Youngil Lim, *Government Policy and Private Enterprise: Korean Experience in Industrialization* (Berkeley: University of California Press, 1981), p.16.

<sup>147</sup>Clifford, *Troubled Tiger*, p.54. From 1961 to 1963, Korea was under a military junta until the election of Park Chung Hee as the country's President in late 1963.

<sup>148</sup>Lim, *Government Policy and Private Enterprise*, p.16.

<sup>149</sup>For an insider's description of Korea's first five-year development plan, see Nam, *Korea's Economic Growth in a Changing World*, pp.21-38.

<sup>150</sup>Lim, *Government Policy and Private Enterprise*, p.17.

**projections or targets, from an expected 137.5 million US dollars to an actual 250.3 million US dollars in 1966. The trend continued in the following five-year development plans (1967-1971 and 1972-1976) with manufactured products turning into the country's main export item and value of total exports reaching numbers well above those projected by the government: 1.06 billion US dollars in 1971 (against the targeted 550 million US dollars) and 7.71 billion US dollars in 1976 (against the planned 3.58 billion US dollars).**

**The economic outcome reveals the capacity demonstrated by private firms to take full advantage of the system of socialisation of private risk to explore the country's potentialities in building an export-oriented manufacturing sector. During the 1960s, the system offered non-discriminatory incentive schemes and financial support to any export-oriented industry, as well as a comprehensive insurance mechanism to reduce potential market risks and uncertainties.<sup>151</sup> But, if government planners failed to perceive the capacity of the country's business sector to export manufacturing goods, what then made the Korean private sector gamble on the future of the sector? At the core of the explanation seems to be an alliance developed between Korean and Japanese businessmen.<sup>152</sup> According to Vivek Chibber, the ultimate goal of this alliance was to use Korea as 'launching pad for exports into advanced capitalist market', in particular the United States: 'the Japanese brought in technology, marketing networks, and finance, while the Koreans supplied cheap labour, a market for Japanese capital goods, and a means of bypassing U.S trade restrictions against Japan.'<sup>153</sup>**

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<sup>151</sup>Ahn and Kim, 'The Outward-Looking Trade Policy and the Industrial Development of South Korea', p.347. As these authors stress: 'Unlike most developing countries, access to basic incentives in Korea in the 1960s was automatic for all production and commercial transactions related to exports.' See also Lim, *Government Policy and Private Enterprise*, pp.18-25. This non-discriminatory system would change in the 1970s when a shift in the government's development strategy involved the allocation of credit primarily to the development of heavy and chemical industries. See Chapter Four.

<sup>152</sup>For works on the importance of Japan, in particular of Japanese businessmen, as an independent variable influencing the performance of the Korean economy, see Vivek Chibber, 'Building a Developmental State: The Korean Case Reconsidered'; *Politics and Society*, 27 (1999), 309-346. See also Robert Castley, *Korea's Economic Miracle: The Crucial Role of Japan* (London: Macmillan Press Ltd, 1997), and Kim, *Big Business, Strong State*, pp.84-9.

<sup>153</sup>Chibber, 'Building a Developmental State', p.335.

**The first steps to gain government support for this alliance emerged in the early 1960s, when Yasuhei Yukawa, the director of the Japan-Korea Trade Association, and a former instructor of Park Chung Hee at the Japanese Military Academy met the Korean President. But it was the lack of normalised ties between Seoul and Tokyo that impeded further strengthening of the ties. This was an important and sensitive political issue as the Korean government feared it could trigger civil unrest due to the national animosity towards Japan following its colonial rule over the Korean peninsula during 1905-1945.**

**This political environment, however, did not stop the Federation of Korean Industries (FKI), gathering the country's major industrialists, to be among the first domestic forces to press for the establishment of diplomatic ties between the two nations.<sup>154</sup> In Japan, the advocacy was done by what was known as the 'Korea lobby' made up of members of the country's fifteen top firms as well as important politicians. The strategy involved also the provision of financial backing to the President's political party, the ruling Democratic Republican Party (DRP), from both Korean and Japanese businessmen. A CIA report from 1966 found that from 1961 to 1965 (the years between the coup d'état led by Park Chung Hee and the normalisation of diplomatic ties with Japan), Japanese firms provided two-thirds of the DRP's budget. Six Japanese firms were said to have paid a total of 66 million US dollars, with individual hand-outs estimated to have ranged between one million US dollars to 20 million US dollars.<sup>155</sup> The ratification of the treaty in mid-1965, supported by President Park but opposed by the majority of the population, opened the doors to full establishment of Korea as a base for Japanese firms engaged in exporting to the U.S.<sup>156</sup> With the structural foundations already set by Korean and Japanese businessmen in the years before 1965, the normalisation of ties put an end to the last barrier to export-led manufacturing industrialisation.**

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<sup>154</sup>Chhibber, 'Building a Developmental State', p.333.

<sup>155</sup>Woo, *Race to the Swift*, p.86.

<sup>156</sup>For the negotiating process leading to the settlement of the treaty, see Bae Ho Hahn, 'Policy Toward Japan', in Koo and Han, *The Foreign Policy of the Republic of Korea*, pp.167-197, pp.171-5.

**The normalisation of ties not only opened the opportunity for Korean and Japanese firms to work together, but also gave the country much needed foreign exchange through the payment of reparations for the colonisation of the country by Japan. The final reparation figures reached a total of US\$800 million at the time (US\$300 million in grants, US\$200 million in government loans, and the remaining in commercial credit). It was an impressive figure for a country that had exported a total of US\$200 million in 1964.<sup>157</sup> By the end of 1974, Japanese firms were responsible for 55 percent of exports by foreign firms in terms of total value. Their influence in promoting Korean exports was immense. Japanese firms dominated several important export-oriented sectors such as chemicals, clay, metals, machinery and electronics. For example, by the end of 1974, foreign firms (led by Japanese investors) were responsible for 77 percent of exports of machinery and parts that totalled 77 million US dollars, 84 percent of total metal products exports of 120 million US dollars, and 89 percent of total electronic machinery exports of 474 million US dollars.<sup>158</sup> Additionally, Japanese firms had a more extensive system of joint-ventures than non-Japanese foreign companies that facilitated the transfer of technological know-how, marketing and management skills.<sup>159</sup> Another element that was important in this relationship was played by Japanese trading companies in the form of marketing and finance. They offered Korean companies marketing and sales networks in the lucrative US market, and guaranteed easy and continuous access to credit from Japanese banks.<sup>160</sup> In sum, the early success of Korean manufacturing exports and their contribution to the country's economic performance owes much to the enterprise demonstrated by local business groups, in alliance with Japanese firms, in identifying market opportunities and taking risks in the international export markets.**

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<sup>157</sup>Woo, *Race to the Swift*, p.87.

<sup>158</sup>Castley, *Korea's Economic Miracle*, p.141 (see table 3.34).

<sup>159</sup>Castley, *Korea's Economic Miracle*, p.141.

<sup>160</sup>Chibber, 'Building a Developmental State', p.334.

However, the entrepreneurial spirit of the Korean firms in joint collaboration with their Japanese counterparts to explore the international market is not sufficient to explain the country's performance. The Korean private sector continued to be technologically poor, badly informed about the international markets and, more importantly, to lack capital. The resolution of this limitation rested ultimately on the supporting and guiding hand offered by the Korean state. Under Park Chung Hee, the Korean government sought not only to guarantee credits and risk insurance to the private sector through the system of socialisation of private risk, but also to certify that the terms of the alliance would not be unfavourable to the Korean firms in natural disadvantage vis-à-vis the more powerful Japanese companies, and to offer technological and investment assistance.<sup>161</sup> In sum, policy choices were not necessarily technically rational and free from political bias. Additionally, the application of disciplinarian measures depended less on the strength of the state and more on the nature of the relationship between the executive and the private sector. Private firms were not only followers of state policy choices but also took the initiative to enter new industries and succeeded in obtaining the support of the Presidency in their business ventures.

The tendency to highlight the strength of the Korean state rests on the belief that the power of the state depends on its control of financial flows. There is no doubt that state control over finance significantly increases the power of the state over the private sector. Yet, it is not clear how this power could be sufficient to give the state the autonomy and capacity to be unconcerned about the private sector's response to policy changes. The analysis offered by the strong state literature seems to misinterpret the terms of the relationship between state and business groups. The cases above show that the informal nature of the ties binding the state and the private sector, contrary to the interpretation offered by the strong state literature, led to a more dynamic relationship between

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<sup>161</sup>Chibber, 'Building a Developmental State', p.336.

**the two to surpass the idea of strong state versus weak business groups. Since the legitimacy of the regime became strongly dependent on its ability to deliver rapid economic growth and development, all involved actors were aware that any move to hurt the private sector needed to be well assessed as it could cause severe disruptions to the entire national economy. As Timothy Lim puts it:**

**The state and big business, then, were locked in a tight, interdependent (if not co-dependent) power-relationship. On the one hand, the state occupied a position of legitimate power (i.e., authority) and “controlled” access to many of the physical and/or financial resources needed by business. Big business, on the other hand, performed many of the activities that sustained the economy, and, by extension, the state’s position of legitimated power. This created an interesting and complex dynamic between the state and the *chaebol*.<sup>162</sup>**

#### **2.4.3 Challenging the Third-Level causation**

**Strong state perspectives usually equate the Korean state with an autonomous and capable bureaucracy that through the system of socialisation of private risk sets cooperative ties with the private sector. However, these perspectives provide an incomplete image of the organisation and workings of the Korean state and its relations with the private sector. They do not only fail to recognise that the Korean state is made of several constitutive layers with the Presidency at the top of the decision-making process but also to acknowledge the capacity of the private sector to influence policy choices.**

**The strong state literature on Korean development tends to reify the role of the bureaucracy as the main actor behind the country’s policymaking process. The bureaucracy is usually introduced as a meritocracy united and coherent in its selection and implementation of**

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<sup>162</sup>Timothy Lim, ‘Power, Capitalism, and the Authoritarian State in South Korea’; *Journal of Contemporary Asia*, 28 (1998), 457-483, p.472.

**development policies.<sup>163</sup> The Korean bureaucracy is indeed selected according to a highly competitive entrance examination that has usually attracted the country's best students. During the presidency of Park Chung Hee there was a concern not only to increase the size of the bureaucracy, but also to improve its professional competence and to boost its capacity to manage the growing complexity of the country's economy.<sup>164</sup> The strong state literature's interpretation fails, however, to understand the political features shaping the organisation and the workings of the bureaucratic machine. One of such features is the organisation of the bureaucracy along regional lines. Despite the tendency to portray Korea as a homogenous country the political considerations of Presidents have led them to use regional affiliations as an important factor defining the organisation of the bureaucracy. In fact, regionalism in civil service has continued to raise great debates in Korea.<sup>165</sup> Since the 1970s, and through the last presidency of Cholla-native Kim Dae Jung (1998-2002), the home region of the last four presidents (Park Chung Hee, Chun Doo Hwan, Roh Tae Woo and Kim Young Sam), Kyongsang, has been over-represented in the bureaucracy. Hwang Jong-Sung argues that, 'because President Park Chung Hee's legitimacy was weak due to his beginning in a military regime and his power was constantly challenged, he implemented the method of regional relationships to overcome potential uncertainty and danger.'<sup>166</sup>**

**Afterwards, the presence of natives from Kyongsang continued to increase in the administrative elite, and as they grew in number, they became an independent power structure. While it is difficult to identify the causal relationship, this political bias in the organisation of the bureaucracy developed alongside an uneven economic regional**

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<sup>163</sup>Evans, *Embedded Autonomy*, and Woo-Cumings, 'The Korean Bureaucratic State; Historical Legacies and Comparative Perspectives'.

<sup>164</sup>See Chapter Three for the measures undertaken by Park Chung Hee to reform the country's bureaucracy.

<sup>165</sup>Heo Nam-chin, 'What Happened to Promised Reforms?', *Joongang Ilbo*, 13 March 2001, p.3, Cho Ki-suk, 'Regionalism Trivializes Korean Politics', *Joongang Ilbo*, 21 March 2001, p.3, Hwang Sung-dong, 'Incomplete Study of Bias in Civil Service', *Joongang Ilbo*, 22 March 2001, p.3, and Hong Soon-il, 'Cronyism', *The Korea Times*, 7 June 2001, p.4 (hereafter KT).

<sup>166</sup>Hwang Jong-Sung, 'Analysis of the Structure of the Korean Political Elite'; *Korea Journal*, 37 (1997), 98-117, pp.113-4. See also Kim Byong-kuk, 'Apartheid, Korean Version', KT, 27 April 1993.

**development in Korea.<sup>167</sup> In 1949, the provinces of Kyongsang (north and south) and Cholla (north and south) were the most populous areas in the country, with approximately 25 percent and 28 percent respectively of the total population. However, by the early 1990s, while the population in Kyongsang increased to 30 percent of the total population, Cholla saw its inhabitants decreasing to approximately 12 percent of the total population, as people migrated out of the region in search of employment. Between 1958 and 1983, Cholla's share of manufacturing employment diminished from 13.1 percent to 5.4 percent, while that of Kyongsang increased from 28.6 percent to 41 percent.<sup>168</sup>**

**In a country where the state granted businesses a large number of financial benefits and tax incentives, geographical affiliation, school connections and kinship networks seemed to have played an important role in the selection of those to be rewarded. The emergence of big business groups such as LG and Samsung from Kyongsang and the relative decline of the Cholla-based Samyangsa Group and Kyongsung Textile Company since the 1960s show how regional affiliations seem to have been important for succeeding in business.<sup>169</sup> While, regional affiliations probably brought certainty and stability within the administration since the 1960s, regional economic inequality is a legacy that has nurtured regional hostilities and divisions to negatively affect the consolidation of Korean democracy.<sup>170</sup> As pointed out by Peter Gourevitch, even strong states rely on the support of social actors to prevail:**

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<sup>167</sup> For a more detailed analysis on the political and economic disparities between regions, see Soohyun Chon, 'Political Economy of Regional Development in Korea', in Richard Appelbaum and Jeffrey Henderson, eds, *States and Development in the Asia Pacific Rim* (Newbury Park: Sage Publications, 1992), pp.150-175. See also Dong Ok Lee and Stanley D.Brunn, 'Politics and Regions: an analysis of the recent presidential election'; *Political Geography*, 15 (1996), 99-119, and Dae Hwan Kim, 'Economic Concentration and Disparities: The Political Economy of Class, Region and the *Chaebol*', in Dae Hwan Kim and Tat Yan Kong, eds, *The Korean Peninsula in Transition* (London: Macmillan Press Ltd, 1997), pp.36-62, pp.43-9.

<sup>168</sup> Chon, 'Political Economy of Regional Development in Korea', p.154.

<sup>169</sup> Chon, 'Political Economy of Regional Development in Korea', p.170. See also Young-Job Chung, 'Chaebol Entrepreneurs In the Early Stage of Korean Economic Development'; *The Journal of Modern Korean Studies*, 2 (1985), 15-29, pp.23-5.

<sup>170</sup> For a study on the impact of regional economic inequality in regional voting in Korea since the democratic opening in 1987, see Kisuk Cho, 'Regional Voting in New Democracies: The Case of South Korea', paper prepared for the 17<sup>th</sup> International Congress of the International Political Science Association, Seoul, 18 August, 1997. See also, Kyoung-Ryung Seong, 'Civil Society and Democratic Consolidation in South Korea: Great Achievements and Remaining Problems', in Larry Diamond and Byung-Kook Kim, eds, *Consolidating Democracy in South Korea* (Boulder, CO: Lynne Rienner Publishers, Inc, 2000), pp.87-109, pp.98-102.

**The autonomy of the state has a social base: for state autonomy to exist for specific purposes, the state must be able to obtain the support, of differing kinds, from societal actors. The strong state is one with the political support to be strong, a state with the compliance and enthusiasm of at least some societal actors that support the actions of strength. When the support disappears, so does state strength.<sup>171</sup>**

**Another political feature moulding the organisation of the bureaucracy and was the creation of a 'bifurcated bureaucracy' during the 1960s.<sup>172</sup> Domestic-oriented ministries such as Transportation, Construction and Home Affairs were filled with patronage appointments, while economic ministries such as EPB, Finance or Trade and Industry kept their professionalism by being left immune from such political considerations. Patronage appointments involved especially members of the military in the early years of the Park's presidency as an instrument to consolidate support within the military hierarchies and keep control of the bureaucracy.<sup>173</sup>**

**Additionally, the workings of the Korean bureaucracy have been far from following the patterns of a united body that applies efficient economic policies. Lawrence Westphal and Irma Adelman point out in their analysis of the Korean planning process that 'the spirit of competition appears to dominate the inter-agency dealings to the detriment of cooperation in planning the achievement of common goals.'<sup>174</sup> The bureaucratic state-centred perspective is nonetheless right in emphasising the role played by the Economic Planning Board (EPB) as a central agency giving coherence to the government's economic policies.<sup>175</sup> The achievement of this coherence involved the resolution of**

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<sup>171</sup> Gourevitch, *Politics in Hard Times*, p.238.

<sup>172</sup> David Kang, *Crony Capitalism: Corruption and Development in South Korea and the Philippines* (Cambridge: Cambridge University Press, 2002), pp.85-90.

<sup>173</sup> See Chapter Three.

<sup>174</sup> Sung-Hwan Jo and Seong-Young Park, *Basic Documents and Selected Areas of Korea's Third Five-Year Development Plan (1972-1976)* (Seoul: Sogang University Press, 1972) p.19.

<sup>175</sup> For a study on the role of the EPB in Korea, see Byung-sun Choi, *Institutionalizing A Liberal Economic Order in Korea: The Strategic Management of Economic Change*, Doctoral dissertation, Harvard University, 1987.

**conflicts between different ministries through several EPB-led consultation forums such as the Economic Minister's Consultation Meeting (EMCM) and the Industrial Policy Deliberation Council (IPDC). Yet, the technocratic bias of the strong state perspective fails to acknowledge that the decisional power of the EPB ultimately rested on the political authority and support given by the President.**

**Hence, during the 1970s, Park Chung Hee moved by economics, politics, national security and ideology decided to concentrate the country's resources in the development of heavy and chemical industrialisation (HCI). In doing so, Park bypassed the advice of the EPB which proposed a gradual promotion of heavy and chemical industries.<sup>176</sup>Under the patronage of Park Chung Hee, an assistant vice minister at the Ministry of Commerce and Industry (MCI), Oh Won Chol, later appointed as a Second Economic Secretary to the President, would be in charge of the new industrial policy through his leading role in the Heavy and Chemical Industries Planning Committee (HCIPC) created in 1973.<sup>177</sup>During the 1970s the Planning Council, under the direct control of the President, emerged as the centre for economic decision-making for HCI.<sup>178</sup>Private companies, interested ministries (in most cases, the MCI), and the Planning Council would jointly initiate new development plans and investment projects. The President would make the final decision following the opinion of the Planning Council, with the Second Economic Secretary taking over the original coordinating role of the EPB during the whole policy process.**

**The EPB seemed, in fact, to have had little power to check the access of private businessmen to the Second Economic Secretary or their direct access to the President. Consequently, the EPB saw its capacity to coordinate economic policies weakened by the new political environment. The EPB still sought to have the new plans and projects subjected to**

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<sup>176</sup>See Chapter Four.

<sup>177</sup>Kim, *Policymaking on the Front Lines*, pp.83-5.

<sup>178</sup>Choi, *Institutionalizing A Liberal Economic Order in Korea*, p.105.

**rigorous feasibility studies, but its efforts were in vain, as the President personally endorsed major investment plans and selected private businesspersons to undertake such projects.**

**The strong state literature further emphasised that in the Korean developmental state, the state and the private sector build cooperative ties, though the former sets the rules of the game through the system of socialisation of private risk. Probably the most cited example revealing to what extent the Korean state could assert its power over the private sector arises from the initiative taken during the early days of the military regime led by Park Chung Hee to expropriate the wealth of the country's major businessmen.<sup>179</sup> After enacting the 'Illicit Wealth Accumulation Law', Park arrested thirty leading business leaders and ordered them to return all the profits gained through rent-seeking since the signing of the Korean War truce in 1953.<sup>180</sup> They were asked to pay the fines in cash or by turning over their assets to the government. This is clearly regarded as the initiative that resolutely established the Korean state in a superior position and guaranteed that the private sector would comply with its developmental plans. However, a closer examination of the whole incident helps build a different representation of the state-business power relations in Korea since the 1960s.**

**It is a representation that moves away from the static reading in which a dominant agent exerts power over a subordinate agent, to a more dynamic and complex understanding of their exchanges. Even if the new leadership showed that it could discipline business groups, its legitimacy rested on its success in achieving economic growth through the implementation of development plans. Paradoxically, the only viable economic force at the time that could help the realisation of the program**

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<sup>179</sup> Karl Fields, *Enterprise and the State in Korea and Taiwan* (Ithaca: Cornell University Press, 1995), pp.52-3.

<sup>180</sup> The law defined as illicit wealth: (1) tax evasion; (2) illegal contribution to political parties; (3) illicit acquisition of national vested properties; (4) extraordinarily preferential monopoly of contracts for construction and supply activities; (5) unusually large and monopolistic allocation of foreign capital; (6) misallocated foreign funds; (7) other capital illegally flown out of the country. See Kyong-Dong Kim, 'Political Factors in the Formation of the Entrepreneurial Elite in South Korea'; *Asian Survey*, 26 (1976), 465-477, p.471.

**was the group of businessmen targeted by the initiative with 'their singular advantage of organization, personnel, facilities, and capital resources.'**<sup>181</sup> Though the government had seized the control of the country's banks thus gaining the control of an important policy instrument, ultimately it had to find a compromise with the business sector.<sup>182</sup> In August 1961 the final decision of the investigation committee reduced by 90 percent the original fines to be paid by the thirty entrepreneurs, and then in January 1962, that amount was again cut in half.<sup>183</sup>

**The private sector was far from being an obedient and passive actor. Kyong-Dong Kim claims that the reduction of fines was a result of the intense lobbying done by the accused businessmen who took advantage of the growing internal factionalism within the new regime over many policy issues, including the implementation of the illicit wealth law.**<sup>184</sup> The businessmen moved to 'buy off' several political leaders in exchange for bribes. The kickbacks were expected to be used as political funds to feed the politicians' factions within a newly launched political organisation supported by the military regime, the Democratic Republican Party (DRP). With all political parties officially banned after the coup d'état in 1961, under the leadership of Kim Jong-pil, a close associate of President Park, the military leaders sought the establishment of the DRP as an effective political party to pursue their interests in anticipation of the country's return to civilian rule after elections in 1963.<sup>185</sup> Finally, some of the indicted businessmen succeeded in persuading the new regime to actually help them build new industrial plants under the five-year development plans. When the plants were completed, the businessmen were expected to pay the imposed fines by turning over a majority of the shares to the government. Instead, most of them decided to pay the fines

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<sup>181</sup>Kim, 'Political Factors in the Formation of the Entrepreneurial Elite in South Korea', p.470.

<sup>182</sup>See Chapter Three for the seizure of the country's banks by the new regime.

<sup>183</sup>Fields, *Enterprise and the State in Korea and Taiwan*, p.52.

<sup>184</sup>Kim, 'Political Factors in the Formation of the Entrepreneurial Elite in South Korea', pp.470-1.

<sup>185</sup>Kelley Kum-mi Hwang, *The State and Society in Korean Development: Domestic Coalitions and Informal Politics*, Doctoral dissertation, University of California-Santa Barbara, 1994, p.131.

**in cash and keep the control of the same firms that the military regime had hoped to nationalise.<sup>186</sup> As Chung-in Moon states:**

**Business might well choose a strategy of compliance and co-operation with the state if more benefits can be expected by doing it. It can also attempt to modify state behaviour through lobbying, protests, blackmail, and networking. In the worst case, business can pull itself out of (inter) dependence with the state and seek its own survival and expansion through such autonomous actions as diversifying political ties and even creating its own political shield (e.g., political parties).<sup>187</sup>**

**In sum, the activities of the Korean bureaucracy have been subjected to the political interests of the country's leaders. In this sense, Korean bureaucracy was far from being the main actor setting the configuration of the policy process. Additionally, the spirit within the administrative apparatus seems to have been more one of competition rather than one of cooperation and unity in purpose. Finally, cooperative ties between the executive and the private sector should be seen as more complex than the usual dichotomy strong versus weak. There is space for variation and that depends on the capacity for negotiation of both sides over policy choices.**

## **2.5 An Alternative Interpretation of the Korean Developmental State: Leadership, Political Strategies and Policy Choices**

**The current developmental state literature on Korea commits the fallacy of causally relating a strong, cohesive and plan-rational bureaucratic state with successful economic performance. The above mentioned episodes, however, portray a more complex image of the Korean developmental state in which the system of socialisation of private risk is far from being depoliticised. Instead, the system is**

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<sup>186</sup>Kim, 'Political Factors in the Formation of the Entrepreneurial Elite in South Korea', p.471.

<sup>187</sup>Moon, 'Changing Patterns of Business-Government Relations in South Korea', p.145. See also Jae Jean Suh, 'The Social and Political Networks Of the Korean Capitalist Class'; *Asian Perspective*, 13 (1989), 111-139.

**subjected to the politics of negotiation between an array of actors with different interests, whether they are members of the executive, bureaucracy, National Assembly or the private sector. The strength of the Korean state to implement and enforce the system of socialisation of private risk should not be seen statically, but as varying over time and space and this depends essentially on capacity of the Korean Presidents to mobilise or retain political support. As in any other country, policy choices in the Korean state are forged by political leaders.**

**In Korea, the President and his staff at the Blue House have reigned over the process of decision-making. Korean Presidents are *de facto* in control and command of the policy process. Chung Duck-Koo, who spent 20 years of his life as an official at the Ministry of Finance and who would become Vice Minister of Finance during the presidency of Kim Dae-Jung (1998-2002) leaves no margin for doubts when he describes the Korean political system: 'It is [a] presidential system, not a cabinet system. The president has the last word.'<sup>188</sup> Policy choices and implementation rest on strategies designed by Korean Presidents to boost their political legitimacy, to build up their power, and to secure regime survival. Their policy strategies, however, are far from being autonomously taken as they are filtered by the complex interaction of institutions, history, context, ideas, and coalition politics. It is this failure to understand the political dynamics embedded in the system of socialisation of private risk and their policy and political outcomes since the 1960s that accounts for the inability of the strong state literature to offer a more comprehensive explanation for the financial crisis in 1997.**

**The following chapters seek to illustrate with more detail the role played by Korean Presidents in the formation, consolidation and transformation of the system of socialisation of private risk and how their policy choices were mediated by historical circumstances, institutional legacies, domestic political and economic context, international**

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<sup>188</sup>Interview with Chung Duck-Koo in Seoul, 14 June 2001.

**environment and ideologies. Chapters Three and Four attempt to analyse the origins and consolidation of the politics behind the system of socialisation of private risk during the 1960s and 1970s. The policy and political outcomes generated during this period will serve as the ‘path-dependent’ background. This political and policy legacy facilitates the investigation in Chapters Five and Six of the steps taken in particular from the early 1990s to radically transform the rules of the system of socialisation of private risk and with what political, economic and social consequences.**

### **3. CHAPTER THREE - Unravelling the Origins of the Korean Developmental State: The Park Chung Hee Regime (1961 – 1979)**

#### **3.1 Introduction**

**The system of socialisation of private risk is a clear testimony of the degree of intervention played by the Korean developmental state in the organisation of the market. Yet, how the Korean developmental state emerged, and by extension the system of socialisation of private risk, remains a much debated issue, with two major views – continuity and discontinuity - exposing different explanations on the genesis of the phenomenon. The continuity perspective emphasises the legacy of the Japanese colonial period as the harbinger of the 'strong' Korean developmental state that emerged in the 1960s. The alternative perspective, the discontinuity school, claims instead that the roots of such a state developed only in the aftermath of the military coup d'état in 1961.<sup>189</sup> The two perspectives, however, are not without their own shortcomings that stem from their tendency to be historically selective and biased.**

**The continuity perspective argues that the Japanese colonial period set the institutional foundations of the Korean developmental state that surfaced in the 1960s. Yet, it fails to seriously consider the political, economic and social impact of a troubled 15-year period following the liberalisation of the country in 1945. Conversely, the discontinuity thesis emphasises the role of an authoritarian and military leadership in building the Korean developmental state during the 1960s. In its attempts to reify**

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<sup>189</sup>For the continuity thesis, see Bruce Cumings, 'The Origins and Development of the Northeast Asian Political Economy: Industrial Sectors, Product Cycles and Political Consequences', in Deyo, ed, *The Political Economy of the New Asian Industrialism*, pp.44-83, Dennis L. McNamara, *The Colonial Origins of Korean Enterprises, 1910-1945* (Cambridge: Cambridge University Press, 1990), Carter J. Eckert, *Offsprings of Empire: The Koch'ang Kims and the Colonial Origins of Korean Capitalism, 1876-1945* (Seattle: University of Washington Press, 1991), Woo, *Race to the Swift*, and in particular Kohli, 'Where Do High Growth Political Economies Come From?'. For the discontinuity view, see Stephan Haggard, David Kang, and Chung-in Moon, 'Japanese Colonialism and Korean Development: A Critique'; *World Development*, 25 (1997), 867-881, and Chibber, 'Building a Developmental State'.

**this leadership, however, this thesis falls short by ignoring two major facts. First, the new rulers' policy choices were influenced by plans and projects devised during the previous civilian government. Second, the new rulers' initial and failed efforts to reform the economic system by administrative fiat served well as strategic learning in terms of feasibility of future policies.**

**This chapter begins by critically analysing the two contending views on the origins of the system of socialisation of private risk. Then, and moving beyond these two perspectives, I argue that Park Chung Hee's choice to create a system of socialisation of private risk was mediated by the legacies of Syngman Rhee and Chang Myon; US pressures for economic reforms and; the belief that economic growth and development could only be achieved through a state-led economic nationalism. Additionally, I will argue that the implementation of the system, at the core of the Korean developmental state, was ultimately shaped by Park Chung Hee's demonstrable capacity to build a supporting coalition with bureaucrats, farmers and business firms. During the presidency of Park Chung Hee, the system of socialisation of private risk worked to strengthen the autonomy and capacity of the presidential office and the bureaucracy, in particular of the Economic Planning Board (EPB), to set the country's pattern of development. Yet, the institutionalisation of the system depended on the role and capacity of Park Chung Hee to maintain it through a credible commitment to an alliance with bureaucrats, farmers and the *chaebol*. This credible commitment was comprised of positive incentives, but also of penalties that would be applied if bureaucrats or *chaebol* failed to attain, or comply with, certain planned targets or guidelines. Furthermore, Park built a repressive security and policing machine through laws and agencies such as Korean Central Intelligence Agency (KCIA), National Defence Security Command (NDSC) as well as the police to keep under control political opposition and civil society. Despite the increasing power of the presidency, the legitimacy of Park Chung Hee's leadership was also highly based on the electoral support from the rural majority, bureaucrats and**

business groups. The first group provided the votes during electoral periods that were regarded more as orchestrated events to measure the popularity of the leadership rather than an opportunity to vote for political change. And more importantly, Park's legitimacy rested on the country's rapid economic growth, which strongly depended on the performance of the business groups supported by good management and by a committed bureaucracy (see Figure One).

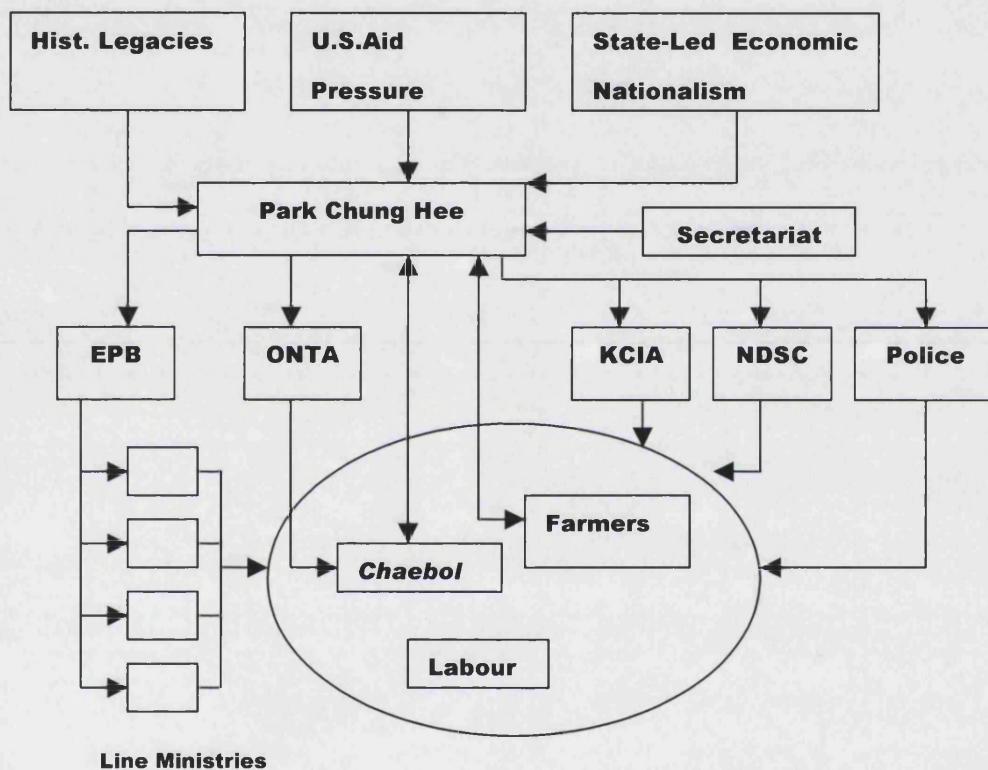


Figure One: Presidential Leadership and Policy Process, Park Chung Hee (1961-1979)

### 3.2 From Continuity to Discontinuity: Debating the Rise of the Korean Developmental State

The continuity thesis recognises the exploitative nature of the Japanese occupation of Korea from 1905 to 1945, but it also claims that the 40-year old Japanese colonial rule over the peninsula led to crucial institutional transformations that moulded the configuration of the postcolonial Korean developmental state. Atul Kohli argues that the

**Japanese colonial rule over Korea left three major legacies.<sup>190</sup> First, in place of what had become a weak and distrusted Korean monarchic system, the colonial regime established an authoritarian and centralized state supported by a competent and disciplined bureaucracy as well as by a strong and powerful police with the capacity to infiltrate and dominate the society.**

**Second, the Korean state was transformed into an efficient economic actor, concerned with building infrastructure, increasing tax collection and agrarian and industrial production. Under the Japanese, the Korean state co-opted the propertied classes by offering such rewards as legal property rights securing the control of the land in perpetuity or jobs in local authorities. This strategy aimed not only at accomplishing the colonial authorities' economic goals but also to keep the country's villages under control. Simultaneously, mechanisms such as the promotion of technology and control over credit were employed to push Korean and Japanese landlords and businessmen to observe the colonial agrarian and industrial policies. This alliance between the state and businessmen is regarded as the force behind Korea's success in exporting goods during the colonial period.**

**Finally, to ensure the success of the production-oriented agenda, the lower classes composed of peasants and the working class were oppressed and exploited by the colonial state in collusion with the local bourgeoisie. By imposing order through force in the Korean society, the colonial state could concentrate on its narrow policy-orientation, i.e., maximisation of agricultural and industrial production. Simultaneously, incomes and wages were in general lower than productivity gains. This resulted in higher profits, savings and investment. In sum, for the continuity thesis, the main features of the Korean developmental state**

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<sup>190</sup>Kohli, 'Where Do High Growth Political Economies Come From?', p.1270.

**that first emerged in the 1960s are no more than a legacy of the colonial period and they ‘were simply never altered in any fundamental way.’<sup>191</sup>**

**While the institutional inheritance of Japanese colonialism may have helped in moulding the features that would later characterise the Korean developmental state, as Vivek Chibber points out, it ‘does not by any means follow that they were sufficient for it.’<sup>192</sup> In fact, by anchoring their analytical cues exclusively on the legacy of the Japanese colonial period, the continuity interpretation of the origins of the Korean developmental state commits the error of ignoring the important political, economic and social impact of a 15-year intermission between the end of Japanese rule in 1945 and the beginning of the Park Chung Hee’s regime in 1961. During this time, Korea went through an American occupation, a civil war, the division of the country into communist North Korea and anti-communist South Korea, and the troubled governments of Syngman Rhee (1948-1960) and Chang Myon (1960-1961).**

**The discontinuity school, on the other side, seriously consider this 15-year interlude. Thus pointing out the difficulty demonstrated by the continuity thesis in explaining why the Japanese legacy was not mitigated by later events. The discontinuity school make four main arguments.<sup>193</sup> First, in terms of economic record, they claim that there are ‘stronger reasons to doubt that any Japanese contribution was an *enduring one*.<sup>194</sup> They argue that the end of Japanese rule was followed by 15 years of political and social antagonisms, national war, policy inconsistencies and erratic economic development. Only after policy changes in the early 1960s, was there a turnaround in the country’s economic record. It is only with the leadership of Park Chung Hee that a more coherent economic policy framework materialised following institutional changes that strengthened the power of the executive in the**

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<sup>191</sup>Kohli, ‘Where Do High Growth Political Economies Come From?’, p.1285.

<sup>192</sup>Chibber, ‘Building a Developmental State’, p.314.

<sup>193</sup>Haggard, Kang, and Moon, ‘Japanese Colonialism and Korean Development’, p.868.

<sup>194</sup>Haggard, Kang, and Moon, ‘Japanese Colonialism and Korean Development’, p.868.

**policy process and reformed the organisation and nature of the bureaucracy.**

**Second, the tendency to emphasise the Japanese legacy rests on a technocratic bias. While the colonial bureaucracy served as an important tool in the hands of the Japanese empire to deliver their production-oriented economic goals, the same bureaucracy inherited by Syngman Rhee and his allies was used to nurture unproductive rent-seeking activities. However, in the early 1960s, under the leadership of Park Chung Hee, the Korean state went through an organisation reshuffle that converted it into an agent for industrial change, economic growth and development.**

**Third, the claim that Korean post-war business conglomerates found their genesis in the Japanese colonial period is also disputable. It was a basic stance at the time to discriminate against Korean firms. In addition, empirical data shows that, for example, in the early 1980s, only one of the top ten business groups in Korea, and six out of the top 50, was created during the Japanese period, 31 of these business groups were formed between 1945 and 1960, during the regime of Syngman Rhee, before the country's economic take-off.<sup>195</sup> While the acquisition of Japanese assets contributed to the growth of some business groups in the 1950s, much of that Japanese-financed capital stock was destroyed or lost value during 1945-1953 and had to be built anew.**

**Finally, the discontinuity school argues that with the exception of labour repression, important social preconditions for the post-war Korean development such as land reform and growing public investment in education were not legacies of the colonial period, but were only possible**

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<sup>195</sup>Kim, *Big Business, Strong State*, p.126. For an analysis of the growth of business groups during the 1950s, see Young-Iob Chung, 'Capital Accumulation of Chaebol In Korea During The Early Stages of Economic Development'; *The Journal of Modern Korean Studies*, 3 (1987), 11-41.

**with the country's independence from Japanese rule.<sup>196</sup> In sum, the discontinuity perspective, unlike the continuity thesis, regards the Japanese colonial period as having less impact on the formation of the Korean developmental state. Instead, it claims that it was only with the leadership of Park Chung Hee starting in 1961 that Korea entered a period of high economic growth.**

**The discontinuity perspective is not without its own faults. The tendency to reify the reformist role played by the military regime under Park Chung Hee in bringing about successful economic performance since 1961 leads it to commit two important oversights. First, it fails to acknowledge that some important policy changes introduced during the military rule were originally designed during the former civilian government led by Chang Myon. Second, it overlooks the fact that, between 1961 and 1963, the country's economy under the new military leadership was far from being a success. In fact, major economic reforms introduced by administrative fiat by the military had a negative impact in terms of economic performance. The policy and political outcomes eventually offered the new leadership important policy lessons, or what Colin Hay and Daniel Wincott would call 'strategic learning', on how to approach future policy choices.**

**In April 1960, right after controversial presidential and vice-presidential elections that had taken place a month earlier, the newly re-elected government led by Syngman Rhee collapsed in the aftermath of large student demonstrations in the capital Seoul protesting against**

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<sup>196</sup>Lee Hahn Been, *Korea: Time, Change and Administration* (Honolulu: East-West Center Press, 1968), p.67. Lee Hahn Been, a well known Korean civil servant, who served during the regimes of Syngman Rhee, Chang Myon and Park Chung Hee, describes the end of the Japanese colonialism in these terms:

The Liberation of 1945 brought about a dominant ideology – the ideology of equal opportunity. This potent ideology gave birth to two important policies with far-reaching consequences, i.e., education and land reform. These two policies, which were carried by the government with support of the society at large, were the cornerstones in the ensuing process of levelling the traditional structure, increasing social mobility, and ushering in the twin processes of urbanization and literacy.

See also James Putzel, 'Land Reforms In Asia: Lessons From The Past For the 21<sup>st</sup> Century'; *DESTIN Working Paper Series No.00-04* (London: LSE Development Studies Institute, 2000).

**police violence.<sup>197</sup> An Interim Government installed by Rhee after his resignation, arranged for a constitutional reform that introduced a parliamentary system and prepared the country for general elections in July the same year. The elections were won by the Democratic Party (DP) and culminated with the selection of Chang Myon as the country's Prime Minister.<sup>198</sup> Despite the tendency to overlook the short tenure of the Chang Myon's regime, overthrown in 1961 by a military coup d'état, the new government initiated significant policy changes.<sup>199</sup>**

**The new government introduced the 'National Construction Service' (NCS), a comprehensive, multi-purpose and multi-year public works project aimed at building the country's infrastructure and fighting unemployment.<sup>200</sup> Meanwhile, under the leadership of the new Finance Minister Kim Young-Sun, a team had already began working on a five-year development plan, in efforts to join other Asian countries where planning had become an established feature of the policy process.<sup>201</sup> Simultaneously, a group of bureaucrats formed a 'Government Reorganisation Study Group' to reform the country's economic administration. The plan involved the creation of a 'super-ministry' that would be named Economic Planning Board (EPB), bringing together the Budget Bureau from the Ministry of Finance (MOF), the Statistics Bureau from the Ministry of Home Affairs, and the Overall Planning Bureau and the Resources and Mobilisation Bureau from the Ministry of Economic Development.<sup>202</sup> The launching of the**

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<sup>197</sup> For an account of this period, see Kim Joung Won, *Divided Korea: The Politics of Development, 1945-1972* (Cambridge: Harvard University Press, 1975), pp.162-5, and George Henderson, *Korea: The Politics of Vortex* (Cambridge: Harvard University Press, 1978), pp.174-176.

<sup>198</sup> For a more detailed view on the workings of the Interim Government, see Lee, *Korea: Time, Change and Administration*, pp.109-122. On the Democratic Party, see also Lee, *Korea: Time, Change and Administration*, pp.123-130. The Democratic Party (DP) was created in 1956 bringing together former members of the then ruling Liberal Party (LP) and the Democratic Nationalist Party (DNP), the major opposition party during the regime of Syngman Rhee.

<sup>199</sup> For a detailed analysis of the policy changes undertaken during the government of Chang Myon, see David Satterwhite, *The Politics of Economic Development: Coup, State and the Republic of Korea's First Five-Year Economic Development Plan (1962-1965)*, Doctoral dissertation, University of Washington, 1994.

<sup>200</sup> On the NCS, see Lee, *Korea: Time, Change and Administration*, pp.130-1.

<sup>201</sup> Satterwhite, *The Politics of Economic Development*, p.332. See also Timothy Lim, *Competition, Market, and the Politics of Development in South Korea, 1945-1979*, Doctoral dissertation, University of Hawaii, 1996, pp.218-222.

<sup>202</sup> Stephan Haggard and Chung-in Moon, 'The State, Politics, and Economic Development in Postwar South Korea', in Hagen Koo, ed, *State and Society in Contemporary Korea* (Ithaca and London: Cornell University Press, 1993), pp.51-93, p.64.

**five-year development plan and the EPB, however, failed to materialise in consequence of the military coup d'état.**

**However, the new military regime led by Park Chung Hee seized both projects and launched them officially as a product of their own work.<sup>203</sup> There were also a series of other policy changes that the military regime claimed as their own but, which had in fact been announced or planned by the Chang administration. Among them were measures to reform the tax system, to prosecute corrupt officials and those who had illegally amassed wealth during Rhee's era, and the expansion of foreign relations with other nations such as then West Germany, to reduce the dependency on the U.S both in terms of investment and assistance.<sup>204</sup> Furthermore, the discontinuity school overlooks the military regime's unsuccessful economic policies launched between 1961 and 1963 and how the policy and political outcomes had important implications in terms of strategic learning.<sup>205</sup>**

**Soon after the coup d'état, three major economic policies were pursued by the new leadership: the Counter-Usury Program on May 25, 1961; the implementation of the country's First Five-Year Development Plan on July 22, 1961 and; a Currency Reform on June 9, 1962. With the announcement of a moratorium for what was thought to be a sizable amount of usurious debts acquired by farmers (and fishermen), the Counter-Usury Program aimed at promoting and improving the rural economy. Usurious loans had been regarded as one of the main factors behind the persistent poverty of the rural areas.<sup>206</sup> In a country where agriculture was still the major economic activity, the measure was seen as a way to augment the authority and legitimacy of the new regime**

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<sup>203</sup> Satterwhite, *The Politics of Economic Development*, p.377.

<sup>204</sup> Satterwhite, *The Politics of Economic Development*, p.381.

<sup>205</sup> For an analysis of the economic policies undertaken during this period by the military regime, see Paul Ho-Yeol Yoo, *A New Political Economy of Economic Policy Change in South Korea, 1961-1963: Crisis, Uncertainty and Contradiction*, Doctoral dissertation, The Ohio State University, 1990.

<sup>206</sup> Yoo, *A New Political Economy of Economic Policy Change in South Korea, 1961-1963*, p.94.

**among the population by presenting themselves as 'saviors of the poor farmers and fishermen.'**<sup>207</sup>

**However, the program failed to produce the expected results in particular the reduction of the farmers' dependency on unregulated financial institutions as well as the latter's importance in the Korean financial system. Since the moratorium caused a temporary paralysis of the financial system in the rural communities, the government made efforts to increase agricultural credit at low interest rates. This new easy-money policy resulted in a 42.5 percent increase in money supply in 1961 from a year earlier, leading to growing inflationary pressures that forced the government to limit its support for agricultural credit. Consequently, private moneylenders soon resumed their activities to become major players in the Korean financial system, and the ratio of private debt to total farm household debt increased from 58 percent in 1960 to 70 percent in 1964.**<sup>208</sup>

**The First Five-Year Development Plan, originally designed by the previous civilian government but revised in its numerical contents to reflect the economic goals of the new military regime, aimed at building a self-sustaining economy and set the foundations for the country's industrialisation.**<sup>209</sup> In effect from January 1962, the plan, however, was criticised from the onset for its 'lack of realism and for overambitiousness.'<sup>210</sup> By the end of the first year, the criticisms seemed to have been valid. The actual growth rate for 1962 reached only 2.8 percent against the planned 5.7 percent, and the actual figures for domestic savings and foreign exchange were far from the planned ones.<sup>211</sup> Consequently, the military regime was compelled to revise the plan and adjust its planned targets, in particular the average annual growth rate from the original 7.1 percent to 5 percent. Nam Duck Woo, a

<sup>207</sup>Yoo, *A New Political Economy of Economic Policy Change in South Korea, 1961-1963*, pp.111-2.

<sup>208</sup>Cole and Lyman, *Korean Development*, p.148.

<sup>209</sup>Nam, *Korea's Economic Growth in a Changing World*, pp.21-38.

<sup>210</sup>Nam, *Korea's Economic Growth in a Changing World*, p.23.

<sup>211</sup>Yoo, *A New Political Economy of Economic Policy Change in South Korea, 1961-1963*, pp.261-2.

**former Minister of Finance (1969-1974) and Deputy Prime Minister and Minister of Economic Planning (1974-1978), describes Korea's First Five-Year Development Plan in these terms: 'The Korean planning experience illustrates the common mistakes often found in underdeveloped countries in that the government embarked on an overambitious development plan without adequate preparation and soon ran into foreign exchange difficulties and inflation.'**<sup>212</sup>

**The Currency Reform in 1962 emerged as a response to potential inflationary pressures caused by a substantial increase of almost 50 percent in the money supply in the previous year. It was also a response to a belief within the new regime that money was being hoarded by large speculators who the country's leadership feared could threaten the stability of the economy.**<sup>213</sup> The reform involved the change of the currency denomination, turning 10 old *hwan* into one new *won*, a limited conversion to 500 new *won* to meet existing living expenses, the registration of all cash, checks, and money orders, and the attempt to allocate all 'surplus' funds into a new 'Industrial Development Corporation' that was expected to finance new industrial activities. The immediate outcome, however, was to 'bring the economic activity nearly to a standstill because of lack of funds.'<sup>214</sup> Within five weeks, and without signs that large amounts of money had in fact been amassed, the monetary authorities brought the reform to an end. As the Bank of Korea clearly puts it, 'the currency reform ended as a failure which did not attain its original objectives and only created socioeconomic problems.'<sup>215</sup>

**Generally, the policies undertaken during this period aimed at mending some past injustices. The policies, mostly populist in nature, were targeted at certain groups that had been relatively ignored in**

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<sup>212</sup>Nam, *Korea's Economic Growth in a Changing World*, p.32.

<sup>213</sup>David C. Cole and Yung Chul Park, *Financial Development in Korea 1945-1978* (Cambridge: Harvard University Press, 1983), pp.58-9.

<sup>214</sup>Cole and Park, *Financial Development in Korea 1945-1978*, p.58.

<sup>215</sup>Bank of Korea, *The Bank of Korea: A History of Fifty Years* (Seoul: The Bank of Korea, 2000), p.157.

**particular during Rhee's regime such as farmers.<sup>216</sup> The failure of these three major economic policies had important policy and political outcomes for the country's new leadership in terms of strategic learning. In its first years of government, the military regime led by Park Chung Hee, seemed to believe that it could reorder the country's economic architecture by administrative fiat. The First Five-Year Development Plan, for example, was initiated without any concern for the opinion of the country's major economic actors, i.e., business groups. Yet, following the initial failure, they were allowed to participate in the design and implementation of the development plans.<sup>217</sup> The growing importance placed on the business sector by the military regime became apparent following the first steps to pardon and reduce the fines imposed on those it had earlier accused of 'illicit wealth accumulation'.<sup>218</sup>**

**Kim Jong Pil was, one of the leading figures behind the coup d'état, head of the KCIA, and a nephew of Park Chung Hee. In an interview with a Korean monthly magazine, Kim made clear the changing and sometimes conflicting views within the military regime on the business sector:**

**Pardoning the illicit wealth accumulators was an obvious violation of the revolution's pledge to eliminate corruption and evil practices. But it was necessary...If we punished businessmen under corruption charges, it was evident that our economy would be paralyzed. Of course, members of the revolutionary council insisted on prosecuting them, but I opposed it. It was essential to co-opt them in order to carry out revolutionary tasks.<sup>219</sup>**

**Likewise, the currency reform was devised in secrecy and implemented without any consideration for the views of the country's**

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<sup>216</sup> Stephan Haggard, Richard N. Cooper and Chung-in Moon, 'Policy Reform in Korea', in Robert Bates and Anne O. Krueger, eds, *Political and Economic Interactions in Economic Policy Reform* (Oxford: Blackwell, 1993), pp.294-332, p.312.

<sup>217</sup> Yoo, *A New Political Economy of Economic Policy Change in South Korea, 1961-1963*, p.265.

<sup>218</sup> See Chapter Two.

<sup>219</sup> Stephan Haggard, Byung-Kook Kim and Chung-in Moon, 'The Transition to Export-Led Growth in South Korea: 1954-1966'; *The Journal of Asian Studies*, 50 (1991), 850-873, p.859. The quotation is taken from the interview given by Kim Jong Pil to the Korean magazine *Monthly Chosun*.

major economic organisations such as the EPB or the Bank of Korea (BOK).<sup>220</sup> The reform for which Chung-yum Kim, Chief of Staff of President Park during the 1970s, claims responsibility was only known to a few, including Park Chung Hee, and practically without any involvement of career economic bureaucrats.<sup>221</sup> After its implementation, the negative impact on the country's economy, the rising opposition from the BOK and concerned economic ministries, as well as the pressures by the U.S, led to the dismissal of the currency reform's architects and an end to the reform altogether.<sup>222</sup> Ultimately, these failed economic reforms showed Park Chung Hee that any efforts to pursue institutional change by arbitrary executive order, even within an authoritarian political environment as in Korea, would fail without strategically seeking the support of a coalition.

The next section presents first the major institutional reforms introduced by the regime of Park Chung Hee (1961-1979) which are at the basis of the system of socialisation of private risk. This is followed by an analysis of what I regard as the historical, international and ideological factors that shaped Park's motivations to favour this system. Yet, motivations and preferences matter little if Park could not implement the system he chose. The failure of the economic reforms attempted by administrative fiat in the first years of the military regime showed that policy implementation would not succeed without mobilisation or support within society. In this sense, these policy episodes represented a significant strategic learning, i.e., the realisation of what is feasible, possible and desirable in terms of policy choices within the Korean context at the time.<sup>223</sup> I argue that ultimately the strength of the system of socialisation of private risk and how it was used to foster economic growth and development rested on the capacity demonstrated by Park in

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<sup>220</sup>Yoo, *A New Political Economy of Economic Policy Change in South Korea, 1961-1963*, p.265.

<sup>221</sup>For an account of the process leading to the implementation of the currency reform in 1962, see the memoirs of Chung-yum Kim, *Policymaking on the Front Lines*, pp.21-7.

<sup>222</sup>For the U.S. pressures to cancel the reform, see Kim, *Policymaking on the Front Lines*, pp.24-7.

<sup>223</sup>See Chapter One, p.24.

**nurturing a supporting coalition made of bureaucrats, farmers and business groups.**

### **3.3 Building the System of Socialisation of Private Risk: Park Chung Hee (1961-1979)**

**The concentration of power in the executive, the re-organisation of the bureaucratic apparatus, and the introduction of policy changes, in particular in the financial system, may be regarded as the three major institutional and policy transformations during the Park era that marked a turning point in the country's economic development history.**

#### **3.3.1 Strengthening the Executive Power**

**In terms of the role of the executive in the policy process, President Park developed several executive mechanisms through which he commanded, coordinated and monitored the bureaucracy and its performance in implementing the country's development strategy.<sup>224</sup> First, Park enlarged, empowered and extensively used the presidential secretariat made up of a chief secretary and six to seven other senior secretaries who were usually among the country's best economic bureaucrats and assisted the President in the coordination and management of the bureaucracy. As the country launched its economic development plans, the staff was expected to counsel the President particularly on economic issues. From a total number of 15 in 1961, the presidential staff rapidly grew to over 100 in 1967 and above 200 in 1968. <sup>225</sup> Consequently, the President and his secretariat became the dominant centre of policymaking and policy implementation.**

**At the same time, Park built a coercive and repressive apparatus through not only a series of legal mechanisms such as the National**

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<sup>224</sup>Young-Whan Hahn, 'Administrative Capability for Economic Development: The Korean Experience'; *Korean Review of Public Administration*, 1 (1996), 177-208, pp.186-190. See also Chung-Kil Chung, 'Presidential Decisionmaking and Bureaucratic Expertise in Korea'; *Governance: An International Journal of Policy and Administration*, 2 (1989), 267-292.

<sup>225</sup>Choi, Institutionalizing A Liberal Economic Order in Korea, p.33.

**Security Law, the Anti-Communist Law and the Law concerning Collective Demonstrations, but also the creation of security and intelligence agencies such as the KCIA.<sup>226</sup> Created in 1961 with an initial 3,000 employees, the KCIA would grow in the following three years to an estimated 370,000 employees (a notable figure for a country at the time with 20 million people). But unlike its U.S. counterpart, the KCIA was explicitly framed to spy on its own citizens, to carry out both domestic and foreign operations.<sup>227</sup> Together with the National Defence Security Command (NDSC) and the police, the KCIA served well the regime interests to control and keep in check political opposition and the civil society.**

**Second, Park relied on a group of so-called “bulldozer” type administrators that helped him achieve the expected economic outcomes in the early stages of the push for rapid economic growth. Hence, during the 1960s, the most representative were Chang Kee Young, Deputy Prime Minister of the EPB (1964 -67), Kim Hyun Ok, first Mayor of Pusan (1962-65) and later of Seoul (1966-70), and Lee Nak Sun, director of Office for National Tax Administration-ONTA (1962-66).<sup>228</sup>**

**Third, in his attempts to scrutinise bureaucratic performance, the President initiated what was known as the ‘New Year Briefing Sessions’, or visits to the offices of each ministry during the months of January and**

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<sup>226</sup>Chung-in Moon and Yong-Cheol Kim, ‘A Circle of Paradox: Development, Politics and Democracy in South Korea’, in Adrian Leftwich, ed, Democracy and Development: Theory and Practice (Cambridge: Polity Press, 1996), pp.139-167, p.144.

<sup>227</sup>Clifford, *Troubled Tiger*, p.80.

<sup>228</sup>Hahn, ‘Administrative Capability for Economic Development’, pp.188-189. Hahn Young Whan describes them in this way:

They were Park’s ‘alter ego’, an incarnation of President’s other self, so deeply committed to the realization of rapid growth. These bulldozers worked extremely hard. Their nickname ‘bulldozers’ came from their work style that did not pay much attention to difficulties or constraints of any nature. They just pushed the program through until the target could be realized. The President provided them with every possible means of support and defended them from all possible attacks. They reciprocated with achievements far better than the President had expected.

Lee Nak Sun, for example, was seen as the man responsible for a 66 percent increase in tax revenues within one year of his appointment. For the Park regime’s strong commitment to tax administration reform in Korea in the 1960s, see Chong Kee Park, ‘The 1966 Tax Administration Reform, Tax Law Reforms, and Government Saving’, in Cho and Kim, eds, *Economic Development in the Republic of Korea*, pp.247-272.

**February to obtain briefings on plans and strategies for the coming year and performance achieved during the previous year. The sessions were also attended by all the ministers, presidential secretaries, governors, leaders of the ruling party and National Assembly, as well as most of the bureau chiefs and section chiefs. This new presidential mode of operation was a clear demonstration that Park Chung Hee had a great concern for results, and only those who succeeded in fully achieving or exceeding the planned targets could survive or be promoted, with those failing to comply with the goals over a certain number of evaluation periods facing possible sacking.**

**Finally, the President himself personally became involved in the implementation of certain projects he deemed crucial for the country's development. For examples, the cases of the Seoul-Pusan Highway, the Ulsan Industrial Complex, the Korean Institute of Science and Technology (KIST), or the POSCO steel mill. For Nam Duck Woo, one of the country's top decision-makers during the 1960s and 1970s, the leadership of Park Chung Hee was crucial for the country's economic development:**

**He (Park) always think about in his head and mind, all the time, all the economic pictures, what is going on, and so on. Once he knows the problem he tries to solve it, one way or another, right or wrong. He defines the program and tries to work out the system to solve the problem. And then tries to maximise the efficiency of the organisation, and the system. He constantly summons the ministers, the secretaries. Once in a month, he attends these briefings at the EPB about the economic situation. He also heads the Export Promotion Meetings. Also every quarter, attends a conference to evaluate the programs. He is really committed himself.<sup>229</sup>**

**With the executive showing a growing willingness to lead, manage and regulate economic policymaking to achieve growth and development,**

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<sup>229</sup>Interview with Nam Duck Woo in Seoul, 31 May 2001.

**the transformation of the bureaucracy into a more effective apparatus was seen as necessary to reach the President's economic goals.**

### **3.3.2 Reforming the Bureaucracy**

**A series of reforms were introduced in the organisation of the Korean bureaucracy during the 1960s. These led to the creation of new agencies and, the redefinition of competencies and conventions in order to attain better performance in the country's economic management. Among the major bureaucratic reforms was the official establishment of the EPB, and new procedures for recruitment, training and promotion within the bureaucracy to improve professional competence.<sup>230</sup> The EPB began its official activities in July 1961 and soon became the main economic governmental body in charge of comprehensive planning and effective execution of the country's Five-Year development plans, the first of these launched in 1962. Additionally, reaffirming the regime's pledge to economic planning and development, the head of the EPB was simultaneously given the position of Deputy Prime Minister (DPM) from December 1963.<sup>231</sup> The importance assigned to economic ministries and technocracy by Park Chung Hee was evident as he actively sought to insulate the EPB from political pressures, and to appoint mainly economic experts to these ministries. Hence, from 1964 to 1979, only seven (14.7 percent) of 47 economic ministers were formerly military, in comparison with the 46 (38.3 percent) of the 120 non-economic ministries.<sup>232</sup>**

**Although less mentioned, the creation of the Office for National Tax Administration (ONTA) in 1966 was probably as important as the EPB for the institutionalisation of the system of "socialisation of private risk". Since its establishment, the ONTA has usually been regarded as the government's most powerful coercive policy instrument to guarantee: (1) that capital allocated to the private sector would go into officially**

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<sup>230</sup>Hahn, 'Administrative Capability for Economic Development', pp.191-3.

<sup>231</sup>Choi, Institutionalizing A Liberal Economic Order in Korea, p.5.

<sup>232</sup>Hahn, 'Administrative Capability for Economic Development', p.195.

**approved business areas and; (2) to punish the businessmen who had violated national economic guidelines. This would usually take the form of tax evasion investigations that subjected the firms judged guilty not only to the payment of additional taxes and penalties, but also to criminal prosecution. Furthermore, tax investigation could result in a decrease of indirect financing funds from financial institutions.<sup>233</sup>**

**Another major reform during the 1960s, involved the consolidation of a meritocratic system in the process of recruitment, training and promotion of the administrative machine.<sup>234</sup> The government re-introduced a highly competitive and open exam system for the higher and lower echelons of the civil service in 1963 that attracted the best Korean students from the country's top universities due to the social prestige usually associated with administrative positions.<sup>235</sup> The changes pushed by Park Chung Hee reinstated an old meritocratic practice inherited from early Korean dynasties and lost during the previous regimes, which seemed to have been more concerned with the politicisation of civil service appointments.<sup>236</sup> Entrance to the Korean civil service could follow three patterns: the civil service examination; special promotion and; special appointment. The first one aimed essentially at employing mid-managers to build a capable managerial body, the second granted some lower managers the opportunity to join the administrative apparatus, and the third guaranteed presidential control over ministries and eased the entrance of professionals into the bureaucracy.<sup>237</sup>**

**The changes were particularly significant in the number of mid-managers recruited through the civil service examination. The numbers that had averaged 25.8 recruits under Syngman Rhee and Chang Myon**

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<sup>233</sup> On the role of the ONTA, see Carter Eckert, 'The South Korean Bourgeoisie: A Class in Search of Hegemony', in Hagen Koo, ed, *State and Society in Contemporary Korea*, pp.95-130 ,pp.102-3.

<sup>234</sup> For an overview of the Korean bureaucracy, see Woo-Cumings, 'The Korean Bureaucratic State; Historical Legacies and Comparative Perspectives'.

<sup>235</sup> For a detailed study on the 1960s reforms on the Korean bureaucracy, see Byung-Kook Kim, 'State Capacity for Reform: The State in Korea and Mexico'; *The Korean Journal of Policy Studies*, 3 (1988), 69-91.

<sup>236</sup> For an analysis of the characteristics of the bureaucracy in the 1950s, see Lee, *Korea: Time, Change and Administration*, pp.101-8.

<sup>237</sup> Kim, 'State Capacity for Reform', pp.81-3.

**grew strongly to 44.6 by 1970 and 174.8 by 1980. Park saw them as important to increasingly manage complex economic issues as the country's move to focus on export-oriented industrialisation. The meritocratic legitimacy was reinforced by their education in elite universities and/or high schools. Not only 96.6 percent had enrolled in a college, but 24.7 percent of them had attained a higher degree. To secure the support and gain the loyalty of the growing number of mid-managers in the administration, Park Chung Hee pursued a strong policy of internal promotion, reducing the share of special appointees.<sup>238</sup> Furthermore, new training programmes for all the higher-ranking civil service were established in 1961 in the Central Officials Training Institute and some ministries launched their own think tanks. Among the most important ones were the Korean Institute of Science and Technology (KIST) in 1967 supported by President Park, and the Korean Development Institute (KDI) under the auspices of the EPB.<sup>239</sup> In sum, Park pursued a reform strategy for the bureaucracy that increased its size, improved professional competence and strengthened its capacity to deal with increasingly complex economic issues as the country focused on export-oriented industrialisation.**

### **3.3.3 Changing the Economic Architecture**

**The reform of the political and bureaucratic institutions was accompanied by significant changes in the country's economic architecture. The new government set two main goals: (1) mobilisation and allocation of financial resources to strategic sectors (exports) as defined by industrial policies set in the country's development plans; and (2) the establishment of the foundations for full governmental control of the financial sector.<sup>240</sup> This involved: the implementation of a five-year development plan (FYDP) setting economic targets (namely in terms of gross domestic product, investment, domestic savings, foreign savings,**

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<sup>238</sup>Kim, 'State Capacity for Reform', p.82.

<sup>239</sup>Hahn, 'Administrative Capability for Economic Development', pp.192-3.

<sup>240</sup>Pyung Joo Kim, 'Financial System and Policy (1961-79): An Assessment of Park's Legacy'; *KIF Paper 95-02* (Seoul: Korea Institute of Finance, 1995) p.19.

**exports and imports growth rates) under the supervision of the EPB, followed by the allocation of resources to the industrial sectors considered a priority for national development. As Ha-joon Chang points out:**

**The designated industries had priority in acquiring rationed (and often subsidised) credits and foreign exchange, state investment funds, preferential tax treatments (for example tax holidays, accelerated depreciation allowances) and other supportive measures, including import protection and entry restrictions. In return for this support, they became subject to state controls on technology (for example production methods, products), entry, capacity expansion and prices.<sup>241</sup>**

**Chang argues that the control played by the government aimed specifically at fighting 'excessive competition' and 'social waste', with violators subjected to penalties such as revocation of licences, fines, and even, prison sentences.<sup>242</sup> Additionally, the government developed a strict system to monitor the performance of the private sector and guarantee the compliance with the targets. The most famous example being the 'Monthly Export Promotion Meetings' chaired by the President and gathering selected ministers and top bureaucrats responsible for trade and the economy; the chief executives of export associations and; presidents of several business groups or *chaebol*.<sup>243</sup> The meeting would start with a briefing on the progress of the country's exports in meeting the targets set in the development plan, followed by a discussion on the possible problems affecting some strategic industries. Ultimately, the meeting 'permitted the President to act directly on problems that individual industries were facing, often by simply issuing directives on the spot.'<sup>244</sup>**

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<sup>241</sup>Ha-joon Chang, *The Political Economy of Industrial Policy* (London: Macmillan Press, Ltd, 1994), p.113.

<sup>242</sup>Chang, *The Political Economy of Industrial Policy*, p.114.

<sup>243</sup>On the Monthly Export Promotion Meeting, see Cheng, Haggard and Kang, *Institutions, Economic Policy and Growth in the Republic of Korea and Taiwan Province of China*, pp.41-3.

<sup>244</sup>Cheng, Haggard and Kang, *Institutions, Economic Policy and Growth in the Republic of Korea and Taiwan Province of China*, p.42.

**In the early 1960s capital was scarce due to the low domestic savings rate, underdeveloped financial and capital markets, as well as declining foreign aid. This led the government to initiate a series of financial reforms to provide it with the control of credit allocation in order to carry on with the industrial policies included in the development plans.<sup>245</sup> During this period, major changes included: the amendment of the Bank of Korea Act (making the central bank subordinate to the Ministry of Finance); the nationalisation of commercial banks and; the creation of new specialised and local banks. Foreign banks were also allowed to enter the Korean market, but not without restrictions on their activities.<sup>246</sup> As the government actively sought the mobilisation of financial resources to support export-led growth, three major reforms took place: (1) currency devaluation; (2) interest rate reforms to stimulate savings and; (3) increase of foreign capital inflows.**

**Currency devaluation was seen as an important component to stimulate export performance. Consequently, from an average rate of 130 won to the dollar in 1963, the local currency was devalued to 255 won to the dollar in 1964.<sup>247</sup> In 1965 the government decided to change its interest rate policies to attract savings from the informal financial market to the banking sector. The nominal interest rate on (one-year) time deposits was raised from 15 percent to 30 percent annually, and the general loan rate increased from 16 to 26 percent.<sup>248</sup> In the first three months, bank deposits grew by 40 percent, and approximately doubled in each of the next three succeeding years.<sup>249</sup> The reform was only partial since many loan categories continued to be heavily subsidised by the government including those related to export and agricultural investment**

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<sup>245</sup>Lee-Jay Cho and Yoon Hyung Kim, 'Major Economic Policies of the Park Administration', in Cho and Kim, eds, *Economic Development in the Republic of Korea*, pp.15-40, p.16.

<sup>246</sup>Cole and Park, *Financial Development in Korea 1945-1978*, pp.66-7.

<sup>247</sup>Haggard, Cooper and Moon, 'Policy Reform in Korea', pp.315-6.

<sup>248</sup>For a detailed analysis of the monetary reform of 1965, see Cole and Park, *Financial Development in Korea 1945-1978*, pp.198-211.

<sup>249</sup>Cole and Park, *Financial Development in Korea 1945-1978*, p.203.

**loans.<sup>250</sup>Finally, in face of continuous shortage of domestic capital, the government sought the inflow of foreign capital. This was first sought through the normalisation of relations with Japan in 1965, followed by the Foreign Capital Inducement Act in 1966, which allowed state-controlled banks to guarantee private sector foreign borrowing.<sup>251</sup>Dimitri Vittas and Yoon Je Cho claim that if investment in Korea had relied uniquely on domestic savings during 1962-1982, the average growth of the economy would have been only 4.9 percent, in comparison with the actual average growth of 8.2 percent.<sup>252</sup>**

**In 1962, an amendment to the Bank of Korea Act reduced the autonomy of the central bank (BOK) and brought the institution under the influence of the Ministry of Finance (MOF).<sup>253</sup>Monetary policy authority and control over foreign exchange moved to the MOF. The changes also provided the MOF with the power to oversee BOK's operations, to manage its budget, the right to request reconsideration of resolutions approved by the Monetary Board (the BOK policymaking body), and the prerogative to recommend the appointment of the BOK governor to the President. Another important reform raised the profile of the Department of Bank Supervision in the central bank to Office of Bank Supervision and Examination (OBSE) outside the BOK executive. While this change was necessary due to the growing number of banking institutions that need to be inspected, it also became a recurrent issue affecting the relations between the MOF and the BOK. The office was eventually made into an 'independent' body under the ministry. Eventually, the amended Bank of Korea Act by reducing the role of the BOK bestowed, on the government, the 'final say on all monetary and financial policies.'<sup>254</sup>**

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<sup>250</sup>Yoon Je Cho and Joon-Hyung Kim, 'Credit Policies and the Industrialization of Korea'; *World Bank Discussion Papers* 286 (Washington: The World Bank, 1995), p.33.

<sup>251</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.34.

<sup>252</sup>Dimitri Vittas and Yoon Je Cho, 'Credit policies: Lessons from Japan and Korea'; *The World Bank Research Observer* 11:2 (August 1996), p.9.

<sup>253</sup>For the amendment of the Bank of Korea Act, see Kim, 'Financial System and Policy (1961-79)', pp.19-20.

<sup>254</sup>Bank of Korea, *The Bank of Korea*, p.154.

**In the early 1960s, the Korean financial market embodied a dual structure: the state-run Korea Development Bank (KDB), the Korea Agricultural Bank (KAB), and the privately-owned commercial banks, most of which had been privatised in 1957.<sup>255</sup> In 1960, the KDB and the KAB accounted for 71 percent of the total lending, with the private commercial banks taking a 29 percent share.<sup>256</sup> Following the military coup d'état in 1961 the new regime, led by Park Chung Hee, moved to take full control of the financial system by nationalising the commercial banks, claiming that they had been 'illegally hoarded' by a small group of large stockholders who had bought the shares in 1957.<sup>257</sup>**

**In terms of special banks, each of them targeting a predefined area of activity, the government altered the Korea Development Bank Charter in December 1961 to bolster the bank's role in the country's industrial development.<sup>258</sup> The amendment increased its capital, allowed it to borrow funds from abroad and the BOK, to guarantee foreign loans obtained by private firms, to supply working capital loans, and to grant long-term loans to government and KDB-owned enterprises. Throughout the 1960s, other special banks were also set to handle policy loans. The Medium Industry Bank (MIB) was created in 1961 to provide loans to medium and small firms, followed the next year by the Citizen's National Bank (CNB), the National Federation of Fisheries Cooperatives (NFFC), and the National Agricultural Co-operatives Federation (NACF). The Korea Exchange Bank (KEB) appeared in 1967 to support foreign exchange transactions by firms. Local banks were established between 1967 and**

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<sup>255</sup>Cole and Yung Chul Park, *Financial Development in Korea 1945-1978*, pp.53-4. See also Bank of Korea, *The Bank of Korea*, p.148. The Korea Development Bank (initially called Korea Reconstruction Bank) was created in 1954 and its main objective was to grant medium- and long-term loans to industry. The Korea Agriculture Bank was officially launched in 1958 with capital subscribed by farmers, agricultural co-operatives and organisations.

<sup>256</sup>Park, 'The Development of Financial Institutions and the Role of Government in Credit Allocation', in Cho and Kim, *Economic Development in the Republic of Korea*, p.45.

<sup>257</sup>Cole and Park, *Financial Development in Korea 1945-1978*, p.53. For example, Lee Byung-chul, the founder and chairman of Samsung, was the main buyer of almost half of the shares on offer. He purchased 85 percent of the Hanil Bank, nearly 50 percent of the Cho Hung Bank, and 30 percent of the Commercial Bank of Korea. See Leroy P. Jones and Il Sakong, *Government, Business and Entrepreneurship in Economic Development: The Korean Case* (Cambridge, MA: Harvard University Press, 1980), p.415, fn.12. For ties between the Rhee's regime and Samsung, see Ingyu Oh, *Mafioso, Big Business and the Financial Crisis: The state-business relations in South Korea and Japan* (Aldershot: Ashgate, 1999), pp.93-7.

<sup>258</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.31.

**1971, one for each of the ten provinces, with the branch network allowed only within the province where the head offices would be located. Foreign banks were allowed to operate in the country in 1967, on the expectation that they would attract the needed foreign capital inflows, and ‘to render [the] domestic bankers’ playground competitive so that they may be induced to improve their banking practices and managerial skills.<sup>259</sup>**

**At the core of the new financial institutional framework was the policy loan, i.e., the major financial tool linking the government, banks and business groups in Korea.<sup>260</sup> It was the policy loan that gave the government the capability to actively intervene in the country’s patterns of industrialisation. Under the regime of Park Chung Hee, there were four types of systems delivering policy loans designed to support export-led growth and the Five-Year Development Plans: (1) via specialised banks (in particular the Korea Development Bank); (2) via commercial banks; (3) via National Investment Fund or NIF (created in 1973 to finance long-term investment in heavy and chemical industry plants and equipment); and (4) via rationing foreign credit.<sup>261</sup> Policy loans could be allocated in two ways. First, through designated credit programmes such as those for exports, agriculture, fisheries or small-and-medium-enterprises (SMEs). Loan eligibility was based on the specific program and borrowers received loans at preferential rates.**

**Second, policy loans could be allocated through government directives, administrative guidance, and *ad hoc* interventions. Loans did not have preferential rates, as the designated credit programmes above, and fell into the same category as the general bank loans. These loans were usually made according to government assessment of the progress of specific key projects and the constraints facing specific firms or industries. Decisions were usually made in consultation between the government and business sectors, after close monitoring of progress by**

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<sup>259</sup>Kim, ‘Financial System and Policy (1961-79)’, pp.21-.5, and pp.30-1.

<sup>260</sup>Kim, ‘Financial System and Policy (1961-79)’, p.49.

<sup>261</sup>Kim, ‘Financial System and Policy (1961-79)’, pp.50-2.

**the government. The government, if necessary, was known to resort to both formal and informal requests to get the banks to support particular exporters.<sup>262</sup> According to Yoon Je Cho and Joon-Kyung Kim, while the *ad hoc* nature of these loans makes it difficult to estimate their amount, they seem to have been substantial and probably more than the ones allocated to earmarked programmes.<sup>263</sup>**

**Ultimately, these changes in the country's financial architecture gave the state the key control over capital allocation and led to the creation of a system of socialisation of private risk. Within this system, and through different formats, whether deposit insurance, lender-of-last-resort, state guarantees, or subsidies to banks facing difficulties due to non-performing loans, the state supported the potential risks associated with private investments in the designated strategic industries for national development. Conversely, this control of the financial system allowed the state to impose performance targets and to discipline those firms that failed to attain such targets by blocking their access to credit. In sum, the new regime led by Park Chung Hee pursued a series of reforms forming the basis of the country's system of socialisation of private risk. The puzzle remains, however, on the motivations that led Park Chung Hee to favour and reinforce this system in pursuit of national growth and development. I argue that Park's strategic actions to build the system of socialisation of private risk were mediated by a combination of historical, international and ideological factors. But, it was Park's ability to assemble and mobilise a coalition during almost two decades of leadership that ultimately guaranteed the strength of the system, at the core of the Korean developmental state.**

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<sup>262</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.32.

<sup>263</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.40.

### **3.4. Shaping the System of Socialisation of Private Risk: History, Institutional Legacies, Context and Ideas**

#### **3.4.1 The Legacies of Syngman Rhee, Chang Myon and U.S. Aid (1948-1961)**

**The First Republic under President Syngman Rhee (1948-1960) and the Second Republic headed by Prime Minister Chang Myon (Aug.1960-May 1961) left important legacies that serve as crucial indicators for the institutional transformation Park Chung Hee engineered to sculpt the system of socialisation of private risk. As Yung-Chul Park points out, ‘the economic and financial policies of every country are strongly shaped by certain fundamental assumptions and objectives, at times not fully articulated, that determine the mind set of policymakers and the public alike. Usually, these come from historical experiences that have, in one way or another, been dramatic.’<sup>264</sup>**

**During the leadership of both Rhee and Chang, party politics hijacked the decision-making process, turning the economic bureaucracy into a hostage of the interests of the executive, ruling party and private firms.<sup>265</sup> During Rhee’s era, the Korean state, under the control of the ruling Liberal Party, became easily exposed to patron-client ties which nurtured the growth of unproductive investments, mainly the manufacturing of import-substitution consumer goods.<sup>266</sup> Furthermore, there was no consistent and systematic attempt to implement long-term development**

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<sup>264</sup> Yung-Chul Park, ‘Concepts and Issues’, in Hugh T. Patrick and Yung Chul Park, eds, *The Financial Development of Japan, Korea, and Taiwan: Growth, Repression, and Liberalization* (New York: Oxford University Press, 1994), pp.3-26, p.4.

<sup>265</sup> Chung-in Moon and Sang-young Rhyu, ‘‘Overdeveloped’ State and the Political Economy of Development in the 1950s: A Reinterpretation’; *Asian Perspective*, 23 (1999), 179-203.

<sup>266</sup> For a general description of the patron-client ties during Rhee’s regime, see Joongi Kim, ‘Corruption, Clientelism and Economic Development in Korea’, Graduate School of International Studies, Yonsei University (mimeo), (not dated) pp.6-9. See also Moon and Rhyu, ‘‘Overdeveloped’ State and the Political Economy of Development in the 1950s’, p.194 and pp.197-8. Moon and Rhyu describe 1950s Korea in these terms: ‘President Rhee reigned, the Liberal Party ruled, and bureaucrats served during the First Republic. Strong political society and weak state characterized the political landscape of the 1950s.’ See also Kim, ‘Political Factors in the Formation of the Entrepreneurial Elite in South Korea’, pp.468-9 and Woo, *Race to the Swift*, pp.65-9. In terms of industrial production, in 1960-1961, just before the military *coup d'état*, food, beverage, tobacco, textiles, clothing, and footwear represented almost 70 percent of the total manufacturing production. See Edward Mason et al, *The Economic and Social Modernization of the Republic of Korea* (Cambridge: Harvard University Press, 1980), p.250.

**plans.<sup>267</sup> The Second Republic under Chang Myon emerged after a series of popular demonstrations against the Rhee government that eventually led to his resignation in 1960. The new administration headed by Chang Myon, though publicly committed to state reform, economic development, and the fight against corruption, faced a difficult political environment. Short-term economic policies, such as the devaluation of the currency and price increases for government-subsidised services, generated inflationary costs that were politically ill-timed when public opinion was not ready to bear them.<sup>268</sup> Simultaneously, as in Rhee's period, members of the ruling party saw in their new power an opportunity to exploit the patronage benefits of office.<sup>269</sup> Founded on a fragile coalition, the government led by Chang Myon lacked autonomy and political support. Consequently, Chang Myon was incapable of settling the conflicting demands placed on it by different social groups.<sup>270</sup>**

**Furthermore, from 1957, Washington not only decided to change its aid policies from provision of grants to loans, but ultimately to cease aid altogether during the 1960s.<sup>271</sup> Since 1945, and in particular after the Korean War, the U.S. played an important role in the country's reconstruction through massive aid allocations.<sup>272</sup> With the end of the conflict in 1953, Korea became increasingly dependent on U.S. aid that financed nearly 70 percent of total imports between 1953 and 1961 and 75 percent of the total fixed capital formation.<sup>273</sup> In the late 1950s, U.S. aid accounted for over 10 percent of Korea's GDP.<sup>274</sup> In 1957, U.S. aid reached**

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<sup>267</sup>Lee, *Korea: Time, Change and Administration*, pp.100-1.

<sup>268</sup>Henderson, *Korea*, p.181.

<sup>269</sup>Kim, *Divided Korea*, p.214.

<sup>270</sup>For the growing disenchantment in the Korean society with the government led by Chang Myon, and in particular with the ruling Democratic Party, see Kim, *Divided Korea*, pp.221-222, Cole and Lyman, *Korean Development*, pp.32-3, and Henderson, *Korea*, pp.179-181.

<sup>271</sup>Tu-jen Cheng, 'Political Regimes and Development Strategies: South Korea and Taiwan', in Gary Gereffi and Donald L. Wyman, eds, *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton, NJ: Princeton University Press, 1990), pp.139-178, p.154. For the changing US aid policies, see Woo, *Race to the Swift*, pp.69-72.

<sup>272</sup>Woo, *Race to the Swift*, p.45. From 1946 to 1976, Washington provided 12.6 billion U.S. dollars of economic and military aid from a total of 15 billion U.S. dollars. Japan contributed with one billion U.S. dollars, and international financial institutions with the remaining two billion U.S. dollars.

<sup>273</sup>Haggard and Moon, 'The State, Politics, and Economic Development in Postwar South Korea', p.61.

<sup>274</sup>Lie, *Han Unbound*, p.29.

**382 million U.S. dollars, and from then it began to drop, to 321 million US dollars in 1958 and 222 million US dollars in 1959.**

**Thus, as 'policy feedback', the First and Second Republics showed how party politics undermined the decision-making process, weakened the economic bureaucracy, and politicised policy choices to ultimately jeopardise the country's economic growth and development. Simultaneously, Washington's decision to reduce aid only contributed to underlining the need for the country to rapidly find solutions for its economic problems.**

#### **3.4.2 Economic Context and U.S. Pressures**

**After the military coup d'état in 1961, the new leadership launched a series of new economic programmes.<sup>275</sup> The new economic programmes aimed at invigorating the economy. Instead, they not only led to a resurgence of high inflation rates, but also to substantial public deficits starting in 1961.<sup>276</sup> Simultaneously, foreign reserves began to rapidly dwindle following the implementation of the country's first five-year development plan. With the new leadership engaged in building a self-sufficient economy, the plan led to a rapid increase in the import of raw materials and industrial machinery to stimulate industrial activities, in particular the construction of large-scale projects such as an integrated iron and steel mill. Since the mobilisation of foreign exchange resources through exports, inter-governmental and private loans failed to reach the planned value, the government was compelled to use the country's foreign reserves. By the end of 1963, Korea's foreign reserves had decreased to no more than 90 million US dollars.<sup>277</sup> To worsen the economic scenario serious crop failures in 1962 and 1963 not only**

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<sup>275</sup>See above for the three major economic policies implemented by the new military regime during 1961 and 1963.

<sup>276</sup>Cole and Park, *Financial Development in Korea 1945-1978*, p.226. See also Haggard, Cooper and Moon, 'Policy Reform in Korea', p.312. According to Haggard, Cooper and Moon, the Counter-Usury Program, together with the ambitious investment targets set in the development plan, and a pay rise offered to public servants contributed largely for a fourfold increase in total bank credit to the public sector in 1961, and a 64 percent rise in 1962.

<sup>277</sup>Cho and Kim, 'Major Economic Policies of the Park Administration', p.20.

**demanded a temporary rise in U.S. grant aid levels during the period but also strongly contributed to push inflation upwards.<sup>278</sup> Inflation rates increased from around 10 percent in 1960 to almost 35 percent in 1964.<sup>279</sup>**

**Faced with food shortages, rising inflation, decreasing foreign reserves, and under the threat of possible loss of much needed aid, the military government became politically vulnerable and seemed to have been left with no other choice but to comply with the U.S. pressure to pursue economic reforms.<sup>280</sup> The U.S. effect on Korean policies was made quite clear by Park Chung Hee in his writings: 'As far as Korea is concerned, she must frankly admit that she is, realistically speaking, under the influence of the United States – whether she likes it or not!'<sup>281</sup> Stephan Haggard, Byung-Kook Kim and Chung-in Moon claim that the inflationary consequences of the military's economic policies led the local director of the U.S. aid mission (USAID) to decide to withhold some parts of U.S. aid, including food assistance, as a way to force the new regime to adopt a stabilisation plan.<sup>282</sup> The rapid decrease, for example, of the food assistance aid program, Public Law 480, had a particular impact in 1971 due to the serious food shortages. In 1971, food aid reached 33.7 million US dollars, against 61.7 million US dollars in 1970 and 74.8 million US dollars in 1969. In consequence, the government was forced to buy some 297.3 million US dollars in food grains from the U.S.<sup>283</sup> Between 1964 and 1966, the military regime pursued what was seen as U.S.-influenced economic reforms, namely currency devaluation, tax and interest rate reforms, foreign capital opening and export-promotion policies.<sup>284</sup>**

**In summary, and in face of a difficult economic environment, and under pressure from Washington to adopt economic reforms, the new military leadership eventually had to filter their economic policy options**

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<sup>278</sup>Cole and Lyman, *Korean Development*, p.172.

<sup>279</sup>Cole and Park, *Financial Development in Korea 1945-1978*, p.225.

<sup>280</sup>On U.S. pressure, see Lim, 'The Origins and Evolution of the Korean Economic System', pp.22-3.

<sup>281</sup>Park Chung Hee, *The Country, The Revolution and I* (Seoul: Hollym Corporation Publishers, 1970), p.153.

<sup>282</sup>Haggard, Kim and Moon, 'The Transition to Export-Led Growth in South Korea', p.863.

<sup>283</sup>Kim, *Divided Korea*, p.280.

<sup>284</sup>Haggard, Cooper and Moon, 'Policy Reform in Korea', pp.315-324.

**in terms of their impact on the relationship with the U.S., at the time the country's main aid donor.**

### **3.4.3 State-led Economic Nationalism and 'Growth-First' Developmental Paradigm**

**The country's economic context, and dependence on US aid, imposed constraints on the behaviour of the new military regime, but it also opened opportunities in terms of policy choices that were embraced by the new leadership. As Wonhyuk Lim points out, 'Park would go far beyond the orthodox economic policies prescribed by the Americans, and adopt drastic measures to promote exports and increase economic independence.'<sup>285</sup> Economic nationalism was particularly respected by the new leadership, and this was visible in the Korean government preference for foreign loans vis-à-vis foreign direct investment.<sup>286</sup> Since the domestic firms at the time, lacked the financial credibility to raise capital in international markets, the government allowed state-owned banks to guarantee foreign borrowing.**

**Economic nationalism was a clear ideological stance driving the economic policy choices set by the new military regime. The population was asked to contribute to the country's rapid economic development through such slogans as 'Let's try to live well' and 'We too can do it'.<sup>287</sup> The actions, speeches and policy choices of Park Chung Hee revealed a leader who was interested in strengthening the nation through economic development.<sup>288</sup> As he put it in his book *The Country, the Revolution and I*, 'creation of a self-supporting economy and accomplishment of an**

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<sup>285</sup>Lim, 'The Origins and Evolution of the Korean Economic System', p.24.

<sup>286</sup>Lim, 'The Origins and Evolution of the Korean Economic System', p.25. See Dae-Hwan Kim, 'The Idea of National Economic Integration and the Experience of Korean Development', in John Borrego, Alejandro Alvarez Bejar and Jomo K.S., eds, *Capital, the State, and Late Industrialisation: Comparative Perspectives on the Pacific Rim* (Boulder: Westview Press, 1996), pp.81-96, pp.85-7.

<sup>287</sup>Kim, 'The Idea of National Economic Integration and the Experience of Korean Development', p.86. Furthermore, the implementation of the leadership's nationalist policy choices were facilitated by the cooperation of a population that, in face of the colonial experience under the Japanese, was itself strongly nationalist.

<sup>288</sup>For a discussion of the impact of economic development as an ideology in the policy process, see Chung-kil Chung, 'The Ideology of Economic Development And Its Impact on Policy Process'; *The Korean Journal of Policy Sciences*, 1 (1986), 28-46.

**industrial revolution is a key to national renaissance and prosperity.<sup>289</sup> In his nationalist stance, Park was not different from Syngman Rhee.<sup>290</sup> What distinguished Rhee and Chang's 'free-market' approach from that of Park's was that Park believed the state had a role to modernise and build a strong nation through rapid economic growth and development.<sup>291</sup> Park made this clear in his *Our Nation's Path*:**

**There was once a time when the laissez faire policy was the only way to guarantee the maximum freedom of people's economic activities, but it was realized subsequently that such a policy was apt to widen the gap between the haves and have-nots and create massive unemployment. Hence, it was felt necessary to combine laissez faire with planning and for the State to directly and positively participate in economic activities so as to guarantee the economic welfare of the individual. Inasmuch as the principal objective of achieving national prosperity is to guarantee the economic welfare of individuals, the Government is called upon to strongly enforce its administrative prerogatives.<sup>292</sup>**

**'Growth-first' soon became the motto at the heart of the new leadership's developmental goals. In an interview, Nam Duck Woo, Deputy Prime Minister and Minister of Economic Planning during the presidency of Park Chung Hee, clarifies the view of the new leadership: '(...)at the time, nobody, including the President and the bureaucracy believed in the so-called private function of the financial market. President Park had a strong belief that if government did take the hands of the bank system, then the banks would favour credit to some "unproductive sectors" like restaurants.'<sup>293</sup> Park Tae Gyu, a professor at the country's leading educational institution Seoul National University (SNU), points out that after the coup d'état, the new military regime employed a group of**

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<sup>289</sup>Park, *The Country, The Revolution and I*, p.171.

<sup>290</sup>Cole and Lyman, *Korean Development*, p.95.

<sup>291</sup>Interview with Park Tae Gyu, Professor at Seoul National University, Seoul, 12 March 2001.

<sup>292</sup>Park Chung Hee, *Our Nation's Path: Ideology of Social Reconstruction* (Seoul: Hollym Corporation Publishers, 1970), pp.37-8.

<sup>293</sup>Interview with Nam Duck Woo in Seoul, 30 May 2001.

economists which he named the ‘state-led group’.<sup>294</sup> These economists emphasised the interventionist role of the state in the economy and adopted as their models Third World nationalism from countries such as India, Egypt and Turkey. Important in Park’s ideological views seem to have been the influence of Park Hee-Bum, one of the members of this ‘state-led group’ and a professor of economics at SNU. He was first formally appointed as a special economic advisor to the President, but later and under strong pressures from the US, he was forced to leave.<sup>295</sup> Nevertheless, Park Tae Gyu argues that, until his assassination in 1979, Park Chung Hee kept a close relationship with Park Hee-Bum.<sup>296</sup>

**South Korea’s particular historical legacies of Syngman Rhee and Chang Myon, the U.S.’s reduction of aid and pressure for economic reforms, and the new leadership’s belief in state-led economic nationalism emerged then as important variables shaping the incentives that led Park Chung Hee to establish a system of socialisation of private risk. The implementation of this system, nevertheless, would not have succeeded if Park Chung Hee had not strategically acted to control a meritocratic bureaucracy with the capacity to hold and maintain such reform initiatives, build a supporting coalition with the country’s farmers and business firms, and repress labour.**

### **3.5 Negotiating the System of Socialisation of Private Risk: Co-Opting Bureaucrats, Farmers and Businessmen**

**Reform of the bureaucracy permitted Park Chung Hee full control over the administrative apparatus, and to guarantee that it would become increasingly meritocratic and insulated from societal interests. The initiative was not only a response to the politically-charged and weak economic bureaucracy of the previous regimes. By taking measures**

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<sup>294</sup>Interview with Park Tae Gyu in Seoul, 12 March 2001.

<sup>295</sup>Interview with Park Tae Gyu in Seoul, 12 March 2001. According to Park Tae Gyu added the “state-led group” was forced to leave the bureaucratic machine under pressure of the U.S. which as shown above clearly disagreed with the earlier economic policies undertaken by the Park’s regime.

<sup>296</sup>Interview with Park Tae Gyu in Seoul, 12 March 2001.

aimed at increasing the size of the bureaucracy, improving its competences through selective recruitment processes, training programs and job incentives, Park sought strategically not only to legitimate his power seized by way of a military *coup d'état*, through economic development but as well as to accommodate political allies. He created a 'bifurcated bureaucracy' feeding domestic-oriented ministries such as Transportation, Construction and Home Affairs with patronage appointments, while guaranteeing the professionalism of the economic ministries such as EPB, Finance or Trade and Industry.<sup>297</sup>

Simultaneously, Park Chung Hee set in 1961 a Ministry of Government Affairs in charge of supervising and reorganising the bureaucracy, to impede the influence of the National Assembly on personnel policy, a widespread practice during the previous regimes. Under Park Chung Hee, bureaucrats were also given the assurance that if they achieved the performance goals set at the top, they could be promoted to a more prestigious position 'all the way up to that of minister'.<sup>298</sup> Appointments of military officers were particularly important in the early years of the regime, because Park Chung Hee needed not only to keep military support in all sectors of the bureaucracy as a means of consolidating and keeping control, but also to include in the new administration individuals with management skills as the Korean military had become modernised more than any other national organisation.<sup>299</sup>

Park's regime also sought the involvement of the country's farmers in this growth-oriented alliance. Following the end of the Korean War in 1953, President Rhee, who had lost support within the population, finalised a major land reform to gain the confidence of the rural majority

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<sup>297</sup>Kang, *Crony Capitalism*, pp.85-90.

<sup>298</sup>Hahn, 'Administration Capability for Economic Development', p.196.

<sup>299</sup>Wan Ki Paik, 'The Formation of the Governing Elites in Korean Society', in Gerald E. Caiden and Bun Woong Kim, eds, *A Dragon's Progress: Development Administration in Korea* (West Hartford, Connecticut: Kumarian Press, 1991), pp.43-57, p.53. See also Lee, *Korea: Time, Change and Administration*, pp.88-9. Lee mentions, for example, the creation of the National Defense College and the ROK (Republic of Korea) Army Logistics in 1956. The ROK Army Logistics was, according to Lee, the first institution in Korea with an advanced management course using the "case-study method".

**and secure his rule over the territory recaptured by the US-UN forces. Land reform was seen as an important tool contributing to the legitimacy of Rhee's government. In exchange for land, tenants had to pay 30 percent of their harvest to the government.<sup>300</sup> This meant that the reform allowed the regime to have access to much needed grain to feed the country's troops. In a similar vein, Park Chung Hee also sought to establish the legitimacy of his regime by attracting the support of the rural majority in a country where the main economic activity was still agriculture.**

**In Korea, even for authoritarian regimes, political legitimacy has rested on whether or not the ruler has the 'mandate of heaven' to govern, drawn from the support of the people.<sup>301</sup> Despite the continuing allegations of illegal practices, the election process has been regarded as a mechanism capable to measure the degree of popular support for candidates. A majority of the votes would confer the highly symbolic 'mandate of heaven'.<sup>302</sup> Although the Counter-Usury Program in 1961 failed to achieve its goals, other agricultural policies pursued by the regime had a positive impact in the development of the rural economy. For example, the military regime reorganised the agricultural and marketing institutions by bringing together the agricultural cooperatives and the Agriculture Bank into one institution named National Agricultural Cooperatives Federation (NACF). This institution was to become responsible for allocating credit to farmers, provide them with agricultural inputs such as fertilizers and pesticides, and marketing farm crops. The creation of an**

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<sup>300</sup>For an analysis on the factors leading to land reform in Korea during the regime of President Syngman Rhee, see James Putzel, *A Captive Land: The Politics of agrarian reform in the Philippines* (London: Catholic Institute for International Relations, 1992), pp.103-5.

<sup>301</sup>Soohyun Chon, 'The Election Process and Informal Politics in South Korea', in Dittmer, Fukui, and Lee, *Informal Politics in East Asia*, pp.66-81, p.68. For studies on the Korean political tradition and its relation to Confucianism, see Hahm Pyong-Choon, *Korean Jurisprudence, Politics and Culture* (Seoul: Yonsei University Press, 1986) and *The Korean Political Tradition and Law: Essays in Korean Law and Legal History* (Seoul: Royal Asiatic Society, 1987).

<sup>302</sup>The adoption of 'western' political institutions (such as the Constitution and other laws) and practices (such as elections) following the liberation from Japan represented the first step by the Korean elites to move away from the old Confucianist political heritage of the past. Consequently, for the Korean elites, legality – or at least the apparent conformity with laws – became the principal foundation of their legitimacy: 'When he is elected or appointed in conformity with the constitution and laws, he enjoys a solid legitimacy.' See Hahm, *Korean Jurisprudence, Politics and Culture*, p.196.

**Office for Rural Development (ORD) was also important for the distribution of improved seed, and information on new crops and cultivation techniques.<sup>303</sup>**

**Finally, these institutional and policy reforms by strengthening the autonomy and capacity of the state, in particular of the executive, provided it with the power to transform the nature of state-business ties. Park's regime was still dependent on business to implement industrial policies and deliver economic growth. However, it also controlled the country's financial system which strengthened its capacity to negotiate the rules of the game. One of the main reasons for the new regime's nationalisation of the country's commercial banks was the claim that the stockholders of the banks were businessmen who had bought the institutions with profits that were 'illegally' gained during the previous regime. Another reason rested on Park Chung Hee's fears that, since the main stockholders of the commercial banks were also the main owners of the country's business firms, the banks would allocate credit to affiliated companies.**

**While the new regime initially prosecuted the owners of the major *chaebol* such as Samsung, Samho, Gaipoong, Tai Han and Lucky-Gold Star, Park Chung Hee and close associates soon became aware that this move could only hurt the government's development plans.<sup>304</sup> Instead of prosecution, as illustrated in section 2.4.3 of Chapter Two, businessmen were released and 'invited' to join a national growth-oriented alliance led by Park Chung Hee. Rather than a relationship dominated by the state, it was built on interdependent ties. The relationship between the two actors was further enhanced by Korean state willingness to prevent the formation of labour movements that could challenge the government's economic agenda. As Byung-Kook Kim and Hyun-Chin Lin point out: 'What Park desired was a labour force resigned to shouldering a**

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<sup>303</sup>For a more detailed analysis of the causes of agricultural growth, see Cole and Lyman, *Korean Development*, pp.142-153.

<sup>304</sup>Haggard, Kim and Moon, 'The Transition to Export-led Growth in South Korea', p.859.

**disproportionate share of the burden of heavy investment in the early stages of industrial development while capital received diverse privileges for its role as engine of growth.<sup>305</sup>**

### **3.6 Conclusion**

**The emergence of the Korean developmental state remains a much debated issue with two major views – continuity and discontinuity – arguing different justifications for the origins of the phenomenon. The continuity school tends to underline the legacy of the Japanese colonial period as setting the institutional foundations for the Korean developmental state. The discontinuity school claims instead that the origins of such a state are in the policies undertaken since 1961 by President Park Chung Hee. The two perspectives are, nonetheless, without their own shortcomings as a consequence of their propensity to be historically selective and bias.**

**While the continuity school fails to take into consideration the political, economic and social impact of a problematic 15-year period following the liberalisation of the country in 1945, the discontinuity school by reifying the developmental role of the post-1960s military leadership ignores two major facts. First, the new military leaders' policy choices were significantly influenced by plans, projects and programs earlier designed by the civilian government led by Chang Myon. Second, the new military leaders' initial and failed attempts to reform the economy by administrative fiat provided important policy and political strategic lessons for future policy choices.**

**An analysis based on historical institutionalism provides the interpretative and analytical tools to understand the relationship between leadership, social interests and policy outcomes within a particular**

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<sup>305</sup>Byung-Kook Kim and Hyun-Chin Lim, 'Labour Against Itself: Structural Dilemmas of State Monism', in Larry Diamond and Byung-Kook Kim, eds, *Consolidating Democracy in South Korea* (Boulder, Co: Lynne Rienner Publishers, 2000), pp.111-137, p.115.

**context and historical momentum. This theoretical framework sets as its focal point the institutional arrangement that structure political relations, whether or not co-operative, and actions to determine the policy process. In the case of Korea, the empirical findings show that the system of socialisation of private risk strategically created and consolidated by Park Chung Hee worked well to support co-operative behaviour between leadership and social interests, in particular bureaucrats and business groups. Park's strategy was essentially based in four main features: (1) the concentration of power in the executive; (2) the development of effective clusters comprised of professional economic bureaucrats; (3) state control of the financial system and; (4) an alliance with bureaucrats, farmers and the *chaebol*.**

**This institutional framework materialized as the rules of the game shaping the political, economical, and informal relationships between Korean leadership, bureaucrats, business groups and farmers, and thus influencing the pattern of policy outcomes. The system emerged as a response to historical legacies, U.S. pressures for economic reform, and an ideological standing held by the country's leadership (state-led economic nationalism) by opening opportunities for co-operation and placing restraints on self-interested behaviour through rewards and penalties. The success of the system rested on the capacity of Park Chung Hee to sustain the system through a credible commitment to an alliance with bureaucrats, *chaebol* and farmers. The credible commitment comprised precisely not only of incentives but also penalties. For example, bureaucrats were offered promotions in return for success in achieving performance targets, but bureaucrats could also be sacked if they failed to achieve those planned targets. Conversely, the *chaebol* traded economic performance and political funds for financial incentives, tax savings and tariff protection. Yet, if the *chaebol* fell short of fulfilling economic guidelines set by the government, they could be blocked from access to credit or exposed to tax investigations. In this sense, the**

**system of “socialisation of private risk” was based on power equilibrium between the involved parts, especially between the state and the *chaebol*.**

**In the process, it helped minimise a collective-action dilemma, i.e., the belief that groups will act only to guarantee a disproportionate share of societal income for themselves rather than advance collective welfare. The rules of the game underpinning the system of socialisation of private risk ultimately influenced preferences and provided expectations both about potential rewards/sanctions and about how to strategically act in face of possible behaviour by other players.**

**The following chapter assesses a particular case of policy reform, the heavy and chemical industrialisation in the 1970s. It analyses why and how President Park acted strategically to consolidate the system and with what policy and political outcomes for future policy choices.**

## **4. CHAPTER FOUR - Consolidating the System of Socialisation of Private Risk: The Heavy and Chemical Industrialisation of the 1970s**

### **4.1 Introduction**

**In the January 1973 New Year's address, President Park Chung Hee announced that the government would implement a heavy and chemical industrialisation (HCI) plan. With this move, Park vowed that Korea would soon become one of the leading developing countries, with a per capita GNP of US\$1,000 and exports of US\$10 billion.<sup>306</sup> The government enacted a Heavy and Chemical Industries Promotion Act to support six major industries: steel, non-ferrous metals, machinery (including automobiles), shipbuilding, electronics and chemicals. The act provided tax and credit benefits as well as the exemption of young engineers and skilled workers from the country's compulsory military service.<sup>307</sup> Key industrial projects in the plan were to be undertaken by private firms. Exceptions to this were the production expansion of iron and steel and the construction of chemical fertilizer plants. This would be left to public companies.<sup>308</sup> Furthermore, the plan expected that most of the selected industries would become the country's leading exporters by 1980.<sup>309</sup> For Suk-Chae Lee, an official in the EPB from 1970 through 1984, the HCI plan marked a significant change in the governmental approach to industrial policy in several ways.<sup>310</sup>**

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<sup>306</sup>Kim, *Policymaking on the Front Lines*, p.85

<sup>307</sup>Suk-Chae Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', in Cho and Kim, eds, *Economic Development in the Republic of Korea*, pp.431-471, p.432. For a detailed work on the role played by the Korean state in pushing for the heavy and chemical industrialisation of the country, see Choue Inwon, *The Politics of Industrial Restructuring: South Korea's Turn Toward Export-Led Heavy and Chemical Industrialization*, Doctoral dissertation, University of Pennsylvania, 1988. Choue, however, assumes the same position as the strong state literature. He emphasises the autonomy of the Korean state in successfully leading and pushing for the restructuring of the country's industrial panorama from light manufacturing to heavy and chemical industries. But Inwon fails to recognise that this strategy only succeeded because the state not only coerced but also motivated, offered incentives and co-opted the *chaebol* to actively participate in the industrial transformation. The *chaebol* were, in fact, initially reluctant to invest in an industrial sector where they did not have much experience. See below for the *chaebol*'s earlier view on HCI.

<sup>308</sup>Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', p.434.

<sup>309</sup>Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', p.434.

<sup>310</sup>Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', pp.436-7.

**First, unlike past five-year development plans (FYDPs) promoting exports as a whole without singling out any particular industry, the ten-year HCI plan targeted a specific industrial sector with a detailed, comprehensive investment to be carried out within a certain timetable. Second, the HCI plan was an 'imperative plan', i.e., it was expected to be 'executed meticulously'. While the FYDPs had an important impact in terms of resource mobilisation and patterns of resource allocation, they were not regarded as imperative plans. Finally, due to the size of the key projects included in the HCI plan, only the country's large firms were fit to take part in the new development strategy. In fact, as II Sakong points out, 'in implementing HCI promotion policies, the government actively encouraged large business groups with proven track records and financial capability to participate in major projects in designated industries.'<sup>311</sup>**

**By early 1980s, the Korean economic structure had been radically transformed. In 1970, in terms of the country's total manufacturing value added and exports, light industry represented 64 percent and 81 percent, respectively, against 36 percent and 18.2 percent for HCI. But in 1983, the situation had reversed, with HCI accounting for 53.9 percent of the manufacturing value added and 56.5 percent of the exports, correspondingly the share of the country's light industry had decreased to 46.1 percent and 43.5 percent.<sup>312</sup> This outcome seemed to have vindicated the government's strategy to push for HCI and to co-opt big business to actively participate in the country's radical industrial transformation. The leadership's decision to invest in the development of heavy and chemical industries was, nonetheless, seen as a bold and risky move at a time when the country's economy faced growing internal and external adversities.**

**As a case-study, this chapter seeks first to understand the active role of Park Chung Hee in pushing for the HCI plan, and how his choice**

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<sup>311</sup>Sakong, *Korea and the World Economy*, p.57.

<sup>312</sup>Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-1979)', p.452 (Table 17.12).

**was moulded by the interface between the system of socialisation of private risk, the domestic economic and political conditions, changing international security environment and ideological motivations. Next, it examines 'who gets what, when, how, at whose expense' within the HCI implementation process and how these patterns of political behaviour influenced the configuration of the new industrial policy and with what political and policy outcomes. I show that the successful implementation of the HCI plan depended on Park's strategic behaviour, not only to build a consensus within the economic bureaucracy over the new industrial policy, but also to protect and secure the state's alliance with the *chaebol*. In the latter case, Park acted not only to rescue the corporate sector in a time of economic difficulties, but also to coerce and induce them through a series of incentives to undertake key HCI projects. Ultimately, this consolidated system of socialisation of private risk inherited from the 1970s produced significant political and policy outcomes that, by placing the country into a certain path-dependent development trajectory, constrained future policy choices.**

## **4.2 Orchestrating a New Industrial Strategy**

**In this section, several factors are examined to understand to what degree they played an important role in shaping the policy choices of Park Chung Hee in the early 1970s as he moved to support HCI. It starts by looking at the internal and external economic conditions at the time, followed by an analysis of the ideologies motivating the leadership to pursue such policy and a consideration of the country's security and domestic environment.**

### **4.2.1 Booming Economy, Increasing Trade Deficits and Rising International Protectionism and Competition**

**During the 1960s, the Korean economy grew rapidly, at 7.8 percent per annum during the (revised) first five-year development plan (1962-1966), rising to 9.7 percent, maintained every year during the second plan**

**(1967-1971).<sup>313</sup> The industrial structure began to experience a major shift in its composition as the manufacturing sector, essentially light industries, became one of the country's leading economic performers. While the agricultural sector share in terms of total GDP declined from 40.4 percent in 1953-1961 to 27.8 percent in 1967-1971, the manufacturing sector increased its share from 12.7 percent to 20.5 percent during the same period. Along with these changes, unemployment rates decreased from 8.2 percent in 1963 to 4.5 percent in 1971.<sup>314</sup> Meanwhile, the number of agricultural workers declined from around 70 percent to 50 percent of the workforce, as the numbers of those employed by the manufacturing sector grew from a mere 1.5 percent in 1960 to 13.1 percent in 1970.<sup>315</sup> The expansion of the manufacturing sector was basically an outcome of the export demand originating from Japan and the US, the country's two major foreign markets. In 1960, Japan was Korea's most important export market taking 61.5 percent of the country's total exports. By 1971, the US overtook Japan to become Korea's main trade partner with almost 50 percent of the country's total exports (from a mere 11 percent in 1960).<sup>316</sup>**

**One of the most relevant economic factors during the 1960s was the country's increasing integration in the world economy. From 1962 to 1971, exports increased from 55 million US dollars to 1.132 billion US dollars, while imports grew from 390 million US dollars in 1962 to 2.178 billion US dollars in 1971.<sup>317</sup> Export dependency jumped from less than one percent to 9.3 percent of the gross domestic product (GDP) during the 1960s, while import dependency increased from around 9 percent to 22 percent for the same period. Exports of manufactured goods were predominantly composed of clothing, footwear, travel goods, textiles, and leather goods.<sup>318</sup> Imports included mainly capital goods and raw materials**

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<sup>313</sup> Cho Soon, *The Dynamics of Korean Economic Development* (Washington: Institute for International Economics, 1994), p.17.

<sup>314</sup> For unemployment figures and manufacturing sector share in GDP, see Cho, *The Dynamics of Korean Economic Development*, pp.19 and p.22, respectively.

<sup>315</sup> Jung-ho Yoo, 'The Industrial Policy of the 1970s and the Evolution of the Manufacturing Sector in Korea'; *KDI Working Paper 9017* (Seoul: Korea Development Institute, October 1990), p.5.

<sup>316</sup> Yoo, 'The Industrial Policy of the 1970s and the Evolution of the Manufacturing Sector in Korea', p.13.

<sup>317</sup> Cho, *The Dynamics of Korean Economic Development*, pp.21-5.

<sup>318</sup> Yoo, 'The Industrial Policy of the 1970s and the Evolution of the Manufacturing Sector in Korea', pp.8-12.

**needed for the export sector as well as for the import-substitution industries nurtured by the government.<sup>319</sup> Such was the success of the export sector that the government claimed that this economic outcome would soon lead to the 'establishment of the nation on the basis of exports' (*suchul ipkuk*).<sup>320</sup>**

**However, despite the continuing and rapid growth of exports, imports grew even faster, leading in consequence to worsening trade deficits during the 1960s. At the end of the Second FYDP in 1971, the trade deficit had jumped to almost 1.05 billion US dollars, from 429.5 million US dollars in 1966, the last year of the First FYDP.<sup>321</sup> If one compares the actual figures for 1971 with the 344 million US dollars originally targeted by the Second FYDP, then the unexpected size of the trade deficit was increasingly seen as a national liability. The significance of the issue gained growing public and governmental attention in the late 1960s. An 'Evaluation Committee of Professors', composed of well-known college and university professors which gathered annually to review the progress of the five-year development plans, raised the alarm over the growing and persistent trade deficits.<sup>322</sup> Among the prescriptions suggested to the government were: restrictions on what was called 'unnecessary imports', in particular consumer goods, and promotion of HCI.**

**Meanwhile, the growth of the manufacturing sector was largely financed by debt (through access in particular to policy loans) rather than internal savings or new equity.<sup>323</sup> The successful performance of the**

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<sup>319</sup>Cho, *The Dynamics of Korean Economic Development*, p.25.

<sup>320</sup>Inwon, *The Politics of Industrial Restructuring*, p.199. See also Castley, *Korea's Economic Miracle*, pp.170-1.

<sup>321</sup>Cho, *The Dynamics of Korean Economic Development*, p.29 and p.35 for targets and performance of the first and second five-year development plans, respectively.

<sup>322</sup>Yoo, 'The Industrial Policy of the 1970s and the Evolution of the Manufacturing Sector in Korea', pp.22-3.

<sup>323</sup>Chung, 'Capital Accumulation of Chaebol in Korea During the Early Stages of Economic Development', pp.20-4. During the 1960s, since the country lacked a large pool of domestic savings, policy loans provided by the government were regarded as the main sources to finance business investments. The advantage of these loans rested not only on the lower interest rates charged (there were times that the official interest rates paid by the borrowers would be negative in real terms, as the inflation rates surpassed the nominal interest rates), but also on the longer maturity terms. Additionally, the government's taxation policy favoured borrowing. If companies produced profits, the government would impose a corporate tax rate of about 40 percent, against a tax of only

**Korean economy during the 1960s, gave rise to an expectation that the expansion would persist for the near future. This optimism led the private sector to escalate its investments. In 1968 and 1969, investment increased at an average rate of nearly 50 percent per annum and domestic credit expanded at over 60 percent.<sup>324</sup> The interest rate reform in 1965 and the new system guaranteeing the repayment of foreign loans greatly helped the private sectors' investment expansion. Among its other efforts to induce foreign capital, the Korean government signed a one-year Stand-by Credit Agreement for 9.3 million US dollars with the International Monetary Fund (IMF) in March 1965.<sup>325</sup> Time after time, the government not only extended the loan period but also increased the amount it owed to the IMF. Between 1965 and 1969, the total domestic indebtedness of the manufacturing sector to financial institutions increased from 2.6 to 9.2 percent of GNP.<sup>326</sup> Consequently, foreign debt that was at a relatively low amount of 157 million US dollars (4.06 percent of the GNP) in 1961 reached 2.922 billion US dollars (30.06 percent of the GNP) in 1971.<sup>327</sup>**

**Real wage rates increased rapidly and this began to weaken the country's international competitiveness, and slow the rate of export growth, from a high of 42 percent in 1968 to 34 and 28 percent in 1969 and 1970, respectively.<sup>328</sup> As Kim Wan-Soon states, 'corporate indebtedness was stretched to such an extent that a moderate slowdown in demand could cause a number of firms to experience serious financial difficulties.'<sup>329</sup> The first signs of increasing financial agony in the private sector surfaced in 1969 when a number of firms failed to meet their foreign debt obligations. In May 1969, the system of socialisation of**

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around 10 percent for interest income on bank deposits. However, the same system regarded interest on loans as managerial costs, and in doing this it promoted debt-building by the corporate sector. See Cole and Park, *Financial Development in Korea 1945-1978*, p.162.

<sup>324</sup>Lim, 'The Origins and Evolution of the Korean Economic System', p.31. See also Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.63 (Table B).

<sup>325</sup>Bank of Korea, *The Bank of Korea*, p.165.

<sup>326</sup>Wan-Soon Kim, 'The President's Emergency Decree for Economic Stability and Growth (1972)', in Cho and Kim, *Economic Development in the Republic of Korea*, pp.163-181, p.163.

<sup>327</sup>Woo, *Race to the Swift*, p.105 (Table 4.8).

<sup>328</sup>Inwon, *The Politics of Industrial Restructuring*, p.232.

<sup>329</sup>Kim, 'The President's Emergency Decree for Economic Stability and Growth (1972)', pp.163-5.

**private risk was put to work. The government, worried with the possible negative impact of the corporate bankruptcies in the country's international credit ratings, intervened to take over the managerial control of thirty firms, struggling to service their foreign loans. The government controlled, auctioned, or refinanced these firms, while financially rescuing state-owned banks that had issued the repayment guarantees. Another ninety firms were also reported to be on the verge of bankruptcy.<sup>330</sup> While guaranteeing the repayment of their foreign borrowings, the government took a 'principled stance' against the insolvent firms and stated that it would keep the management of these firms accountable for their prior business deals. Despite governmental intervention, the number of firms which had taken foreign loans and gone into bankruptcy continued to grow. By 1971, the total was more than two hundred.<sup>331</sup>**

**With the aggravation of the economic scenario, the IMF approached Korea to call for the implementation of a stabilisation package.<sup>332</sup> The government acquiesced with the IMF proposal in 1971, after the US linked consideration of further developmental loans to the acceptance of the program.<sup>333</sup> The IMF program advocated tightening of monetary control, which restricted credit activities of the domestic commercial banks, and consequently the latter could not offer much relief to heavily-indebted firms. Domestic credit expansion slowed from 66.3 percent and 59.8 percent in 1968 and 1969 to 32.3 percent and 28.2 percent in 1970 and 1971.<sup>334</sup> At the IMF's insistence, the government was forced to cancel 61 loans already approved for 1971, totalling 250 million US dollars. Following the announcement of the ceiling on loans, even those who had government approval found foreign banks unwilling to serve further credit.**

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<sup>330</sup>Lim, 'The Origins and Evolution of the Korean Economic System', pp.31-2. See also Woo, *Race to the Swift*, p.109, and Kim, *Divided Korea*, pp.277-8.

<sup>331</sup>Inwon, *The Politics of Industrial Restructuring*, p.233.

<sup>332</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.63, and Lim, 'The Origins and Evolution of the Korean Economic System', pp.32-3.

<sup>333</sup>Woo, *Race to the Swift*, p.110.

<sup>334</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.63 (Table B).

**The IMF had set the ceiling at 468 million US dollars in commercial loans, but only 345 million US dollars were in fact received in 1971.<sup>335</sup>**

**In an effort to stimulate exports and help struggling export-led manufacturing firms, the Economic Planning Board announced a currency devaluation of 18 percent in 1971, and an additional seven percent in the following year.<sup>336</sup> Yet, as Woo Jung-en pointed out, 'this was bitterly resented by businessmen, including exporters, who considered the sharp rise in the won cost of debt-financing ill-timed, adding insult to injury.'<sup>337</sup> The measures had a negative impact particularly in the manufacturing sector. The debt to equity ratio that was at 92.2 percent in 1963, rapidly increased to 270 percent in 1969, 328.4 percent in 1970 and 394.2 percent in 1971, with profits falling sharply from 9.1 percent in 1963 to 3.3 percent in 1970 and 1.2 percent in 1971.<sup>338</sup> The rate of delayed payments as well as dishonoured checks and bills rose, as business prospects deteriorated.**

**The country's economic situation became even more strained as the US, and other industrial countries, began to adopt protectionist measures, especially against labour-intensive manufactured goods from developing nations. This trade policy affected the Korean textile industry, in particular, in its relations with the US. In October 1971, the US imposed a quota on Korean textile exports to affect a sector that a year earlier accounted for 40 percent of the country's total exports.<sup>339</sup> In the final quarter of 1971, exports to the US fell 15 percent, and government officials estimated that the quota would cost Korea 840 million US dollars of export income during the Third FYDP (1972-1976).<sup>340</sup> At the same time, the growing participation of Southeast Asian countries, as well as of the**

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<sup>335</sup>Kim, *Divided Korea*, p.278.

<sup>336</sup>Lim, *The Origins and Evolution of the Korean Economic System*, p.33.

<sup>337</sup>Woo, *Race to the Swift*, p.110.

<sup>338</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.64 (Table C).

<sup>339</sup>Yoo, 'The Industrial Policy of the 1970s and the Evolution of the Manufacturing Sector in Korea', pp.20-1, and Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', p.438.

<sup>340</sup>For the Korea-U.S. Textile Agreement, see Yonhap News Agency, *Korea Annual 1972* (Seoul: Yonhap News Agency, 1972). See also Kim, *Divided Korea*, pp.280-281, and Woo, *Race to the Swift*, pp.125-6.

**People's Republic of China, in the international export market for labour-intensive and light-industry products was a sign that Korea's comparative advantage was under threat and could soon vanish.**

**Ultimately, the country's continuing trade pattern began to be regarded as a structural built-in tendency, i.e., the trade deficit would continue to grow as long as the country failed to develop its own heavy and chemical industries to replace imports. Simultaneously, the Korean manufacturing industry began to suffer from the protectionist measures undertaken by developed countries and from the competition challenge pushed by newcomers into the international export market. Consequently, the Korean government began to increasingly see the upgrade of the country's industrial structure as the solution for the country's economic problems.**

#### **4.2.2 Changing Security Environment and Building a 'Rich Nation, Strong Army'**

**The decision to push for HCI came also in a period of security uncertainty and the policy was seen as an opportunity to build an indigenous defence industrial sector through forward and backward linkages. Furthermore, Park's HCI drive seems to have been rooted in an old Japanese nationalist view – 'rich nation, strong army'- that emerged as the dominant ideological paradigm shaping the country's new economic direction.<sup>341</sup>As Nam Duck Woo, at the time Minister of Finance, puts it out:**

**To my knowledge, he (Park Chung Hee) was motivated by the belief that the real economic strength of a country derives from the strength of its heavy industry, as was well illustrated by the Japanese experience before**

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<sup>341</sup>Chung-in Moon, 'Democratization and Globalization as Ideological and Political Foundations of Economic Policy', in Jongryn Mo and Chung-in Moon, eds, *Democracy and the Korean Economy* (Stanford: Hoover Institution Press, 1999), pp.1-33, p.5. Park Chung Hee, however, in a speech on April 28, 1969, commemorating the 424<sup>th</sup> anniversary of the birth of Admiral Yi Sun-sin, seemed to have associated this view to the country's most famous military strategist: "Thus, he (Admiral Yi Sun-sin) stressed the urgent need for building strong armed forces for making the country strong and rich. Only such a great statesman as he, who possessed far-reaching wisdom and discretion, could confidently make such a prophecy for the sole purpose of saving a nation from an imminent crisis." See Shim Bum Shik, *Major Speeches by Korea's Park Chung Hee* (Seoul: Hollym Corporation Publishers, 1970), p.242.

**and after the Second World War. His belief was later buttressed by the need he felt to develop the defence industry in the wake of changing US policy toward South Korea following the fall of Vietnam, signalled by the withdrawal of the US Seventh Division from Korea in 1971. He thought it was imperative for him to create a self-reliant defence posture on the basis of enhanced industrial capability.<sup>342</sup>**

**The occurrence of new hostilities with North Korea, and a possible end of Washington's security commitments in the region following a surprising announcement that it would start withdrawing troops from the country, led Seoul to seek the development of the country's own defence industries.<sup>343</sup> On January 21, 1968, Pyongyang sent a 31-member North Korean commando to raid the Blue House. Although the mission was aborted, the team was deterred only a few miles away from the presidential building. Two days later, North Korea seized the US ship *USS Pueblo* and its eighty-two crew members, off the North Korean coast. In 1969, North Korea shot down a U.S. E-121 reconnaissance plane with thirty-one crew members. As North Korean military provocations seemed to be on the rise, President Park Chung Hee exhorted the US, at the time in charge of controlling the operations of the South Korean army, to intervene and strike against North Korean bases. However, with deep involvement in the Vietnam War, the U.S. response was muted.**

**In July 1969, Washington declared the Nixon Doctrine asserting that 'Asian hands must shape the Asian Future', followed with the announcement by the end of the year that it would withdraw an entire combat division from South Korea. Washington notified Seoul that it planned to withdraw 20,000 out of the 63,000 troops stationed in**

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<sup>342</sup>Nam, *Korea's Economic Growth in a Changing World*, p.88. As a latecomer, Japan's success in developing its own heavy and chemical industries during the 1960s and early 1970s by relying on foreign technology and equipment served well as a model for the Korean regime. See Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', p.439.

<sup>343</sup>For the security issues in Korea in the later 1960s and early 1970s, see Haggard and Moon, 'The State, Politics and Economic Development in Postwar South Korea', pp.74-5.

**Korea.<sup>344</sup>The unexpected announcement was met with strong opposition from the Korean government calling it 'entirely premature' due to the continuing provocation by North Korea and the still weak South Korean army. Presenting the 1970's National Budget to the National Assembly in November 1969, Park Chung Hee made clear the government's policies for coming Third FYDP (1972-1976):**

**The government will reinforce its diplomacy for defence first of all. In order to promptly and successfully react to any situation that might be brought about by the aggression of the North Korean Communists, the government will strengthen its diplomatic efforts for national defence on the basis of the Korea-United States Mutual Defence Treaty. As the new Asian policy of the US government calls for self-support and self-defence of each nation, as the current situation demands that Koreans should take up their own burden of national defence, the government will consolidate the foundation for self-defence and develop defence industry by cooperation with the US.<sup>345</sup>**

**By June 1971, American troops had been reduced to 43,000 in the peninsula. The move represented a significant dent in what was estimated to be a 250 million US dollars annual contribution to the Korean economy by the American military presence. In addition, Seoul was forced to re-evaluate the US commitment to Korean defence.<sup>346</sup>Uncertainty over the country's security was exacerbated after July 1971, when Henry Kissinger landed secretly in Beijing to begin the historic Sino-American rapprochement. This event was later followed by President Nixon's official visit to China. In Seoul, President Park Chung Hee interpreted the US initiative as implying the 'US acceptance of a hostile, powerful, and revolutionary country in South Korea's immediate neighbourhood, tied by a military alliance to North Korea', and posed the question of trust**

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<sup>344</sup>Don Oberdofer, *The Two Koreas: A Contemporary History* (London: Warner Books, 1997), pp.13-4. Don Oberdofer was the Washington Post's Northeast Asia correspondent from 1972-1975, and continued to cover issues related to Korea in the seventeen years thereafter as the newspaper's diplomatic correspondent.

<sup>345</sup>Shim, *Major Speeches by Korea's Park Chung Hee*, p.373.

<sup>346</sup>Yoo, 'The Industrial Policy of the 1970s and the Evolution of the Manufacturing Sector in Korea', p.19.

**between Seoul and Washington.<sup>347</sup> North Korean provocations began to decrease after 1970, and the U.S. stopped withdrawing troops and reconfirmed its military support against North Korean military aggression. However, Seoul's leadership remained uncertain about U.S. commitment towards the country's security. In face of this security scenario, the regime believed that the development of heavy and chemical industries could become the basis for an indigenous industrial defence sector.**

#### **4.2.3 Politics of Dissent and the Yushin Constitution**

**At the same time, with the economy facing difficulties, the country's security under challenge, domestic concerns began to arise as well. Domestically, growing political opposition began to threaten the stability of Park's regime.<sup>348</sup> With presidential elections set for 1971, and President Park Chung Hee constitutionally barred from a third term, the choice of a successor rapidly turned the ruling Democratic Republican Party (DRP) into a factional battlefield.<sup>349</sup> By 1969, it was obvious that the ruling party would not reach an agreement on who would succeed Park Chung Hee. This raised the fear that in case of two candidates from the DRP bidding for the presidency, the opposition candidate could win the elections. The solution, although not unanimous in the party and contested by the opposition, was to amend the Constitution to allow a third term for President Park Chung Hee. A national referendum in October 1969 passed the amendment with 65.1 percent of the voting electorate approving the change. Not, however, it seems without the apparent vote buying by the ruling party:**

**It was reported that local government party officials openly passed out money and bread to villagers in rural areas, and it was estimated that the government expended about \$15 million in support of the amendment, as**

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<sup>347</sup>Oberdorfer, *The Two Koreas*, p.13.

<sup>348</sup>For an analysis on the growing political conflicts affecting the country in the last years of the 1960s and early 1970s, see Kim, *Divided Korea*, pp.272-286.

<sup>349</sup>For the country's party system and the factionalism within the DRP during the late 1960s, see Cole and Lyman, *Korean Development*, pp.241-6.

**opposed to about \$1.5 million spent by the opposition. It was also reported that the DRP spent \$600,000 for awards to 8,471 local party officials following the referendum, the amount of each official varying by the percentage of pro-government votes received in his district.<sup>350</sup>**

**This amendment, while guaranteeing a possible third mandate for Park Chung Hee, undermined his political legitimacy. Consequently, his legitimacy depended further, therefore on economic performance. During the next two years, 1970 and 1971, as shown above, the country's economy rapidly deteriorated thus endangering what remained the executive's main source of political legitimacy. Moreover, the success of the 1960s export-led industrialisation had nurtured the emergence of a new social force: industrial workers. As their opposition to the economic orientation of the government grew over time, they began to demand the inclusion of economic justice and wealth redistribution on the national political agenda. Hitherto, this agenda had been dominated by the discourse of fast and high economic growth.**

**The economy had grown rapidly during the 1960s, but by the end of the decade there were still no signs of improvement in the working conditions of the labour forces.<sup>351</sup> The government repressed any attempt to organise labour unions, the institution of a minimum wage had still to materialise, and wage levels lagged behind gains in productivity. Frustrated industrial workers, particularly in export industries, staged unorganised and spontaneous protests against what they saw as poor working conditions. These demonstrations had little impact on the development of a labour movement until November 1970, when a young worker Chun Tai Il immolated himself in a desperate attempt to make public the intolerable conditions in garment factories. His death became a**

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<sup>350</sup>Kim, *Divided Korea*, p.276.

<sup>351</sup>For an analysis on the growth of the working class and labour movements, see Hagen Koo, 'The State, Minjung, and the Working Class in Korea', in Hagen Koo, *State and Society in Contemporary Korea*, pp.131-162. See also Inwon, *The Politics of Industrial Restructuring*, pp.241-5.

**symbol for the working class movement, and had an important effect on intellectuals, students and church leaders. As Hagen Koo states:**

**It awakened them and made them realize where society's most serious problems lay and how strategic the labour movement could be for their democratization struggle. Student-labour linkages began to develop during this period, as did the labour involvement of activist church groups. Thus economics and politics became closely entwined to shape the character of the working-class activism to come.<sup>352</sup>**

**Labour strikes rapidly increased from 70 in 1969, to 101 in 1971. More significant were labour-management disputes that jumped from 130 in 1969 to 1,656 in 1971.<sup>353</sup> Concentrated in the cities, this urban 'distributional coalition', formerly ineffective and divided, began to find a common stand against the alliance between the government and the *chaebol*. Journalists began to expose the conditions in work places and intellectuals wrote pieces challenging the 'ideological' basis of the government's economic policy. It was a policy, they argued, too much focused on growth performance, disregarding distributional issues. In May 1970, even the Ministry of Health and Social Affairs released a report claiming that unequal distribution of income was seriously contributing to social unrest.<sup>354</sup>**

**Under this domestic political scenario, and with the approach of the April 1971 elections, Park's regime became more defensive. Meanwhile, the opposition party and its candidate, Kim Dae Jung, centred their campaign on challenging the government's successful economic development record by claiming that it had produced ample imbalances between cities and rural areas, rich and poor, and big business and small- and medium-sized firms.<sup>355</sup> Kim Dae Jung's popularity seemed to show no signs of abating. A rally in Seoul attended by nearly half a million**

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<sup>352</sup>Koo, 'The State, Minjung, and the Working Class in Korea', p.139.

<sup>353</sup>Inwon, *The Politics of Industrial Restructuring*, p.242.

<sup>354</sup>Kim, *Divided Korea*, pp.279-280 and Inwon, *The Politics of Industrial Restructuring*, pp.246-7.

<sup>355</sup>Inwon, *The Politics of Industrial Restructuring*, p.248.

**supporters of the opposition leader indicated that he could become the next Korean President. Against this background, on the eve of the election's day, Park Chung Hee announced that he would not bid again for the presidential office.<sup>356</sup> However, when the votes were counted, surprisingly, Park had won with a reported 51.2 percent of the total votes, against Kim Dae-Jung's reported 43.6 percent.<sup>357</sup> Results showed that while the rural electorate had been crucial for Park's victory by giving him 58.0 percent of the total rural vote, the opposition candidate took the urban areas, in particular the capital, Seoul, with 51.5 percent of the votes.**

**The opposition, however, received the results with scepticism, and soon declared the election invalid, claiming that it had been stained by irregularities, in particular in rural areas where voters were said to have been intimidated to vote for the ruling party's candidate. The victory of Park Chung Hee in rural areas, in fact, seemed to have been anomalous as these areas had been facing economic decline for the past two years.<sup>358</sup> With growing popular resentment over reported electoral irregularities in the countryside, and the successful result of the opposition candidate in the urban areas, Park Chung Hee and his government lacked a clear 'mandate of heaven' to govern the country.**

**After the 1971 election, protests by the urban poor, industrial workers and students continued, and the government's response was to suppress their activities.<sup>359</sup> In August 1971, around 30,000 urban poor gathered in a southern suburb of Seoul to stage a violent protest attacking police stations and government buildings. The riot was the first violent episode involving the urban poor, and it highlighted the dark side of the export-led industrialisation: rapid and uncontrolled urban migration,**

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<sup>356</sup>Yonhap News Agency, *Korea Annual 1972*, p.26.

<sup>357</sup>For an account of this election, see Kim, *Divided Korea*, pp.282-4.

<sup>358</sup>Kim, *Divided Korea*, p.283. He points out that government's statistics showed that 1.5 million people, or ten percent of the total rural population, had left their farms during 1968 and 1970, and it was believed that the migration was essentially due to poor rural conditions.

<sup>359</sup>Haggard and Moon, 'The State, Politics and Economic Development in Postwar South Korea', p.74.

**poor housing and working conditions. Moreover, as labour union membership grew from 23,000 in October 1963 to 493,000 by August 1971, industrial workers began to demand higher wages and representation in the National Assembly. The year of 1971 was also a very tumultuous period in colleges and universities throughout Korea. Students rallied in protest against government plans to intensify military training in schools and growing political corruption in the country. Additionally, in December 1971, Korean military forces that had been stationed in Vietnam began to return home in a time of political, economic and social crisis. There were fears that war veterans could 'share grievances' and turn them against the government.<sup>360</sup>**

**As political dissent continued, on 6 December 1971, Park Chung Hee declared a State of National Emergency. A year later claiming reasons of national security, he imposed martial law and announced his intention to amend the Constitution. This move opened the way for the institution of the authoritarian *Yushin* Constitution (literally meaning revitalisation), which led to the consolidation of presidential power, neutralisation of opposition forces, and insulation of economic policymaking from social forces. The *Yushin* Constitution introduced important changes in the country's political institutional framework.**

**First, the president would be indirectly elected by the members of the National Conference for Unification. The creation of the conference permitted the president to be re-elected without any difficulties. Consequently, in December 1972, and July 1978, President Park was re-elected unanimously without any competition. In sum, the presidential contest was eliminated from party politics. Second, the presidential term was extended from four to six years, and the third term restriction was removed from the Constitution. Third, only two-thirds of the members of the National Assembly were to be elected directly by the people, with the remaining one-third to be appointed by the President. This helped the**

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<sup>360</sup>Kim, *Divided Korea*, pp.284-5.

**ruling party keep control over the National Assembly as it could easily obtain two-thirds. It also made the National Assembly a marginal actor in the policy process, as the Blue House secretariat and bureaucrats gained unparalleled power. Finally, any constitutional amendment was possible without parliamentary consent.<sup>361</sup>President Park's control over the society increased with the institution of legal instruments such as the National Security Law, the Anti-Communist Law, and the Social Safety Law.<sup>362</sup>In his New Year's address in January 1973, Park Chung Hee announced his new vision and the economic basis for the *Yushin* regime: the promotion of the heavy and chemical industries. As a promising new development policy, the HCI emerged as the regime's policy choice to boost Park's political legitimacy, to strengthen his power and to guarantee his regime survival.**

**In conclusion, pressing economic needs in face of the country's trade imbalances and international protectionism and competition, aspirations to build a national defence industrial sector driven by ideological beliefs as well as by security concerns, and growing domestic political dissent threatening the stability of the regime, all contributed to shape Park's choice to push for the development of heavy and chemical industrialisation. Yet, the implementation of HCI rested in Park's strategic behaviour in building and mobilising a supporting coalition not only within a divided economic bureaucracy over the value of the new development strategy as well as within an initially reluctant business sector.**

#### **4.3 Implementing Heavy and Chemical Industrialisation: Bureaucratic Mobilisation and Business Incentives**

##### **4.3.1 Rallying the Economic Bureaucracy**

**During the 1960s, the EPB had clearly played the dominant role in the coordination of the economic policy process. However, the EPB's**

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<sup>361</sup>Byong Man Ahn, 'The Process of Political Changes in Korea- An Analysis of Crucial Elections and Party Politics'; *Korea and World Affairs*, 9 (1985), 625-646, p.635.

<sup>362</sup>Moon and Kim, 'A Circle of Paradox: Development, Politics and Democracy in South Korea', p.144.

**strategy to deal with the country's economic impasse in the early 1970s failed to satisfy President Park Chung Hee.<sup>363</sup> The EPB envisaged the reduction of the role of the state in support of what it called a 'civilian-initiated mode' and the gradual promotion of heavy and chemical industries.<sup>364</sup> This would involve: the promotion of import substitution in some sectors in face of the continuing trade deficits and; the exports of heavy and chemical products in which Korea could show a comparative advantage. The economic rationale behind the thinking of the EPB was not only the fact that HCI, by nature, required large amounts of capital but also that the promotion of these industries would require time due to the country's businesses lack of experience in operating in the sector.**

**However, the long-term strategy devised by the EPB failed to address the pressing security needs of the country's leadership. Ultimately, President Park Chung Hee decided to support a different strategy. Put together by the Blue House Chief of Staff Kim Chung-yum and vice-minister at the MCI, Oh Won-chul, the strategy involved a fast-track plan linking the development of HCI with an indigenous defence sector.<sup>365</sup> Kim, writing in his memoirs, clearly states the rationale behind the HCI plan:**

**Private armament factories are economically infeasible because expensive, specialized machines must stay idle when the demand is low. All weapons can be dissembled into parts. Well-designed parts could be manufactured in different factories and eventually assembled to make precise weapons. Modern weapons required the same manufacturing standards as sophisticated heavy and chemical industries. For the Korean economy, the promotion of the heavy and chemical industries was essential, not only for economic necessity, but also for national security reasons. The promotion of the Korean defence industry should be pursued**

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<sup>363</sup>Kang, *Crony Capitalism*, pp.92-3.

<sup>364</sup>Inwon, *The Politics of Industrial Restructuring*, pp.267-8.

<sup>365</sup>For an insider's account of the policy process leading to the adoption of the HCI plan, see Kim, *Policymaking on the Front Lines*, pp.83-7.

**in line with the build up of the heavy and chemical industries. Each factory could specialize in a particular weapon part to minimise economic loss. Although the construction of weapons and production facilities was the fundamental issue, securing and training engineers and skilled workers was just as important.<sup>366</sup>**

**Kim states that Park Chung Hee resolved to lead the implementation of the plan. In the process, he concentrated more policy powers within the presidential office. Park's determination had the effect of weakening the role of the EPB in the policy process and this latter's intentional goal to reduce the role of the state in the economy. Nam Duck Woo was at the time Minister of Finance. He was initially reluctant to support the plan, but later changed his view after being persuaded by Park.<sup>367</sup> Nam points out that the President's interest in accelerating the heavy and chemical industrialisation of the country was such that those in charge of the new strategy failed to prepare a financial planning assessment. Fearing the collapse of the banking system, Nam found out that the only way to provide some form of order and framework, in terms of money flows for the new projects, was to launch the National Investment Fund (NIF) in January 1974. The NIF was a financing scheme to support the implementation of the new policy.<sup>368</sup>**

**Meanwhile, Park decided to ask Oh to join the Blue House as his Second Economic Secretary, a newly created position.<sup>369</sup> Oh was an engineer who had served in the MCI for a decade before joining the Blue**

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<sup>366</sup> Kim, *Policymaking on the Front Lines*, p.84. On the other side, the development of a defence industry seemed to have had an impact in the growth of other industries. According to Shim Jae Hoon, Senior Bureau Chief for the Far Eastern Economic Review, the growth of the telecommunications industry and of the textile industry is related with defence-oriented signal communication equipment and the need to develop synthetic fibers for military use, respectively. He added also that the electric oven (one of the country's most successful exports) was also a "spin-off" of the defence industry. Interview in Seoul, 8 March 2001.

<sup>367</sup> Interview with Nam Duck Woo in Seoul, 30 May 30 2001.

<sup>368</sup> Interview with Nam Duck Woo in Seoul, 30 May 2001. For a more detailed explanation of the NIF, see Nam, *Korea's Economic Growth in a Changing World*, pp.92-3. The NIF was set to finance in particular long-term investment in plants and equipment for the selected industries. It aimed at bringing together several public funds such as the civil servants' pension funds into a special account through the sale of National Investment Bonds to these funds with the option to convert the bonds to equity in later years. Additionally, the country's banks and insurance companies were also asked to contribute with deposits to the NIF.

<sup>369</sup> Kim, *Policymaking on the Front Line*, p.85. For the role played by Oh in the HCI policy process, see Inwon, *The Politics of Industrial Restructuring*, pp.296-300.

**House. Through his position as chair in the Heavy and Chemical Industries Planning Committee (HCIPC) created in 1973, Oh became the main coordinator behind the implementation of the HCI plan.<sup>370</sup> From then on, the HCIPC, under the direct control of the President, emerged as the centre for the country's economic decision-making.<sup>371</sup> During the 1960s, Park's lack of a 'sophisticated' understanding of economic issues made him highly dependent on the expertise provided by his advisors in the Blue House. Conversely, during the implementation of the HCI plan in the 1970s, Park actively intervened in the policy process.<sup>372</sup> This became evident as Park personally endorsed major investment plans and selected private businesspersons to undertake key projects. Business groups, participating ministries (in most cases, the MCI), and the HCIPC would jointly initiate new development plans and investment projects.**

**Despite the growing role of the HCIPC in the country's policy process, Park Chung Hee strategically sought the support of the EPB and MOF illustrating his effort to build a consensus within the economic bureaucracy over the new development strategy. Reaching out to the EPB and MOF involved in particular the offer of organisational privileges that aimed at the expansion of their power and prestige by adding new bureaus and increasing the number of higher-ranking officials.<sup>373</sup> As Byung-Kook Kim puts it: 'They (EPB and MOF) controlled strategic policy networks, commanded critical economic resources, and most importantly, possessed Korea's best bureaucrats. Simply silencing the EPB's voice of caution and ordering MOF's unswerving obedience to his HCI directives hardly solved Park's political problem of bureaucratic mobilization.'<sup>374</sup> Furthermore, Park would play promotion schemes through which he could show that those who decided to contribute to the HCI drive would be rewarded with power and honour.**

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<sup>370</sup> Choi, *Institutionalizing A Liberal Economic Order in Korea*, pp.102-4.

<sup>371</sup> Choi, *Institutionalizing A Liberal Economic Order in Korea*, p.105.

<sup>372</sup> Chung, 'Presidential Decisionmaking and Bureaucratic Expertise in Korea', p.279.

<sup>373</sup> Byung-Kook Kim, 'The Leviathan: Economic Bureaucracy under Park Chung Hee', paper prepared for the Annual Meeting of the American Political Science Association, Boston 29 August – 1 September 2002, p.23.

<sup>374</sup> Kim, 'The Leviathan', p.24.

#### **4.3.2 Saving and Luring the Business Sector**

**The new development strategy implied necessarily the involvement of the private sector, which was expected to undertake key projects (the exception being the expansion projects in iron and steel and construction of new chemical fertilizer plants to be carried out by public companies).<sup>375</sup> However, when the plan was first devised in the early 1970s, hundreds of firms, as shown above, were undergoing difficulties as they failed to meet their debt obligations, which led to a growing fear that the heavily indebted corporate sector could soon collapse and potentially generate political and social unrest. The implementation of the IMF programme in 1971 worsened the business conditions as the government adopted a stricter monetary policy which restricted credit allocation. Faced with this situation, financially distressed firms turned to the last available mechanism to underwrite their activities and pay back their debts: the unregulated money market or curb market, with its heavy interest rates and short-term maturity.<sup>376</sup>**

**Curb market interest rates reached 51.36 percent in 1970 and 46.44 percent in 1971, in comparison with the nominal interest on general bank loans of around 24 percent in 1970 and 23 percent in 1971.<sup>377</sup> As Jung-en Woo points out: 'The curb had long been part of the dualistic financial system in Korea, and had proved flexible, pervasive, and resilient. While outside the rule of law, it was tolerated, if not implicitly encouraged by financial authorities in Korea, because the curb was the only source from which households, as well as some businesses, could obtain loans.'<sup>378</sup> Despite the government's attempts to control and rein in the informal financial market, according to surveys during the 1960s, these illegal loans were very popular among the majority of large and**

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<sup>375</sup>Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', p.434.

<sup>376</sup>For a detailed analysis of the workings of the informal financial market in Korea, including the curb market, and its interactions with the regulated financial market, see Cole and Park, *Financial Development in Korea 1945-1978*, pp.110-133.

<sup>377</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.63 (Table B).

<sup>378</sup>Woo, *Race to the Swift*, p.113.

**small and medium-sized businesses.<sup>379</sup> The deals would usually be surrounded by secrecy. Borrowers rarely revealed the identities of their lenders or brokers. Disclosure could, in fact, represent the end of their access to the curb market, and to what was the only available mechanism to obtain swift short-term credit. Borrowers usually signed an agreement in which they accepted never to resort to courts to dispute their cases if they could not repay their debts.<sup>380</sup>**

**The low-interest-rate policy seems to have been the single most important cause for the expansion of the unregulated financial market in Korea and the persistence of financial dualism during the 1960s and 1970s. The low-interest rate policy led to a voracious demand for bank credit by the corporate sector. Official interest rates were adjusted for inflation and kept far below the market level. Therefore, savers were encouraged to enter the curb market attracted by higher rates of returns even if more risky. Due to the country's chronic capital shortage, and the authorities' policy of selectively allocating the available capital to strategic sectors, the curb market became the safety valve for firms that failed to obtain credit in the regulated financial system.<sup>381</sup>**

**Members of the Federation of Korean Industries (FKI), representing the interests of the *chaebol*, were concerned with the possible instability in the curb market due to the current economic situation.<sup>382</sup> They feared that as soon as rumours in the market identified a particular firm with a cash flow problem, curb market loans could be withdrawn at short notice. The FKI therefore began to press the government to take on extraordinary measures to tackle the situation and help the corporate sector. During two meetings held with President Park in June 1971, the chairman of the FKI proposed the intervention of the government to confront the domestic**

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<sup>379</sup>Kim, *Big Business, Strong State*, p.147. According to a 1963-64 survey by the Bank of Korea (BOK), 75 percent of businesses questioned said that they resorted to curb market loans.

<sup>380</sup>Cole and Park, *Financial Development in Korea 1945-1978*, p.119.

<sup>381</sup>Cole and Park, *Financial Development in Korea 1945-1978*, pp.137-8.

<sup>382</sup>Seok-Jin Lew, *Bringing Capital Back In: A Case Study of the South Korean Automobile Industrialization*, Doctoral dissertation, Yale University, 1992, pp.160-2.

**sources troubling the corporate sector. This intervention would include: first, the conversion of very expensive curb-market loans into cheaper bank loans; second, corporate tax cuts; and third, lower interest rates and less restricted monetary policy.**

**The government sought to address the problems facing the corporate sector by announcing a 10-billion won Industry Support Fund. This was seen as a significant amount taking into consideration the fact that money supply had only increased 3.5 billion won by July 1971. The fund was later followed by an interest rate cut in January 1972.<sup>383</sup> Yet, business leaders saw the measures as insufficient and inadequate to halt their difficulties. According to Kim Chung-yum, for business leaders the solution involved an attempt to regulate the curb market:**

**One day, the federation's chairman called on the president and asked for a solution. He explained that all companies were working very hard, but that high interest loans from the informal money market were absorbing all their profits, and that they were all apprehensive because of the threat of moneylenders calling in their loans simultaneously. He said that the emergency loans from the banks were insufficient and that many enterprises would go bankrupt if an emergency administrative measure concerning the informal money market loans were not introduced.<sup>384</sup>**

**Upon a request from Park Chung Hee, Kim Chung-yum studied the situation and proposed that the solution had to involve the state-controlled banking system. Banks would have to lend the firms enough money to pay off their private loans. However, the financial authorities were only able to gather 10 billion Won to support the private sector, out of the estimated 100 billion Won (by the Ministry of Finance), or 180 billion won (by the Federation of Korean Industries) borrowed by Korean firms at the curb market.<sup>385</sup> Therefore, 'the only way to decrease the rate of**

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<sup>383</sup>Yonhap News Agency, *Korea Annual 1972*, p.137.

<sup>384</sup>Kim, *Policymaking on the Front Lines*, p.67.

<sup>385</sup>Kim, *Policymaking on the Front Lines*, p.68.

**business failures, prevent a banking crisis, and avoid a chain reaction of bankruptcy and mass unemployment was to freeze the informal money market for a certain period of time.<sup>386</sup> Having won the agreement of the President, the preparation and content of the policy to deal with the unregulated money market was kept secret. This was for fear that making it public would lead private lenders to withdraw their loans, and potentially cause a sudden collapse of the economy. Among those involved in the process were the President, Kim Chung-yum, Nam Duck Woo (Minister of Finance), and bureaucrats in the MOF, MCI and several banks.<sup>387</sup>**

**Support over the decree's efficacy, however, was far from being unanimous among the top decision-makers. Nam Duck Woo said that he decided to go along with the decree, but not without reservations: 'I was not very enthusiastic about the original proposal to freeze the curb market. Apart from its short-run effects, it would not put an end to the operation of the curb market, which is deeply rooted in Korea's economic culture, unless the financial sector were fully liberalized to the degree that the curb market is absorbed into a single open market in which a uniform rate of interest will prevail.'<sup>388</sup> Ultimately, the final decision to rescue the corporate sector came not from the country's central agency EPB, but from the Blue House.<sup>389</sup>**

**In a surprising but strategic move on 3 August 1972, the Korean President Park Chung Hee, under Article 73 of the country's Constitution, issued the *Presidential Emergency Order on Economic Stabilization and Growth* aimed at bailing out the debt-ridden corporate sector.<sup>390</sup> In a prepared statement on the decree, President Park Chung Hee said that it**

<sup>386</sup> Kim, *Policymaking on the Front Lines*, p.69.

<sup>387</sup> Inwon, *The Politics of Industrial Restructuring*, p.256. See also 'Man of the News: Minister Nam Architect of Painstaking 'Order'', The Korea Herald, 4 August 1972, p.1 (hereafter KH).

<sup>388</sup> Nam, *Korea's Economic Growth in a Changing World*, p.91.

<sup>389</sup> Lew, *Bringing Capital Back In*, pp.162-3.

<sup>390</sup> On the contents of the decree, see 'President Freezes All Private Loans, Orders Rationalization of Business: Banks to issue W200 Bil. Bonds for Enterprises', KH 3 August 1972, p.1, 'Text of Emergency Economic Measures', KH 4 August 1972, p.3, 'To Fight Economic Recession: Park Freezes Private Loans, Sets Up Funds', KT 3 August 1972, p.1 and Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.64.

**aimed at promoting private investment for continuing economic growth, and to guarantee national stability. In the statement, he identified two main problems plaguing the Korean economy, and in particular the private sector: (1) the 'vicious cycle of inflation and steady increase of commodity prices, public utility rates and foreign exchange rates' that 'resulted in bringing instability to the lives of citizens'; and (2) the 'rampant circulation of high-interest private loans' that had become 'another malady in our economy' by weakening and burdening the corporate sector's financial structure.<sup>391</sup>The decree called for all firms to report to the government the curb loans they owed as of 2 of August.**

**The main contents of the decree included a moratorium on the payment of all corporate debt to curb lenders and broad rescheduling of bank loans at a reduced interest rate. All curb loans were to be transferred to bank loans at a monthly interest rate of 1.35 percent or 16.2 percent annually (at a time when the curb market interest rate was at more than 40 percent), with the moratorium to last three years, after which they had to be repaid over five years. Banks were to issue special bonds worth 200 billion Won, with the funds gathered to become available as long-term loans to firms at an annual interest rate of eight percent with a three-year grace period, followed by a repayment over five years. Bank interest rates on up to one-year loans were set at 15.5 percent from 19 percent.**

**The decree arranged also for the establishment of a 1 billion-Won Trust Guarantee Fund to support the small and medium industry, and a similar one for the agriculture and fisheries sectors. Moreover, the government would set an Industrial Rationalization Fund with an initial 50 billion Won to offer long-term loans at low interest rates, as well as taxation benefits, to firms that met the rules stemming from the Committee on Industrial Rationalization. Finally, the decree stipulated the stabilization of the won-dollar exchange rates at 400 won to one US dollar,**

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<sup>391</sup>'Text of Emergency Economic Measures', KH, 4 August 1972, p.3.

**as well as an increase of no more than three percent per year for public utility rates and commodity prices. The impact of the decree was widely felt in the Korean economy. The volume of informal loans reported surprised the Korean society, with creditors reporting 357.1 billion won and debtors 345.6 billion won. Even if taking the lower figure, this was to represent approximately 88 percent of money supply at the time.<sup>392</sup> The figures were three times bigger than expected by tax officials who had made their predictions based on the amount of taxes paid on borrowed money by businesses.<sup>393</sup>**

**The decree saved the highly debt-ridden corporate sector, at the expense of the curb lenders and depositors.<sup>394</sup> The financial status of the business firms improved rapidly, as their interest burden was significantly reduced with the implementation of the decree. For example, in the manufacturing sector, the ratio of interest expenses to sales volume fell from 9.9 percent in 1971 to 7.1 percent in 1972 and more sharply to 4.6 percent in 1973. Furthermore, debt to equity ratio decreased from 394.2 percent in 1971, to 313.4 in 1972 and 272.7 in 1973. Simultaneously, profits rose from 1.2 percent in 1971 to 3.9 percent in 1972, and 7.5 percent in 1973.<sup>395</sup> This emergency decree whilst aiming at the financially distressed business sector turned out to benefit the *chaebol*, in particular. Conversely, the small- and medium-sized enterprises (SME) were not significantly aided, and even had to shoulder the disruptions caused by the decree in the workings of the informal money market.<sup>396</sup> As the implementation of the decree proceeded, three episodes illustrated well the benefits gained by the country's major corporations.**

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<sup>392</sup>Kim, 'Financial System and Policy (1961-79)', p.35.

<sup>393</sup>'Staggering Figure: Full Picture Drawn of Private Loan Mart', KT 11 August 1972, p.1.

<sup>394</sup>'Private Loans Massive: Economic Decree Seen Big Favor to Business', KT, 6 August 1972, p.4.

<sup>395</sup>Cho and Kim, 'Credit Policies and the Industrialization of Korea', p.64 (Table C).

<sup>396</sup>On the reactions to the decree by the business sector, see 'Business Circles Hail Movement to Defer Private Loan Payments', KH, 4 August 1972, p.6 and 'Freeze May Bring Shortage of Funds', KT 4 August 1972, p.1. On the impact on the small- and medium-sized firms, see 'Private Loan Freeze: Small Firms Suffer From Fund Squeeze', KT 17 August 1972, p.4 and 'Small Businesses Feel Squeeze Since Freeze', KH, 17 August 1972, p.6.

**First, according to a report by the Bank of Korea, thirty undisclosed firms had borrowed more than 100 million won each in the informal money market.<sup>397</sup> But more important was the fact that while there were only 547 cases (1.3 percent of the 40,677 registered cases of curb market loans) accounting for loans over 100 million won, the total amount of these loans reached 182.98 billion won, or 52.9 percent of the total amount of registered curb market loans.<sup>398</sup> Two unnamed companies were said to have contracted curb market loans totalling 4.9 billion won and 4 billion won each.<sup>399</sup>**

**The second episode, involved the running of the 50-billion won Industrial Rationalization Fund set by the government to offer low-interest and long-term loans to modernise equipment. The fund pushed for business mergers, improvement of the capital structure of the manufacturing sector as well as of the productivity and international competitiveness of Korean firms. The Industrial Rationalization Council under the Office of the Prime Minister, was put in charge of administering the fund and selecting firms that would get hold of financial benefits. The council, chaired by the head of the EPB, included among its members other economic ministers, governors of the special banks, and private members appointed by the President. Nonetheless, the final approval of the recipients rested with the President.<sup>400</sup> The fund was apparently designed to support SMEs.<sup>401</sup> However, between 1972 and 1975, 73 percent of the total fund, or 48.1 billion won, was released to support *chaebol*-**

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<sup>397</sup>Cole and Park, *Financial Development in Korea 1945-1978*, pp.164-5 (Table 33). The Bank of Korea's Report of the Results of the August 3, 1972 Presidential Emergency Decree (August 1973), is cited by the authors in their analysis on the outcome of the decree. The survey considered 6 different loan sizes, from the lowest below 3 million won, to the highest over 100 million won, as reported by borrowers. The two highest loan sizes (50 to 100 million won, and over 100 million) accounted for 222.02 billion won, or 64.2 percent of the total amount of curb market loans, although they represented only 2.7 percent of the cases.

<sup>398</sup>Cole and Park, *Financial Development in Korea 1945-1978*, pp.164-5. For an example of a major firm that highly benefited from the decree, see the case of Hyundai Motors Corporation in Lew, *Bringing Capital Back In*, pp.165-6.

<sup>399</sup>'The Periphery of the 8.13 Decree', The Shindong-a Ilbo, October 1972, pp.136-149.

<sup>400</sup>Kim, 'The President's Emergency Decree for Economic Stability and Growth (1972)', pp.176-178. According to Wan-Soon Kim, to be eligible to the fund, companies had to meet the following criteria: "(1) industries producing goods or services indispensable to the nation; (2) industries promoting related industries; (3) machine and raw material manufacturing industries; (4) export industries, tourism, and other foreign-exchange earning industries; (5) farmers' subsidiary businesses or agricultural/fisheries processing industries that would significantly increase the incomes of farmers and fishermen.

<sup>401</sup>Kim, 'The President's Emergency Decree for Economic Stability and Growth', p.177.

**dominated industries, such as iron and steel, nonferrous metal, shipbuilding, electronics, electrical machinery, and coal.<sup>402</sup> Kim Wan-Soon highlights that the council, and ultimately the president, had virtually complete discretion over the allocation of the fund: 'Because almost any enterprise could construct an argument for privileges under some provision of the decree, and given the excess demand for preferential credit at low rate (8 percent per annum), discretion was thus inevitable.'<sup>403</sup>**

**The third episode involved the reduction of interest rates on bank loans from 19 to 15.5 percent. The demand for credit greatly exceeded its availability. Therefore, the allocation of funds conformed to a discretionary process that naturally tended to benefit major corporations, since smaller firms lacked collateral and credit status.<sup>404</sup> After the implementation of the decree, the opposition New Democratic Party (NDP) claimed in the National Assembly that the measures favoured major firms. Additionally, the NDP also claimed that the measures provided preferential treatment to those that were already recipients of various financial privileges. A member of the parliament for the NDP insisted that all of the big businesses that had reported debts above 100 million Won were foreign-loan recipients, where credit tended to be allocated according to connections in the ruling party or in the bureaucracy.<sup>405</sup> These three episodes, size of curb market loans, industrial rationalisation fund, and reduction of interest rates, illustrate well the benefits of these initiatives for Korea's *chaebol*.**

**Under the dire economic situation affecting the corporate sector, the decree reaffirmed Park's commitment to a 'growth-first' development programme within the system of 'socialisation of private risk', i.e., the state guaranteed the risks associated with private investments. If the government had failed to intervene through the decree, many businesses**

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<sup>402</sup> Kim, *Big Business, Strong State*, p.149.

<sup>403</sup> Kim, 'The President's Emergency Decree for Economic Stability and Growth', p.177.

<sup>404</sup> Kim, 'The President's Emergency Decree for Economic Stability and Growth', p.173.

<sup>405</sup> 'House Deliberation: NDP Claims Decree Favors Major Firms', KT, 19 August 1972, p.1.

**would have gone bankrupt; the owner-managers of failed firms would have lost their ownership and control stakes; banks and curb lenders would have had to bear great financial losses and; ultimately unemployment would have rapidly increased and threatened social and political stability. Furthermore, an increasing number of bankruptcies could potentially undermine Korea's international credit standing and hinder the much needed flow of foreign loans into the country to feed the high growth policy supported by the government. Meanwhile, the decree also offered the opportunity to consolidate the regime's alliance with the private sector, Park Chung Hee saw the private sector's involvement as essential for the successful implementation of heavy and chemical industrialisation.**

**After the decree, Korea's big business groups, however, were unenthusiastic about participating in the heavy and chemical industrialisation.<sup>406</sup> Jong-Chan Rhee argues that, 'businessmen hesitated to invest in the HCIs because their already highly indebted firms were short of internal savings and because they were faced with a long period of return on their heavy and chemical investment and opaque prospects for the markets.'<sup>407</sup>Consequently, the government decided to select private investors and through a strategy of 'carrots and sticks' to induce and coerce them to undertake the key HCI projects.<sup>408</sup> Among the incentives to attract the private sector were: the creation of the National Investment Fund (NIF); tax exemptions and reductions; trade policy changes imposing import restrictions on certain products to encourage their purchase from domestic HCI firms; robust investments in the expansion of science and technological education and in R & D and; construction of industrial complexes to reduce costs for example in infrastructure to achieve operational efficiencies by concentrating in one single area related industries.<sup>409</sup>**

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<sup>406</sup>Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', p.436.

<sup>407</sup>Rhee, *The State and Industry in South Korea*, p.69.

<sup>408</sup>Dai-Seok Choi, 'The Limits of State Strength in South Korea: The Case of the Heavy and Chemical Industrialization Plan'; *Korea Observer*, 26 (1995), 63-95, pp.73-5.

<sup>409</sup>For a more detailed description of the incentive system offered by the Korean government, see Lee, 'The Heavy and Chemical Industries Promotion Plan (1973-79)', pp.441-9.

However, the state would not only become a major domestic customer for many projects, but also allowed either monopoly or oligopoly in the HCI. The state considered it a 'more desirable' industrial strategy than a competitive structure, due to the country's small domestic market size, importance of economies of scale and huge capital requirements.<sup>410</sup> On the other hand, business groups that failed to comply with the government orientation were expected to cope with economic penalties usually by suspending, or strongly reducing, their access to capital.<sup>411</sup> In the end, the state's strategy of 'carrots and sticks' led the *chaebol* to 'believe that as long as they helped fulfil the leadership's vision of development, they could reasonably expect that the state would assist them with any means.'<sup>412</sup> Under these conditions, Samsung was, for example, selected to develop aircraft engine assembling (in agreement with Boeing), Daewoo to focus on assembling fuselage and air wings, and Hyundai to produce frigates.<sup>413</sup>

In summary, with the HCI strategy, Park Chung Hee aimed at solving three major issues. First, the HCI allowed him to address the growing security concerns and build an indigenous defence industry. This, however, required the involvement of the private sector, and as long as the latter was undergoing financial distress, it could not be of much help for the government's development plans. The decree by alleviating their financial problems, also contributed to consolidating the governmental nexus with the country's major firms. Second, the deterioration of the international trade environment with the rising protectionism in developed nations, and growing competition in particular from Southeast Asian countries, provided the government with the economic rationale to allocate a greater share of the financial resources to the development of heavy and chemical industries and more value-added products. Finally, domestic politics provided the thrust for the HCI drive as it would

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<sup>410</sup> Choi, 'The Limits of State Strength in South Korea', p.74.

<sup>411</sup> Rhee, *The State and Industry in South Korea*, p.71.

<sup>412</sup> Choi, 'The Limits of State Strength in South Korea', p.74.

<sup>413</sup> Interview with Shim Jae Hoon, Seoul, 8 March 2001.

**legitimate the *Yushin* system and guarantee the political survival of Park Chung Hee. Although the new *Yushin* Constitution granted extensive powers to the President and was approved with 92 percent of the popular vote in a referendum, it took place under martial law, which: banned political activities of all sorts; temporarily closed the universities; and imposed press censorship.**

**Under these conditions, the legitimacy of the new system was far from guaranteed. By announcing that the new industrial development plan would further enrich the nation and increase per capita income to 1,000 US dollars by the early 1980s, Park sought to legitimise his leadership through economic performance. The fact that the issue of the decree (3 August 1972), martial law and the amendment of the Constitution (17 October 1972), and the announcement of the new economic strategy (12 January 1973) took place in succession with two month intervals between them seemed to indicate that there was a concerted and conscious effort on the part of the government to transform the country's developmental path.**

#### **4.4. Conclusion**

**This case-study illustrates well how the HCl was essentially a project led by the President and his secretariat in the Blue House in response to domestic economic difficulties, international trade changes, growing security concerns, ideological motivations and political needs. This chapter also shows why and how Park Chung Hee strategically acted to protect the system of socialisation of private risk and with what political and economic implications and consequences. Despite the different views on HCl, Park Chung Hee actively rallied the economic bureaucracy in support of the new industrial strategy. Simultaneously, Park also sought to secure the alliance with the country's largest firms by issuing the emergency order to bailout the debt-ridden corporate sector,**

**as well as by offering a series of incentives to induce their participation in the strategic HCI.**

**But by adopting this new industrial strategy, the Korean state placed the country on a path-dependent development strategy with significant political and economic consequences that would later constrain attempts at institutional change. First, during the 1970s, the system of socialisation of private risk concentrated the country's financial resources in the growth and development of the heavy and chemical industries. By clearly selecting the *chaebol* as the main recipients of the available resources, and turning them into the country's main economic actors, the system under the management of the Korean state actually made the country's economy hostage to the *chaebol's* market behaviour and accomplishments.<sup>414</sup>**

**It was during the 1970s, that the *chaebol* came not only to take control of the manufacturing sector, in particular heavy and chemical industries, but also to hold a near monopoly or oligopoly in many capital- and technology-intensive sectors. *Chaebol* provided not only jobs to a large percentage of the country's workers, but also produced a wide range of consumer products and services.<sup>415</sup> Additionally, while the state continued to guarantee the risks assumed by private investments, in its eagerness to radically transform the country's industrial structure, it failed to play its disciplinarian role as expected within the system of socialisation of private risk. After the issuance of the presidential decree in 1972, business profits grew rapidly, and their debt status improved considerably. However, this condition did not last long. Within a year, the soundness of the corporate sector's financial structure began to deteriorate and soon it dropped back to levels preceding the issuance of the decree, as businesses resorted again to debt for new HCI**

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<sup>414</sup>For works on the growth of the *chaebol*, see Kim, *Big Business, Strong State*, and Myung Hun Kang, *The Korean Business Conglomerate: Chaebol Then and Now* (Berkeley: University of California Press, 1997), Fields, *Enterprise and the State in Korea and Taiwan*, and Kim, *Business Concentration and Government Policy*.

<sup>415</sup>Kim, *Big Business, Strong State*, p.52.

**investments.<sup>416</sup> The government sought to correct corporate governance and the financial structure of the major business groups.**

**Among the most important was the '29 May Measure' in 1974 that comprised five major directives: (1) to take corporations public; (2) to establish a monitoring system over the credit and tax-paying status of closed enterprises and their major stockholders; (3) to strengthen credit control over large enterprises to reduce their reliance on bank credit; (4) to drive the heavily-leveraged enterprises to sell part of their current business, in case of the entry into a new business; and finally (5) to fortify tax enforcement and reinforce an outside auditing system on enterprises and their major stockholders.<sup>417</sup> By demanding firms to be listed in the stock market, the government sought to disperse ownership, professional management, and ultimately lead firms to issue equity to finance long-term investment and reduce the firms continuous dependence on debt. However, until 1972, only 66 firms had decided to go public. By the end of 1979, 300 companies were already listed in the stock market.<sup>418</sup>**

**Yet, the measures failed to produce the sought after outcomes, as the *chaebol* remained mostly under family control and continued to rely on debt to build up their businesses. Nam Duck Woo says that he designed the '29 May Measure' while he was still the Minister of Finance, and that they aimed at reforming corporate governance by requiring, for example, reliable and transparent financial statements or limitations of loans to unsound businesses. However, once he left the ministry in 1974 to take his position as Deputy Prime Minister (DPM) and Minister of Economic Planning, his successors at the MOF failed to 'stick to that system' due to opposition of the *chaebol*.<sup>419</sup>**

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<sup>416</sup>Cole and Park, *Financial Development in Korea 1945-1978*, p.167.

<sup>417</sup>Kim, 'Financial System and Policy (1961-79)', p.37.

<sup>418</sup>Lim, 'The Origins and Evolution of the Korean Economic System', pp.35-6. See also Kim, 'Financial System and Policy (1961-79)', pp.35-9.

<sup>419</sup>Interview with Nam Duck Woo in Seoul, 30 May 2002.

**Another policy outcome of the decree with significant implications for the working of the country's financial system was the creation from 1972 of three types of non-bank financial institutions (NBFIs) to assimilate curb-market funds into the regulated financial system: (1) investment and finance companies; (2) mutual savings and finance companies; (3) credit unions and mutual credits. Later in 1976, the merchant banking corporation was also allowed into the financial system to attract further inflow of foreign capital. It was regarded as a 'department store' for financial commodities. Their businesses ranged from international financing for firms; loans for equipment; and working capital for underwriting and brokerage of securities sales.<sup>420</sup>**

**The NBFIs were given greater freedom in the management of their financial resources compared with the banking organisations, which allowed them to gain a competitive edge.<sup>421</sup> Since they were allowed to offer higher deposit interest rates, their market share expand rapidly. Their share of the country's total deposits rose from 18.3 percent in 1972, to 30.9 percent in 1980, and 59.5 percent in 1990.<sup>422</sup> Additionally, the NBFIs became important players in the stock market. These seemed to have been sufficient reasons to attract the country's major *chaebol* to own and control most of the NBFIs from the late 1970s.<sup>423</sup> The *chaebol*'s stakes in the NBFIs ultimately allowed them to borrow much of their working capital from these sources, and in the process become less dependent on state-controlled banks.**

**In summary, the new industrial strategy in the 1970s produced significant policy and political outcomes, especially in terms of power distribution within the actors involved in the system of socialisation of**

<sup>420</sup>For an overview on the different non-banking financial institutions (NBFIs), see Kim, 'Financial System and Policy (1961-79)', pp.20-4. See also Cho, *The Dynamics of Korean Economic Development*, pp.123-7.

<sup>421</sup>Byung-Sun Choi, 'The Politics of Financial Control and Reform in Korea'; *The Korean Journal of Policy Studies*, 6 (1991), 41-73, p.47.

<sup>422</sup>Cho, *The Dynamics of Korean Economic Development*, p.126. Unlike Korea, in Taiwan, the share of total deposits in the NBFIs up until 1990 never surpassed 30 percent.

<sup>423</sup>Choi, 'The Politics of Financial Control and Reform in Korea', p.47. See also Seong Min Yoo, 'Chaebol in Korea: Misconceptions, Realities and Policies'; *KDI Working Paper*, No.9507 (Seoul: Korea Development Institute, 1995), p.27.

**private risk. By concentrating the country's resources in the HCI and the *chaebol* that had been selected to undertake the industrial projects, the Korean state eventually contributed, whether or not intentionally, to make the country's economy structurally dependent on the *chaebol's* economic performance. This had the effect of increasing the *chaebol's* leverage to negotiate the rules of the game within the system of socialisation of private risk. This power was further strengthened by the *chaebol's* growing stakes in the country's non-banking financial institutions (NBFIs) that emerged as part of the emergency order to deal with the curb market. Since the NBFIs were granted greater freedom in the management of their financial resources, the *chaebol's* stakes in these domestic financial institutions reduced their dependence on state-controlled banks. In consequence, the disciplinarian capacity of the Korean state, based in their control of capital flows, was weakened. In this context, the *chaebol*, fearing less the potential penalties, were also less bounded by the executive's economic guidelines.**

**By making the country's economy structurally dependent on the *chaebol's* economic performance and weakening the disciplinarian power of the Korean state, these policy and political outcomes were the first signs that the power equilibrium within the system of socialisation of private risk was changing and under challenge. Eventually, as will be shown in Chapters Five and Six, they would hinder efforts by Korean leaders in the next decades to induce institutional reform in the face of the political, economic and social changes taking place in Korea.**

## **5. CHAPTER FIVE - Transforming the System of Socialisation of Private Risk: The Kim Young Sam Presidency (1993-1997)**

### **5.1 Introduction**

**On November 21, 1997, in the midst of what would come to be called the 'Asian Financial Crisis', Korea's Minister of Finance announced that the government was officially seeking an IMF rescue package to avert the collapse of the country's economy in face of a depreciation of the currency and liquidity crisis. In the following weeks, the value of the Korean won decreased more than 50 percent, the stock market price index plummeted from 498 to 350 and the interest rates for short-term loans jumped to 40 percent a year.<sup>424</sup> While Korea's financial troubles continued to escalate, the IMF made available a rescue package during the first week of December. Meanwhile, international credit rating agencies downgraded Korean bonds from A1 status to 'junk bond' status by mid-December.<sup>425</sup> Consequently, Korean banks were suddenly cut off from the international financial markets. International banks not only stopped renewing maturing loans, but also started to rapidly withdraw funds from Korea. During the last week of December, the severity of the situation was such that Korea was on the verge of defaulting on its foreign debts. This was only prevented by a last-minute loan by the IMF and several G-7 countries.**

**The nation, and the world, was in shock because for the past three decades Korea had successfully been transformed from a poor nation into one of the world's largest economies. Yet, since the end of the regime led by Park Chung Hee in 1979, the new Korean leadership began to adopt policies aimed at transforming the rules of the game of what stand at the core of the Korean developmental state, i.e., the system of socialisation of private risk. The economic strategy undertaken by Park Chung Hee**

<sup>424</sup>Yung Chul Park, 'Investment Boom, Financial Bust'; *Brookings Review*, 16 (1998), 14-17, p.14.

<sup>425</sup>Irma Adelman and Song Byung Nak, *The Korean Financial Crisis of 1997-98*, University of Berkeley, mimeo (August 1998).

**radically changed the country's economic structure, but it also nurtured serious economic and social structural problems that were left behind to be solved by the coming presidencies. It was this legacy, as it will be shown below, that significantly influenced the configuration of institutional reform in Korea pushed by Korean leaders since the 1980s and continued during the presidency of Kim Young Sam.**

**Two major causes are identified here as having strongly contributed to the crisis within Korea: the dismantling of industrial policy and financial liberalisation undertaken at a fast pace during the government of Kim Young Sam. Under this new environment, the capacity of the state to guide and discipline the *chaebol* through the control of credit allocation weakened. The outcome was over-investment and high indebtedness of Korean conglomerates. Eventually, this threatened the stability of the country's financial system built on tight ties between the banks and industry. The policy outcomes of these changes raise two major puzzles. First, if industrial policy and financial regulation underpinned the success of Korean development, why did Kim Young Sam decide from the early days of his mandate to transform the system of socialisation of private risk? Second, if successful development in Korea was a product of a strong and disciplinarian state, why then did the state fail to supervise the financial and corporate sectors as was expected within the system of socialisation or private risk?**

**This chapter begins by briefly examining in what way the dismantling of industrial policy and financial liberalisation contributed to the Korean financial crisis. Then, I introduce an overview of the major administrative and economic reforms undertaken by Kim Young Sam (1993-1997) and aimed at transforming the system of socialisation of private risk. I then attempt to explain why Kim sought to dramatically reform the system that for more than three decades had been the foundation of the country's economic success.**

**For more than three decades, the system of socialisation of private risk drove Korean economic growth. This, as historical institutionalism points out, had path-dependent consequences. The policy choices made at an early point in this period of extended growth made changes later on more difficult. In the case of Korea, a core feature of the country's development was the institutionalisation of a system of "socialisation of private risk" that rested on cooperative ties between presidential leadership, bureaucrats and business groups. Any attempt to change the institutional setting would thus be difficult and would necessarily require an understanding among the three actors. However, by seeking changes in the institutional framework by administrative fiat without first seeking a negotiation of the rules of the game with the other involved parts, Kim Young Sam assumed a risky political and policy strategy that ultimately had a negative impact on the implementation of the reforms.**

**I argue then that, learning from failed reforms undertaken during the presidencies of Chun Doo Hwan (1980-1987) and Roh Tae Woo (1988-1992), driven by ideological motivations, and responding to a new international economic context, Kim Young Sam sought dramatically to reform the system of socialisation of private risk that had been the foundation of the country's economic success. Setting himself as a president who would lead by example and who would break with the old corruption practices between the state and business groups, Kim did not seek to build a supporting coalition for his initiatives. The country's democratisation, nonetheless, made the policy process more complex as new actors gained prominence to influence policy choices.**

**The decision by Kim to abandon cooperative ties with the *chaebol* and his effort to curb their economic concentration was strongly influenced by growing social demands for economic justice, in particular by very active non-governmental organisations (NGOs). At the same time, the country's economy that depended on the *chaebol's* performance could be hit if there was a slowdown of the latter's investments and activities**

**due to closer scrutiny by the government. Despite the pressure from NGOs, an economic downturn could turn public opinion, as well as the country's vocal mass media, against the president. On the other hand, throughout the years, the *chaebol* had strengthened their political influence by offering political donations to the country's policymakers and politicians. As members of the National Assembly which had increased its power vis-à-vis the presidential office, many of these policymakers and politicians as members of the National Assembly gained influence over the policy process. In Figure Two (see below) the policy process under President Kim Young Sam showed a new dynamic environment as new actors with increasing political powers moved to assert their interests and to influence policy choices. This was the case in particular of such Korean social actors as the NGOs, media and labour unions.**

**Although Kim Young Sam revealed a strong will to push for the reforms, his strategic failure to build a coalition in support of institutional change combined with weak economic leadership resulting in inconsistent policy decisions, ultimately contributed to the mismanagement of the country's economy that culminated in the IMF crisis which erupted in late 1997.**

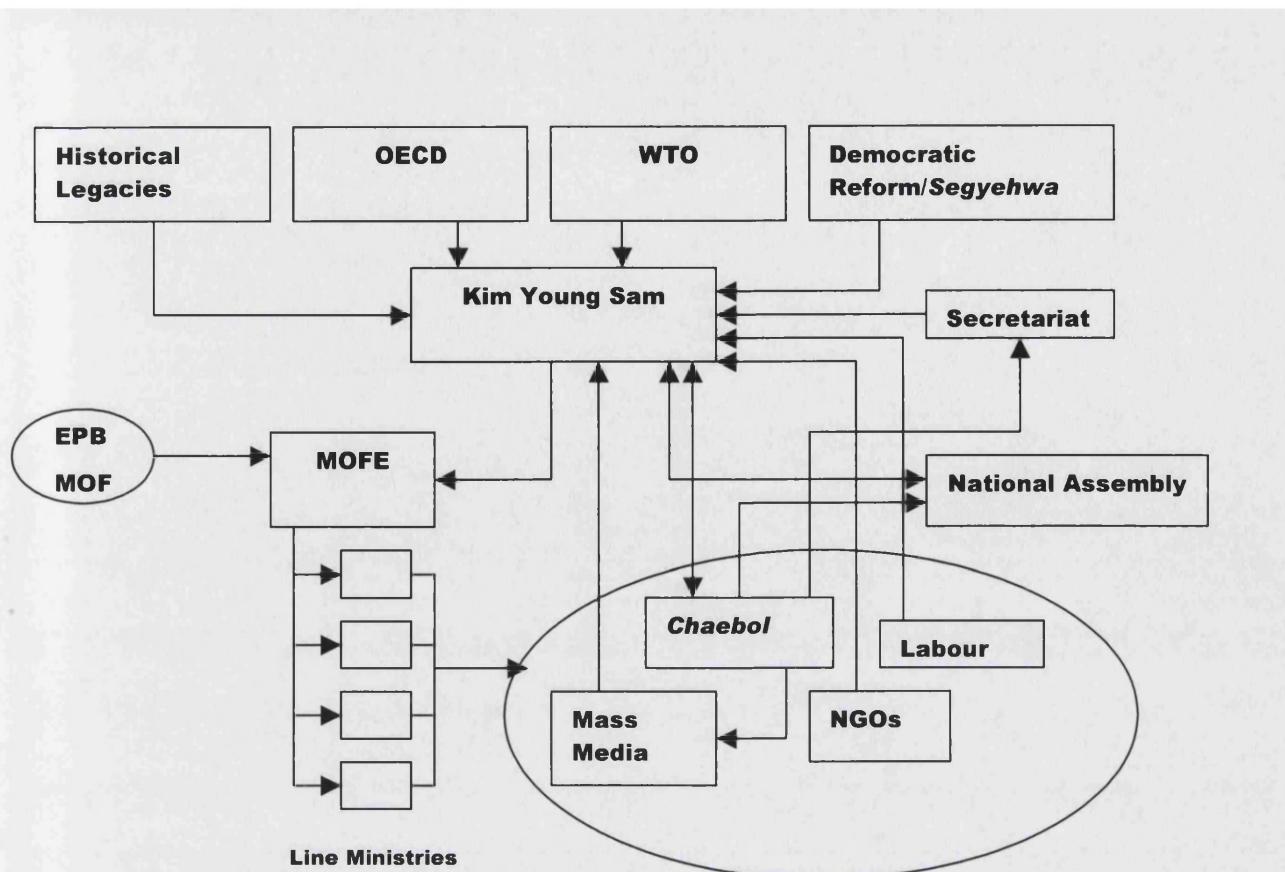


Figure Two: Presidential Leadership and Policy Process, Kim Young Sam (1993-1997)

## 5.2 The System of Socialisation of Private Risk and the IMF Crisis

In the aftermath of the IMF crisis in 1997 and the subsequent collapse of the Korean corporate and financial sectors, it became apparent that Kim Young Sam's presidency undertook two major policies which contributed to the country's economic meltdown: (1) the dismantling of industrial policy and; (2) financial liberalisation.<sup>426</sup> Industrial policy had been a crucial state mechanism to check 'excessive competition' and inefficient management. However, the declining role of industrial policy during Kim Young Sam's administration was seen as having led to: over-investment by the business sector; falling profitability due to low capacity utilisation; and, finally, to the collapse of a series of corporations in major industries such as electronics, cars, steel, petrochemicals, and shipbuilding.<sup>427</sup> This over-investment was exacerbated by steps undertaken by the new presidency to liberalise the financial

<sup>426</sup>See in particular Chang, Park and Yoo, 'Interpreting the Korean Crisis', and Wade, 'International Institutions and the US Role in the Long Asian Crisis of 1990-2000'.

<sup>427</sup>Chang, Park and Yoo, 'Interpreting the Korean Crisis', p.740.

**system which eventually weakened the role of the state in allocating credit to the business sector.**

**From 1993, the rapid liberalisation of the financial system facilitated access to foreign borrowing by the country's business groups. In the years preceding the crisis (1994-1996), Korea experienced an investment boom that contributed to heavy foreign indebtedness, and the subsequent insolvency of Korean firms.<sup>428</sup> Foreign debt grew from around 43 billion US dollars in 1992 to close at 121 billion US dollars in 1997.<sup>429</sup> However, while Korea's foreign debt figures were not at an unsustainable level by international standards, its maturity structure was seriously poor. The share of short-term debt (which is defined as debt with less than a year's maturity) in total external debt, rose from 43.2 percent in 1992 to 57.6 percent in 1997.<sup>430</sup> Consequently, the country's access to international capital markets became particularly vulnerable to shifts in foreign confidence over the country's economic prospects. Since liberalisation had been more extensive in relation to short-term lending, financial institutions had an incentive to engage in short-term loan deals since their use involved less borrowing costs.**

**In sum, the 'dismantling' of what were regarded as the pillars of the system of socialisation of private risk – industrial policy and strict financial regulation – are indicated as major causes contributing to the crisis that hit Korea in 1997. For Robert Wade, U.S. pressure, (in particular by the U.S. Treasury since the early 1990s) was behind the policy process that led to the dismantling of the rules of the game. These rules had sustained, for almost two decades, the capacity of the Korean state to influence the country's developmental path and industrial change.<sup>431</sup> But the role played by external pressure, in particular from the U.S., on Korea's policy choices is not sufficient to explain the policy reforms that**

<sup>428</sup> Stephan Haggard and Jongryn Mo, 'The political economy of the Korean financial crisis'; *Review of International Political Economy*, 7 (2000), 197-218, p.200.

<sup>429</sup> Asian Development Bank, *Rising to the Challenge in Asia*, p.4 (table 1).

<sup>430</sup> Asia Development Bank, *Rising to the Challenge in Asia*, p.11 (table 4).

<sup>431</sup> Wade, 'International Institutions and the US Role in the Long Asian Crisis of 1990-2000', pp.14-7.

**are correlated with the crisis. At least, as important as external pressures, are the policy preferences of the country's leadership and how they sought to implement them.**

### **5.3 Building a 'New Korea' & a 'New Economy': Kim Young Sam (1993 – 1997)**

**In a press conference shortly after his victory in the December 1992 presidential elections, Kim Young Sam, the country's first civilian president since 1961, vowed to implement sweeping reforms to build a 'New Korea'.<sup>432</sup> Kim's vision for the country emphasised the need to consolidate democracy, with a clean government and politics, a strong economy, a morally healthy society, and a unified nation.<sup>433</sup> For Kim, who officially became president on 25 February 1993, the consolidation of democracy called for an executive-led campaign to clean-up the country's old political and economic patterns, habits and institutions.**

#### **5.3.1 Cleaning the Government, Reorganising the Administration**

**President Kim's major goal was to institute political reform, by first targeting political corruption. Quoting a Korean adage, Kim made clear that his anti-corruption campaign to succeed had to start from above: 'The river upstream must be clean if it is to be clean downstream.'<sup>434</sup> Thus, he initiated his campaign by exposing the unethical behaviour of civil servants, military personnel, high-ranking government officials, bank officials, as well as members of the National Assembly and even former presidents. Setting the example, and early on in his mandate, Kim voluntarily disclosed his financial income and wealth following the promise that 'for the five years of my term I will not receive money from any business firm or individual.'<sup>435</sup> Kim further emphasised that during his**

<sup>432</sup>'Kim YS To Take Reformatory Steps', KT, 1 January 1993, p.1.

<sup>433</sup>See also Sung Deuk Hahn and Kwang Woong Kim, 'Institutional Reforms and Democratization in Korea: The Case of the Kim Young Sam Administration, 1993-1998'; *Governance: An International Journal of Policy and Administration*, 12 (1999), 479-494, p.478.

<sup>434</sup>'Corruption Will Not be Tolerated', KT, 10 February 1993, p.2.

<sup>435</sup>'Kim Won't Accept Political Funds', KT, 5 March 1993, p.1.

**administration 'you will not hear the phrase tie-in between political power and business groups as long as I am in office', and that 'without action against unlawful political fund-raising, it is impossible to eradicate corruption and irregularities.'**

**Under the pressure of the president, the staff at the presidential office (Blue House), cabinet, members of the National Assembly, high-ranking civil servants, prosecutors and judges were also asked to make their financial and property assets publicly known.<sup>436</sup> The release of the financial statements shocked the nation by revealing the degree of wealth accumulated by officialdom and the statements served as evidence for the growing suspicions that the country's elites had enriched themselves through unethical means. Simultaneously, the campaign unveiled the extent to which several bank presidents had manipulated the rules of the country's financial system after taking bribes and forced borrowers to deposit with them in return for loans.<sup>437</sup> The reforms were so sweeping and unexpected, in terms of their magnitude that the Korean population seemed to have been caught by surprise.<sup>438</sup> It was, nevertheless, a highly popular move that only boosted Kim's popularity ratings.<sup>439</sup>**

**In the new spirit of breaking ties with the past military regimes, Kim Young Sam further asserted his democratic legitimacy by excluding former military personnel from cabinet posts (except as defence minister), and dissolving a military inner circle originally founded by Park Chung Hee named *Hanahoe* (One Society).<sup>440</sup> Simultaneously, Kim weakened the**

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<sup>436</sup>For anti-corruption initiatives in the administration, National Assembly, and Prosecution Office, see 'Financial Statements to Be Audited', KT 7 March 1993, p.3, 'War Launched Against Corruption in Officialdom', KT 9 March 1993, p.3, 'Prosecutors Wealth Bigger than Thought', KT 28 March 1993, p.3, 'Ruling DLP Seals Up Lawmakers' Wealth Issue, Hoping Repercussions Peter Out', KT 31 March 1993, p.2, 'Assets and Anxiety', Far Eastern Economic Review, 8 April 1993, p.20, 'Opposition Lawmakers Not Any Better When It Comes to Speculative Investment', KT, 7 April 1993, p.3.

<sup>437</sup>'Bank of Seoul President Resigns', KT 19 March 1993, p.9, 'Clean-Up Drive Chills Banking Circle', KT, 20 March 1993, p.9, 'KFB President Park Resigns', KT, 15 April 1993, p.9.

<sup>438</sup>'People Dizzied by Pres. Kim's Quick, Bold Reform Action', KT, 26 March 1993, p.2.

<sup>439</sup>'Pres. Kim Given High Marks for Brooming Out Past', KT, 25 March 1993, p.3.

<sup>440</sup>Young-Chul Paik, 'Political Reform and Democratic Consolidation in Korea'; *Korea and World Affairs*, 18 (1994), 730-748, pp.735-8. The *Hanahoe*, seen as the most politicised private organisation within the army, was created by Park Chung Hee as his military supporting backbone. Former Presidents Chun Doo Hwan and Roh Tae Woo were members of *Hanahoe*.

**capacity of the National Security Agency (formerly KCIA), and other intelligence and military agencies that had been used by former military leaders as their oppressive tool against political opposition and civil society. The major political case, however, occurred in late 1995, when the two former presidents, Chun Doo Hwan and Roh Tae Woo, were arrested in an unprecedented move.<sup>441</sup> Thus illustrating Kim's commitment to political reform.**

**Pressed by Kim Young Sam, the passage in the National Assembly of the Public Official Ethics Act in May 1993 and of the Presidential Emergency Order on Real Name Financial Transaction System three months later helped strengthen the image of a government committed to consolidating democracy and establishing a clean government.<sup>442</sup> The Public Officials Ethics Act implemented a system requiring the registration and disclosure of the assets of public officials on a yearly basis. The objective of the system was to monitor any efforts by public officials to enrich themselves through public service by comparing the figures for their wealth before and after their appointments. The second case, the real name financial transaction system, seen by the president as the 'reform of the reforms', aimed at curbing ongoing corrupt ties between government officials and business groups.<sup>443</sup> The measure attempted not only to facilitate the investigation of, but also to control, informal money flows by tracking down the sources of the funds hidden behind false name bank accounts.**

**In 1994, the New Election Law and the Political Fund Law, two other major laws aiming at securing less costly and rigged elections**

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<sup>441</sup>For the trial of the two former presidents, 'Arrests of Two Ex-Presidents'; *Korea Focus* 3:6 (1995), 113-5 (originally published as editorial in *The Chosun Ilbo*, December 4, 1995), and Jung Hae-gu, 'History on Trial: Convictions Set Record Straight'; *Korea Focus* 4:5 (September-October 1996), 49-54 (originally published in the monthly newsmagazine *Win*, September 1996).

<sup>442</sup>For the Public Officials Ethics Act, see Paik, 'Political Reform and Democratic Consolidation in Korea', p.738. See also Hahn and Kim, 'Institutional Reforms and Democratization in Korea', p.482.

<sup>443</sup>This reform is examined in detail in Chapter Six.

**passed in the National Assembly.<sup>444</sup> The New Election Law aimed at securing clean, less costly and freer elections by setting a spending limit during the campaign and thus acting against previous money-dominated elections involving vote-buying, entertainment and gifts. The Political Fund Law, with the purpose of promoting fairness during elections, rectified the previous imbalance in the distribution of political funds by the Central Election Management Committee that tended to benefit the ruling party.**

**Finally, Kim Young Sam also actively pursued the reform of the administrative apparatus by setting up a Presidential Commission on Administrative Reform (PCAR) in April 1993 and reorganising the central administration between March 1993 and December 1994. One of the policies advocated by Kim during his campaign and reiterated soon after his victory was 'small government with strong leadership'. <sup>445</sup> The reorganisation of the administration led to the reduction of central government positions. This involved the removal of nine ministers and vice-ministers, 34 general directors, 127 division chiefs, and almost 1,000 lower administrative positions. <sup>446</sup> Another motivation underlying this reorganisation was the search for greater administrative efficiency by removing what were considered to be overlapping organisational functions and achieving effective policy coordination, in particular in the economic and industrial policy areas.<sup>447</sup> Among the solutions found was the merger of several ministries. For example: merger of the Economic Planning Board (EPB) and the Ministry of Finance (MOF) in December 1994 into the new Ministry of Finance and Economy (MOFE).**

**In sum, under the leadership of Kim Young Sam, the Korean state initiated important political and administrative reforms. Alongside the**

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<sup>444</sup>Paik, 'Political Reform and Democratic Consolidation in Korea', pp.740-2. See also 'All Change: Political reforms set to shake up campaigning', Far Eastern Economic Review, 17 March 1994, p.20.

<sup>445</sup>'Kim YS To Take Reformatory Steps', KT 1 January 1993, p.1. For the PACR, see Hahm and Kim, 'Institutional Reforms and Democratization in Korea', p.483.

<sup>446</sup>Yong-Duck Jung, 'Reforming the Administrative Apparatus in Korea: The Case of the "Civilian Government"', *Korean Review of Public Administration*, 1 (1996), 253-290, pp.255-7.

<sup>447</sup>Hahm and Kim, 'Institutional Reforms and Democratization in Korea', p.483.

**anti-corruption campaign, and the legislative and administrative reforms, the new leadership also announced that it would build a ‘New Economy’ described by Kim Young Sam as ‘the economy in which business activities are freed from regulations, one can harvest according to his sweat, and social justice is realized.’<sup>48</sup>**

### **5.3.2 Instituting the ‘New Economy’, Curbing the Chaebol**

**In early 1993, despite high economic growth rates by international standards, there was a sense of economic gloom affecting the country. This was due to growing awareness that Korea was undergoing a ‘competitive crisis’ as the country’s industries began to lose competitiveness in the international markets. The Economic Planning Board (EPB) said that industrial output and shipments hit a 10-year low in 1992, and analysts pointed out that in the international markets, Korean products faced competition from cheaper products originated in developing countries, as well as from more sophisticated and high-quality ones from Japan and the US. These two countries succeeded in cutting production costs by relocating their factories to Southeast Asia and Latin America.**

**The main thrust of the ‘New Economy Plan’ (1993-1997) launched in June 1993 was to promote economic justice through fair income distribution and change the national pattern of development from being led by the state to allow the private sector to take the initiative.<sup>49</sup> The plan included three major policy reforms: deregulation, privatisation, and internationalisation. The deregulation initiative sought to address the growing complaints from the private sector that numerous regulations had increased the cost of doing business in Korea and deregulation was seen as a step to improve the country’s business environment as well as**

<sup>48</sup>Byung-Sun Choi, ‘From Euphoria to Atrophy: The Politics of Economic Reform in Korea’, in Byung-Sun Choi, Hakun Kim, Jaehong Kim, Iljoong Kim, eds, *Economic Reforms And Political Hurdles in Korea* (Seoul: Korea Economic Research Institute, 1997), pp.9-47, p.16, and ‘Pres.Kim Demands Sweat, Tears, To Pull Off Economic Leap’, KT, 20 March 1993, p.2.

<sup>49</sup>For an overview of the Five-Year Economic Development Plan, see Yonhap News Agency, *Korea Annual 1994* (Seoul: Yonhap News Agency, 1994), pp.66-74.

**to stop corruption.<sup>450</sup> During the four-year period of Kim Young Sam's presidency, 5,788 deregulatory measures were selected, with 4,648 implemented and the remaining 1,140 in the process of being deregulated.<sup>451</sup> The privatisation program launched in 1993 selected 61 out of a total of 133 state-owned enterprises.<sup>452</sup> All the selected firms were expected to be sold to the private sector by 1998. The government announced that it would sell all the government shares and that it would transfer management rights to the private sector to enhance managerial efficiency.<sup>453</sup> Finally, the internationalisation program involved not only the country's ratification of the General Agreement on Tariffs and Trade (GATT) following the successful settlement of the Uruguay Round, but also the application to enter the Organization of Economic Cooperation and Development (OECD), both of which required the liberalisation of the economy.<sup>454</sup>**

**Consequently, in accordance with the settlement of the Uruguay Round, Kim Young Sam's government opened the country's import markets for the manufacturing and service sectors. Despite strong domestic political opposition, the agricultural sector was also opened.<sup>455</sup> Export-promotion measures and industrial policies were transformed from directly supporting specific sectors to providing and supporting infra-structural and science and technology development.<sup>456</sup> As a requirement for the country to join the OECD, an event that took place**

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<sup>450</sup> Seong Min Yoo and Sung Soon Lee, 'Evolution of Industrial Organization and Policy Response in Korea: 1945-1995', in Dong-Se Cha, Kwang Suk Kim, Dwight H. Perkins, eds, *The Korean Economy 1945-1995: Performance and Vision for the 21<sup>st</sup> Century* (Seoul: Korea Development Institute, 1997), pp.426-467, p.455. For deregulation policy, see also Kim Iljoong, 'Deregulation in Korea: A Critique from the Public Choice Perspective', in Choi et al., eds, *Economic Reforms and Political Hurdles in Korea*, pp.107-146.

<sup>451</sup> Sung-hee Jwa and Jun-Il Kim, 'Korea's Economic Reform: Political Economy and Future Strategy', in Chung-in Moon and Jongryn Mo, eds, *Democratization and Globalization in Korea: Assessments and Prospects* (Seoul: Yonsei University Press, 1999), pp.247-271, p.261.

<sup>452</sup> Jaehon Kim, 'Privatization Policy in Korea: Political Motivations Behind Economic Goals', in Choi et al., *Economic Reforms and Political Hurdles in Korea*, pp.74-105, p.80.

<sup>453</sup> Yoo and Lee, 'Evolution of Industrial Organization and Policy Response in Korea: 1945-1995', p.456.

<sup>454</sup> Chung-in Moon, 'In the shadow of broken cheers: the dynamics of globalization in South Korea', in Aseem Prakash and Jeffrey A. Hart, eds, *Responding to Globalization* (London: Routledge, 2000), pp.65-94, pp.74-5. See Ha Dong-man, 'Basic Steps to Internationalize Korean Economy'; *Korea Focus* 2:2 (1994), 69-74, pp.68-9 (originally published in *The Monthly Nara Kyungje on Economic Policy*, January 1994).

<sup>455</sup> Kim In-june, 'Impact of Uruguay Round on Korean Economy'; *Korea Focus* 2:2 (1994), 29-37, p.29 (originally published in *The Shin Dong-a Monthly*, January 1994).

<sup>456</sup> Moon, 'In the shadow of broken cheers: the dynamics of globalization in South Korea', p.75.

**in 1996, the government announced in May 1993 a comprehensive five-year financial liberalisation program that would be added to the 'New Economy Plan'. This plan clearly envisioned the reduction of the interventionist role of the state in the financial system. The plan comprised of four major areas: (1) liberalisation of interest rates; (2) termination of all policy loans by 1997; (3) management of banks to gain more autonomy; (4) and liberalisation of capital accounts.<sup>457</sup>**

**As part of the 'New Economy' and its goal to realise social justice, Kim Young Sam's presidency also sought to dilute the *chaebol's* economic concentration.<sup>458</sup> This intention took the form of a *chaebol* specialisation policy which included three interrelated goals: (1) reduction of the dominant *chaebol's* role in the economy; (2) push for specialisation in a few core business activities as a way to improve international competitiveness; and (3) the promotion of small and medium-sized firms.<sup>459</sup> The final plan to deal with the *chaebol* was a policy of forced 'specialisation', in which the 30 largest business groups were barred from further diversification into areas 'new' and 'unrelated' to their core business.<sup>460</sup> As an incentive, the government proposed to eliminate credit limits and make more funds available to those *chaebol* that decided to streamline their businesses. Conversely, it warned that fair trading regulations would be strengthened on new investments or loan guarantees for those that preferred to keep to old habits. These incentives and penalties aimed at guaranteeing the *chaebol's* compliance with the policy.**

**The administrative and economic reforms pursued by Kim Young Sam threatened the equilibrium that had sustained the system of socialisation of private risk, by reducing the role of the state and**

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<sup>457</sup>Ismail Dalla and Deena Khatkhate, 'Regulated Deregulation of the Financial System in Korea'; *World Bank Discussion Papers* 292 (Washington: The World Bank, 1995), pp.19-23. See also '5-Year Reform Plan Set: Chaebol Won't Be Able to Abuse Financial Cos.', KT, 29 May 1993, p.9.

<sup>458</sup>'5-Year Plan Envisages Keeping Tighter Grip on Chaebol', KT 21 April 1993, p.7.

<sup>459</sup>'Divide and Rule: Kim hopes to reduce chaebol power', Far Eastern Economic Review, 7 January 1993, p.22.

<sup>460</sup>Choi, 'From Euphoria to Atrophy: The Politics of Economic Reform in Korea', p.28.

**challenging the economic role of the *chaebol* in the country's economy. In the next sections, I show how Kim Young Sam's attempts to transform the foundations of the system were motivated by a combination of factors: historic and domestic legacies, ideological motivations, and international context.**

#### **5.4 Moulding the 'New Korea': Historical Legacies, Ideological Motivations and International Context**

**In late 1970s, and still under the leadership of Park Chung Hee, Korea entered a major economic crisis. After a long period of sustained economic growth during the 1960s and 1970s, the situation began to reverse in the latter period of the 1970s.<sup>461</sup> Growth rates that had averaged 9.3 percent from 1972 to 1978 fell to 3.1 percent between 1979 and 1981. In 1980, for the first time since 1962, there was a decline of 3.7 percent. Inflation rates soared to 18.3 percent in 1979, 28.7 percent in 1980 and 21.6 percent in 1981. Export growth rates that had rapidly increased since the 1960s also began to falter, from 44.4 percent in 1972-1978 to 18.7 percent in 1979-1981. The current account deficit of 1.085 billion US dollars in 1978 grew rapidly to 4.151 billion US dollars in 1979, 5.321 billion US dollars in 1980 and 4.646 billion US dollars in 1981.<sup>462</sup> Exogenous and unexpected events contributed to the declining status of the economy. The second oil shock hastened inflation and led to a sharp increase in the balance of payments deficit.<sup>463</sup> The abrupt rise of interest rates following the oil shock affected Korea in particular because the country had borrowed heavily abroad to finance the heavy and chemical industrialization of the 1970s. Additionally, a major decline in local rice production in 1980, the nation's main food crop, contributed to rising inflation.**

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<sup>461</sup>For an account of the crisis in the late 1970s, see Chung-in Moon, 'The Korean Economy in Transition: Political Consequences of Neoconservative Reforms'; *Working Papers in Asia/Pacific Studies*, 27706 (Asia/Pacific Studies Institute, Duke University, March 1988).

<sup>462</sup>Sakong, *Korea and the World Economy*, pp.264-5 (Table A.39).

<sup>463</sup>Moon, 'The Korean Economy in Transition', p.3.

**While, exogenous factors added to the economic crisis, the rapid and unbalanced growth of HCI, and its impact on the country's pattern of development, began to be subjected to domestic criticisms.<sup>464</sup> Undoubtedly, the country's economy grew rapidly during the implementation of the HCI during the 1970s. However, the policy also came to be seen as leading to excessive credit expansion, overinvestment, and underutilisation of industrial capacity.<sup>465</sup> Labour shortages rose as the HCI demand for high-skilled workers could not be matched by the market. This pushed wages up that were not met by similar productivity gains. During 1975-1980, while productivity grew by 11.2 percent, real wages increased by 13.4 percent.<sup>466</sup> Additionally, the concentration of financial resources in the development of export-oriented heavy and chemical industrial sectors drained the domestic-focused industries, mainly housing and consumer goods, of much needed capital to expand their production in response to the growing demand of an increasingly affluent Korean population.<sup>467</sup>**

**The crisis had the effect of leading to a reassessment of the country's old model of development based in the system of socialisation of private risk, specifically the interactive role played by the state and the *chaebol*. Yet, as Merilee Grindle and John W. Thomas point out, rather than state the obvious, i.e., that crisis generates reforms, the question is to understand what crisis means for the leadership in terms of the policy process and the types of decisions that crisis is expected to engender.<sup>468</sup> In Korea, the crisis led policymakers to progressively shift the country's economic orientation from state-led to market-oriented.<sup>469</sup> This was already evident in the last years of Park's regime, following the appointment in late 1978 of Shin Hyon Hwak as the new Deputy Prime**

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<sup>464</sup> For a critical view by one of the country's most renowned economists and policymakers during the 1980s on the problems generated by the heavy and chemical industrialisation, see Sakong, *Korea and the World Economy*, pp.56-66. Il Sakong was the Senior Counsellor to the Minister of Economic Planning Board in 1982 and Senior Secretary to the President for Economic Affairs between 1983 and 1987.

<sup>465</sup> Sakong, *Korea and the World Economy*, pp.58-9.

<sup>466</sup> Moon, 'The Korean Economy in Transition', p.4.

<sup>467</sup> For a description of the problems affecting the domestic industries at the time, see Clifford, *Troubled Tiger*, pp.131-3.

<sup>468</sup> Grindle and Thomas, *Public Choices and Policy Change*, p.74.

<sup>469</sup> Choi, *Institutionalizing A Liberal Economic Order in Korea*, pp.250-7.

**Minister (DPM). In April 1979, Shin announced the 'Comprehensive Measures for Economic Stabilisation'.<sup>470</sup>**

**Among the measures were: (1) price deregulation and import liberalisation; (2) more investment in light industries to produce essential commodities and necessities to correct investment imbalances; (3) temporary suspension of all new and large scale projects and restructuring of the heavy and chemical industrialisation; (4) tight monetary policy, re-evaluation of preferential policy loans and financial sector reforms; and (5) a ban on real estate speculation to promote savings. An unexpected series of domestic and international events, however, impeded the full implementation of the plan. Among them were the assassination of Park Chung Hee in October 1979, and the sudden increases in oil prices that severely hit an economy trying to fight inflation. Nevertheless, the principles underpinning the proposals survived the events as they would later inspire the economic policy choices undertaken by Korean leaders since the 1980s.**

**Furthermore, in the case of Korea, the HCI had essentially been driven by the country's *chaebol*. One of the most significant outcomes of this industrial policy was to increase the *chaebol's* control of the country's economy. This led to a growing conviction in Korea that one of the policy outcomes of the HCI strategy was to produce economic concentration in the hands of a few companies and to contribute to the country's unbalanced development. As Stephan Haggard and Chung-in Moon argue: 'the 'big push' (as the HCI became commonly known) was blamed for the increasing concentration of wealth, the widening gap between rural and urban incomes, the growth of urban marginalism, and perhaps – most importantly, sharp increases in the prices of basic necessities and housing in urban areas.'<sup>471</sup>**

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<sup>470</sup>Choi, *Institutionalizing a Liberal Economic Order in Korea*, pp.256-7.

<sup>471</sup>Stephan Haggard and Chung-in Moon, 'Institutions and Economic Growth: A Theory and the Korean Case'; *World Politics*, 42 (1990), 210-237, p.218.

#### **5.4.1 The Legacies of Chun Doo Hwan (1980-1987) and Roh Tae Woo (1988-1992)**

**Under these conditions inherited from the regime led by Park Chung Hee, the Fifth Republic under Chun Doo Hwan (1980-1987) and the Sixth Republic under Roh Tae Woo (1988-1992) took the initiative to alter the rules of the game embedded in the system of socialisation of private risk. The new economic policies involved changes in the 'spoils' system created by Park Chung Hee not only due to economic priorities, but also in response to the growing belief that previous *chaebol*-biased policies had intensified economic inequalities in the country. The new strategies began to reflect the ideological paradigm shift from 'growth-first' that was at the basis of the Park's regime to 'fairness of wealth distribution'. The latter aimed at economic and social equity as well as balanced economic development which included the reduction of the *chaebol*'s economic concentration.<sup>472</sup> With 'economic stability and gradual liberalisation' set as the new economic orientation and 'fairness of wealth distribution' as the new ideological paradigm, the presidencies of Chun Doo Hwan and Roh Tae Woo were not only responding to the country's changing economic conditions, but also trying to gain political support and legitimacy among the growing and urbanised Korean middle class.<sup>473</sup>**

**In the Korean political system whenever a new leader emerged to take over the presidency he sought to cast off and to discredit the former president's legacy by undertaking major changes in the organisation of the state and its policies. This ultimately leads to a reconfiguration of the state's ties with society. Hahm Sung Deuk argues that this strategy by the new presidents builds on their ambitions to leave their mark on history. Since the new leaders did not have strong political bases, they would attempt to expose the wrongdoings of the past presidencies to boost their**

<sup>472</sup> Byung-Sun Choi, 'Political and Economic Democratization and Its Impact on Government-Business Relationship in Korea'; *The Korean Journal of Policy Studies*, 3 (1988), 30-50, p.34.

<sup>473</sup> For Chun Doo Hwan and middle class, see Moon, 'The Korean Economy in Transition', p.9. In the case of Roh Tae Woo, among the main political goals of the Sixth Republic were distributive justice, promotion of labour's welfare and the growth of middle class. See Lee, *The State, Society and Big Business in South Korea*, pp.60-1.

**own political legitimacy.<sup>474</sup> The political legitimacy of Chun Doo Hwan was weakened by the fact that his regime had illegally seized power through a military coup d'état as well as by its dictatorial and authoritarian nature. On the other side, Roh Tae Woo, despite winning seemingly open and fair democratic elections, obtained only 36 percent of the total vote and had still to succeed in gaining the trust of the society in face of his personal ties with Chun Doo Hwan and his military past.<sup>475</sup> Furthermore, in the case of Roh, he had to face a new and unfamiliar political terrain as the country's democratic transition beginning in 1987 established new conventions and customs for political participation.**

**Presidents Chun and Roh vowed to establish clean government in Korea by undertaking anti-corruption purges as well as administrative reforms as a way to buttress their political legitimacy.<sup>476</sup> For example, in 1981, under the authoritarian leadership of Chun, the Korean government initiated the country's first reduction-oriented administrative reform that led to the elimination of many high-ranking positions.<sup>477</sup> Park Chung Hee had expanded the role of the state in the economy by: creating several agencies; transforming the bureaucracy into a meritocratic administrative body and; changed the economic architecture to allow greater state intervention. In contrast, Chun set a new agenda of administrative reform by defending the creation of a 'small government'.<sup>478</sup> Yong-Duck Jung argues that the ultimate consequence of Chun's policy initiative was to**

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<sup>474</sup> Interview in Seoul with Hahm Sung Deuk, Director of the Centre for Presidential Studies (Korea University), 26 June 2001.

<sup>475</sup> Roh won because the opposition votes were split between Kim Young Sam from the Reunification Democratic Party and Kim Dae Jung from the Party for Peace and Democracy, who failed to present a unified political platform. The divided opposition votes together totalled 55 percent of the total votes.

<sup>476</sup> For a journalist's account of the "purification campaign" during Chun Doo Hwan, see Clifford, *Troubled Tiger*, pp.163-169. See also Kang, *Crony Capitalism*, pp.104-106. Among the ones affected by the purge were former Prime Minister Kim Jong Pil, the former head of the Korean Central Agency (KCIA) and Presidential Chief of Staff in the Blue House, Lee Hu Rak, and former Presidential Economic Secretary and architect of the heavy and chemical industrialisation, Oh Won Chol. For a brief summary on the hearings at the National Assembly during the presidency of Roh Tae Woo, see 'Hearings Bring Real Picture of 5<sup>th</sup> Republic Irregularities to Light', KT, 11 November 1988, p.2. Revelations during the parliamentary inquiry led to the arrest and imprisonment of several 'power brokers' during the Fifth Republic and the 'exile' of President Chun in a Buddhist monastery. See '47 Arrested in Probe of Past Regime's Scandals', KT, 1 February 1989, p.1. For the process leading to the new democratic constitution, see Shin Doh C., *Mass Politics and Culture in Democratizing Korea* (Cambridge: Cambridge University Press, 1999), p.4.

<sup>477</sup> Chung-Kil Chung, 'Conditions of Successful Administrative Reform – A Historical Perspective –'; *The Korean Journal of Policy Studies*, 8 (1993), 1-14, pp.11-2.

<sup>478</sup> Jung, 'Reforming the Administrative Apparatus in Korea', p.257.

**imbue Korean society with a new norm of administrative reform entailing the reduction of the administrative organisation, staff and budget.<sup>479</sup>**

**Similarly, while Park's government had developed a cooperative understanding with the *chaebol* to guarantee the maintenance and consolidation of the system of 'socialisation of private risk', Chun and Roh decided to publicly adopt an anti-*chaebol* posture to address the issue of fairness of wealth distribution. Under Chun, and in face of the country's deteriorating economic conditions, the executive first implemented a successful stabilisation program that helped the economy rebound, and later structural adjustment reforms to change the country's pattern of industrial development.<sup>480</sup> The structural adjustment program, in particular, by involving the restructuring of industry, financial liberalisation and gradual opening of the domestic market to foreign imports was expected to specifically affect the activities of the country's *chaebol*.<sup>481</sup>**

**As with Chun, Roh Tae Woo also pursued anti-*chaebol* policies, which included credit restrictions and tax probes to fight the growing real estate and stock market speculation, and to push the *chaebol* to undertake business specialisation to improve their international competitiveness and reduce their economic concentration.<sup>482</sup> The government asked business groups to dispose of their idle land and buildings. In case of non-compliance, the government threatened a possible veto over access to bank loans; immediate repayment of**

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<sup>479</sup> Jung, 'Reforming the Administrative Apparatus in Korea', p.258.

<sup>480</sup> For a detailed analysis of the economic reforms undertaken during the regime of Chun Doo Hwan, see Moon, 'The Korean Economy in Transition'.

<sup>481</sup> For an overview on the financial reforms during Chun Doo Hwan, see Pyung Jo Kim, 'Financial Institutions: Past, Present, and Future', paper presented at the workshop on *Comparative Analysis of Development Policies in China, Japan, and Korea*, Seoul, 16-20 May 1990, pp.29-40.

<sup>482</sup> For the fight against real estate speculation, see Hee-Nam Jung, *Land, State And Capital: The Political Economy of Land Policies in South Korea, 1960-1990*, Doctoral dissertation, University of Hawaii, 1993, pp.6-8. See also Jae-young Son, 'A Brave Experiment: Korea's Recent Land Policy Reform And the Role of Land Holding Tax', *KDI Working Paper* No.9302 (Seoul: Korea Development Institute, March 1993), p.8 (Table 2). A study on land distribution done by a committee set by the government in 1989 found out that the top 5 percent of land owners held 65.2 percent of all land area owned by individuals and that "the degree of land concentration probably exceeded even the most pessimistic of previous estimates, and is far worse than any indicators of income distribution." See also 'Top 30 Biz Conglomerates Front Runners in Buying Speculative Real Estate', KT, 7 March 1990, p.7. On dealings in the stock market, see 'Biz Groups' Portfolio Income Doubled', KT, 12 October 1989, p.9.

**outstanding bank loans and; tax investigations.<sup>483</sup> Additionally, each of the top 30 business groups were pushed to nominate two or three subsidiaries as their 'core business' and strongly urged to specialise in these industries, in exchange for the exclusion of these subsidiaries from the list of credit controls.<sup>484</sup>**

**The anti-chaebol policies pursued by Chun and Roh failed to produce the desired result. The country's conglomerates managed to overcome the obstacles erected by the government and take advantage of the liberalisation measures. For example, the liberalisation of the non-banking financial sector (e.g., short-term finance companies, securities corporations, insurance companies) and the growing internationalisation of the country's financial system offered the chaebol the opportunity to access new sources of corporate financing despite attempts to limit credit flows to the conglomerates. The credit control system implemented in 1984 did not apply to non-banking financial institutions (NBFIs).<sup>485</sup> By the end of 1989, Korea's 30 major conglomerates took on 39 percent of all outstanding loans at NBFIs, compared with 32.4 percent in 1988.<sup>486</sup> A trend that continued during the presidency of Roh Tae Woo, as the chaebol increased their control of financial institutions as a medium to raise business funds.<sup>487</sup>**

**Furthermore, while both Chun and Roh publicly maintained that they did not want economic power to be concentrated in the hands of a few chaebol, they nonetheless continued to favour a selected few among**

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<sup>483,49</sup> Big Firms Told to Dispose Of Idle Land Within 6 Months', KT, 9 May 1990, p.1. See '30 Business Groups Asked to Report Hidden Real Estate', KT, 9 May 1990, p.6.

<sup>484</sup> '30 Large Business Groups Subject to Credit Control', KT, 15 March 1990, 'Biz Specialization To Be Freed from Credit Control', KT, 29 March 1990, p.9.

<sup>485</sup> The liberalisation of the non-banking financial sector began in the early 1970s, as shown in the previous Chapter, but was accelerated during the 1980s. Following the "Madame Chang" scandal in 1982, which is analysed in Chapter Six, the government allowed the opening of more mutual savings and finance companies (MSFCs) and short-term finance companies (STFCs) as long as they had the minimum capital requirement as a way to attract funds from the underground money market. See 'Gov't Frees Establishment of Short-Term Finance Cos', KT, 29 July 1982, p.1.

<sup>486</sup> 'Nonbanks Dominating Financial Marts', KT, 16 March 1990, p.9.

<sup>487</sup> 'Large Business Groups' Entry Into Financial Sector on Constant Rise', KT, 16 September 1992, p.9. A report released by the Korea Development Institute in September 1992, revealed that the share of capital owned by the country's largest 30 chaebol in 1990 in financial institutions had already increased to 45.04 percent from 38.73 percent in 1986.

**the conglomerates through their control of the banking system and permits and licenses for lucrative investment projects. In exchange, the favoured corporations would come forward with political donations. This was evident, first, in the case of Chun, with the implementation of the Industrial Rationalisation Program and the firms that were selected to take over weaker ones in merger plans for certain business areas. In Roh's case, it was seen in the tender announced for six large government projects in mid-1992.<sup>488</sup> During the Chun and Roh administrations, the strength of the state began to progressively wane as the country pursued a phased liberalisation of the economy. The state continued, nonetheless, through its control of the financial system, to hold enough power to negotiate the rules of the game with a selected few. Additionally, and despite the anti-chaebol policies, the economic and political power of the conglomerates remained very much intact.<sup>489</sup> These were important institutional and political legacies left by Chun and Roh that as 'policy feedback' helped shape Kim's policy initiatives to challenge the *status quo* within the system of "socialisation of private risk".**

#### **5.4.2 Moral Leadership and the Ideology of Democratic Reform**

**With a long history as an opposition leader during the military regimes campaigning for the democratisation of Korea, the election of Kim Young Sam in 1993 represented a turning point in the country's history and a further step towards the consolidation of the democratic process initiated in 1987 with the 29th June's Declaration.<sup>490</sup> Soon after his**

<sup>488</sup>For the political considerations influencing the Industrial Rationalisation Program during Chun Doo Hwan, see Chapter Two, pp.53-5. The 6 large government projects, known as the "Last Golden Eggs" included mobile telecommunications service, passenger car manufacturing, cable television service, high-speed railroad between Seoul and Pusan, an international airport in Inch'on, and the construction of a liquefied natural gas (LNG) carrier. The involvement in these public projects was expected to redefine the domestic business scenario in the 21<sup>st</sup> century. With presidential elections in December 1992, the licensing of such public projects was seen by some as an opportunity for the ruling party to collect political funds. For the public projects, see 'Conglomerates Lobbying for 6 Large Gov't Projects', KT, 26 June 1992, p.8 and 'Big Public Projects' Approvals Must Be Delegated to Next Gov't', KT, 30 June 1992, p.7.

<sup>489</sup>For an analysis of the continuing economic concentration in the hands of the *chaebol* by the early 1990s, see Min Byoung-moon, 'How Should the Conglomerates be Dismantled?'; *Korea Focus* 1:1 (1993), pp.57-67 (originally published in the *Shin Dong-A Monthly*, August 1992).

<sup>490</sup>For the full declaration, see Robert Bedeski, *The Transformation of South Korea, Reform and Reconstruction in the Sixth Republic under Roh Tae Woo, 1987-1992* (London: Routledge, 1994), pp.169-170. The Declaration, an eight-point pledge by Roh Tae Woo, then the presidential candidate for the ruling Democratic Justice Party

victory, speaking to journalists, Kim Young Sam emphasised that 'my government will be totally different from Roh's and I will exercise presidential power fully and guide the nation through strong leadership.'<sup>491</sup> As Young-Chul Paik points out, 'political reform under Kim's administration was started under the initiative of the president himself and carried out by his personal drive. Kim's reform was thus 'reform from above' often accompanied by the element of surprise, even bypassing close advisers.'<sup>492</sup> Doh C. Shin argues that, driving Kim Young Sam was a sense that 'democratic consolidation required the building of a truly moral community by removing every authoritarian enclave rather than sustaining an alliance with it.'<sup>493</sup>

**It was a vision not only based on 'legal legitimacy' following his election through free and direct elections, but also on morality.<sup>494</sup> It was a style of leadership informed by traditional Confucian political discourse founded on the belief that when a man reached a certain level of moral integrity then people were expected to follow him making it unnecessary for the leader to resort to naked power or the use of violence.<sup>495</sup> Kim Young Sam wanted to present himself as a moral ruler and root his presidency on what, in Confucian terms is known as the 'rule of man'. As Kim put it, 'it is my belief that a leader can exert true authority and strong leadership only when he leads by example and sets high ethical standards. My conviction is that the ethical integrity of the leader is essential to building a sound society and a healthy society.'<sup>496</sup> Hence, and in an attempt to attest to his moral leadership, Kim opened the area near the previously secretive Blue House to the public for the first time in decades, and**

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(DJP) in the country's first direct presidential elections, served as the blueprint for the country's new democratic Constitution. Drafted and approved by the National Assembly and ratified by more than 90 percent of the votes in a national referendum, the constitution underlined the principles of presidential democracy, i.e., the separation of powers and checks and balances between the executive, legislative, and judicial branches of the government.

<sup>491</sup> 'Kim YS To Take Reformative Steps', KT, 1 January 1993, p.1.

<sup>492</sup> Paik, 'Political Reforms and Democratic Consolidation in Korea', p.739.

<sup>493</sup> Shin, *Mass Politics and Culture in Democratizing Korea*, p.201.

<sup>494</sup> Chaibong Hahn and Sang-young Rhyu, 'Democratic Reform and Consolidation in South Korea: The Promise of Democracy', in Chung-in Moon and Jongryn Mo, eds, *Democratization and Globalization in Korea: Assessments and Prospects* (Seoul: Yonsei University Press, 1999), pp.69-88, pp.78-80.

<sup>495</sup> Hahn and Rhyu, 'Democratic Reform and Consolidation in South Korea', p.79.

<sup>496</sup> See Kim Young Sam, 'Toward Resurrection of the National Economy'; *Korea Focus*, 1:5 (1993), p.128 (speech at the National Assembly on September 21, 1993).

**ordered the destruction of a series of 'safe houses' used by former presidents for what were seen as suspicious and informal political meetings.<sup>497</sup>**

#### **5.4.3 Responding to International Changes: Trade Conflicts, WTO, OECD and Seghewya**

**Since 1965, Korea has become increasingly integrated in the international economy. That year, total trade volume amounted to 630 million US dollars, or 21 percent of the country's GDP. But thirty years later, in 1995, the volume had increased to 260.18 billion US dollars, accounting for almost 57 percent of the country's GDP. By 1997, trade volume reached 63.5 percent of GDP to make the country a 'truly trading state'.<sup>498</sup> But this increasing economic interdependence exposed Korea to structural limits of its own protectionist measures.<sup>499</sup> In the aftermath of the country's trade surplus between 1985 and 1987, Korea's trading partners, in particular the US, began to demand reciprocal market opening under threat of voluntary export restraints, quantity restrictions and anti-dumping measures.<sup>500</sup> Simultaneously, multilateral pressures to open the domestic market intensified with the emergence of the World Trade Organization (WTO).<sup>501</sup> While growing international pressures might have played an important role in shaping Kim Young Sam's initiative to open the domestic markets, Kim himself seems to have been predisposed to take on an internationalist approach during his presidency. Speaking to reporters in February 1994, he clarified his thinking about the internationalisation of Korea:**

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<sup>497</sup> Chong Wa Dae (Blue House) Safe Houses Not 'Safe' Anymore', KT, 6 March 1993, p.2. See also Yonhap News Agency, *Korea Annual 1994* (Seoul: Yonhap News Agency), pp.57-9.

<sup>498</sup> Moon, 'In the shadow of broken cheers', p.72.

<sup>499</sup> For an analysis of the extent of import controls within a case of export-oriented economy as Korea between the 1960s and early 1980s, see for example, Richard Luedde-Neurath, *Import Controls and Export-Oriented Development: A Reassessment of the South Korean Case* (Boulder, Co: Westview Press, 1986).

<sup>500</sup> Ahn and Kim, 'The Outward-Looking Trade Policy and the Industrial Development of South Korea', p.355. For U.S and European Community (EC) trade actions against Korea during the 1980s, see C.S. Elliot Kang, 'Segyehwa Reform of the South Korean Developmental State', in Samuel S. Kim, ed, *Korea's Globalization* (Cambridge: Cambridge University Press, 2000), pp.76-101, pp.80-4.

<sup>501</sup> Jwa and Kim, 'Korea's Economic Reform', p.258, and Ahn and Kim, 'The Outward-Looking Trade Policy and the Industrial Development of South Korea', p.361.

**I am chagrined to find that the importance of internationalization is yet to be generally well understood and that a solid consensus has yet to be formed on this task. A century ago, we failed to internationalize on our own initiative and were thus forced by others to open up our country. This is why Korea remained backward, soon to be reduced to a colony of a foreign power. If we are not to repeat the mistakes we made 100 years ago at the time of Korea's first opening, we must actively endeavour to accomplish Korea's second opening on our own initiative. We must learn the lessons of history. Instead of deplored the fact that our doors are unlocking, we should ourselves throw our doors open and march out into the wide world.<sup>502</sup>**

**Kim's intentions to 'internationalise' the country emerged soon after his election in 1993, as his presidency without much national consultation decided to push for the country's formal membership application to the Organization for Economic Cooperation and Development (OECD). The accession happened in 1996, but as a precondition for entry, Korea proceeded with the liberalisation of capital accounts and undertook a series of other financial reforms. The idea of entering OECD was first publicly advanced by Kim Young Sam in his election platform in 1992.<sup>503</sup>Joining the OECD ultimately represented also the country's best opportunity to advance into the ranking of advanced nations, and to realise one of the core elements of Kim's vision for the country: 'My only desire is that I will go down in history as the president who laid a solid foundation for an advanced country, a country of high ethical standards. To have passed on a proud country to posterity is my sole dream and wish.'<sup>504</sup>**

**By the end of 1994, democratic reform discourse began to loose appeal within the population, as democratic consolidation started to be**

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<sup>502</sup>Kim Young Sam's Opening Remarks at a Press Conference to Mark the First Anniversary of his presidency (February 25, 1994) in Yonhap News Agency, *Korea Annual 1994*, p.353.

<sup>503</sup>Andrew Horvart, 'Living the sham of a free market', *Euromoney*, September 1996, p.328.

<sup>504</sup>Kim, 'Toward Resurrection of the National Economy', p.134.

**taken for granted. Kim Young Sam then began to advocate what became known as *seyehwa* (globalisation), as the new ideological framework underpinning his presidency.<sup>505</sup> The new policy became a ‘new hegemonic ideology’ to replace the old developmentalism.<sup>506</sup> *Seyehwa* did not only target the economic arena, but also education, law, foreign policy, politics, culture, environment and quality of life. The new ideological framework provided Kim Young Sam with a new political catch-phrase, to replace the democratic reform discourse. But it was also used to legitimise political manoeuvres necessary in face of the country’s new international commitments. For example, in the aftermath of the Uruguay Round settlement, the government fearing, retaliation against Korean-made manufactured products, decided to open the domestic rice market to foreign imports despite strong domestic opposition. The deliberation to open the domestic rice market could be justified in the name of *seyehwa*.<sup>507</sup> Thus, *seyehwa* became an instrument to redefine existing and essentially inward-looking preferences within the Korean society and to help create new ones welcoming foreign forces.<sup>508</sup> At the same time, *seyehwa* also served to validate the implementation of sweeping policy changes as the country opened its domestic markets.**

**In this section, I showed how Kim Young Sam’s actions to transform the system of “socialisation of private risk” were moulded by the interaction of historical and domestic legacies, ideological motivations, and international events. However, as I will point out in the next section, Kim’s reformist project was marred by weak economic leadership that produced inconsistent and erratic policy choices. Simultaneously, Kim committed the strategic error to pursue his reformist project by administrative fiat without building a supporting coalition. This**

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<sup>505</sup>For an analysis of the emergence of *seyehwa* as the ideological leitmotiv sustaining the presidency of Kim Young Sam, see Davis B. Bobrow and James J. Na, ‘Korea’s Affair with Globalization: Deconstructing Segyehwa’, in Moon and Mo, eds, *Democratization and Globalization in Korea: Assessments and Prospects*, pp.179-207.

<sup>506</sup>Moon, ‘Democratization and Globalization as Ideological and Political Foundations of Economic Policy’, p.11

<sup>507</sup>Moon, ‘In the shadow of broken cheers’, (2000), pp.75-6.

<sup>508</sup>See for example Lee Hong-Koo, ‘Attitudinal Reform Toward Globalization’; *Korea Focus*, 2:2 (1994), pp.85-94 (originally published in *Sasang Quarterly*, Winter 1993).

**had the effect of weakening the capacity of the state to supervise the financial and corporate sectors which ultimately contributed to the mismanagement of the economy and the IMF crisis.**

### **5.5 Blitzing Reforms From Above: Weak Leadership, Coalition Failures and Crisis**

**The *segyehwa* policy Korea is pursuing represents an effort to eliminate the inefficiency and malpractice stemming from protectionism and regulation and improve and upgrade institutional systems and practices to a world level. The ultimate objective is to make Korea a country people all over the world would like to visit, invest in and reside in. In this sense, the *segyehwa* policy that Korea is pushing is not for the sake of Korea alone, but also to help the development of the world as a whole.<sup>509</sup> (Kim Young Sam, May 1996)**

**In 1997, the country's macro-economic situation seemed to be improving in comparison with previous years. The current account deficit had decreased from 23.7 billion US dollars in 1996 to 8.8 billion US dollars in 1997. Inflation had been stable with an increase of 4.4 percent during the year, and the economy was expected to grow 7 percent.<sup>510</sup> Yet, on November 1997, the government announced that it had appealed for assistance of the International Monetary Fund (IMF). As Chung-in Moon put it, 'the myth of Korean economic miracle was shattered, and national shame prevailed.'<sup>511</sup> As mentioned in the introduction to the chapter, two major causes have been identified as contributing to the crisis: the dismantling of industrial policy and financial liberalisation. Under this new environment, the capacity of the state to guide and discipline the *chaebol* through the control of credit allocation weakened. Hence, Korean conglomerates rapidly expanded their borrowing, which resulted in over-**

<sup>509</sup> Kim Young Sam's speech to the Seventh Annual Corporate Conference of the Asia Society Toward the Globalization of the Republic of Korea (Seoul, May 9, 1996) in Yonhap News Agency, *Korea Annual 1996* (Seoul: Yonhap News Agency, 1996), p.364.

<sup>510</sup> Joon-Ho Hahn, 'Financial System Restructuring in Korea. The Crisis and Its Resolution'; *KDI Working Paper* No.9802 (Seoul: Korea Development Institute, Feb.1998), p.4.

<sup>511</sup> Moon, 'In the shadow of broken cheers', p.77.

**investment and high indebtedness in a move that endangered the stability of the country's financial system built on tight ties between the banks and industry.**

**I argue that the Korean state failed to supervise and discipline the corporate and financial sectors because of weak economic leadership that formulated inconsistent policy decisions alongside a strategic failure in building a supporting coalition to push the reforms ahead. In the Korean political system where the president is expected to be actively involved in the formulation, monitoring and implementation of public policies, President Kim Young Sam failed to perform that role.**

**First, Kim Young Sam had many advisors, but his poor economic understanding contributed to his lack of systematic vision to reform the economy.<sup>512</sup>The decision to apply for the country's accession to the OECD serves well as an example. While the decision to enter the OECD could offer the opportunity to 'overcome entrenched bureaucratic and corporate obstacles to needed reforms', as argued by the government, it also involved what was seen as a premature liberalisation of the capital account.<sup>513</sup>This policy was seen as highly risky and criticised by officials at the Ministry of Finance and Economy (MOFE) and the Bank of Korea (BOK) for the negative implications it could have for the country's economy. An official at the MOFE said that the ministry's greatest fear was 'hot money from abroad', which could cause 'very high damage if suddenly withdrawn. If that happens, we cannot maintain the soundness of markets.'<sup>514</sup>Kim Young Sam, nevertheless, decided to go ahead.**

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<sup>512</sup>Interview with Hahn Seung Deuk, Director of the Centre for Presidential Studies (Korea University) in Seoul, 26 June 2001.

<sup>513</sup>'Korea's OECD Entry and Tasks Ahead'; *Korea Focus*, 4:6 (1996), pp.120-1 (originally published as an editorial of *The Korea Economic Daily*, November 27, 1996).

<sup>514</sup>Quoted in Peter McGill, 'Joining the Club', *Euromoney*, September 1995, pp.373-4. McGill quotes another economist from the BOK who said:

We have to be more competitive before we open our financial markets. The World Trade Organization and OECD are demanding we liberalize all regulations in the banking sector. We feel we have already opened too much, but we read in the newspapers that the OECD is still not happy. My view is that we have many things to lose if we hurry up to enter the OECD.

**Kim Young Sam's image of weak economic leadership was further accentuated by the fact that he failed to commit himself to several stages of the economic policy process, and instead delegated authority to his staff in the Blue House.<sup>516</sup> Comparing Kim Young Sam's presidency with subsequent administration by Kim Dae Jung (1998-2003), Kim Tae Hwan, a director at MOFE, stated that in the latter case, the government was much more centralised. There were around 20 ministers formally allowed to set independent policies, but in fact they had to report to the president anytime they would come up with a new project.<sup>517</sup> The continuous reshufflings of the country's economic bureaucracy during Kim Young Sam's mandate was an indication of a leadership in disarray over economic policy choices, with Deputy Prime Ministers (DPMs) in charge of finance and economy reshuffled seven times and with an average tenure of less than eight months. Consequently, it became practically unfeasible for the MOFE to formulate and implement consistent policies.<sup>518</sup> This weak economic leadership eventually contributed to bureaucratic disputes over policy choices and policy gridlock.<sup>519</sup>**

**Simultaneously, by rooting his leadership and reform initiatives in Confucian moral codes, Kim Young Sam tried to distinguish his presidency from past regimes and push for far-reaching reforms without the prerequisite of a supporting coalition.<sup>520</sup> It was a strategic failure because without a reliable and supporting coalition to push ahead with the new policies, the reforms initiated by Kim Young Sam would come under threat. Capitalising on his wide initial popularity as the country's first civilian president since the 1960s and as a leading figure of the**

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See also 'Korea's Entry into OECD'; *Korea Focus*, 3:2 (1995), pp.127-9.(originally published as an editorial in *The Chosun Ilbo*, Feb.25, 1995).

<sup>515</sup>For the negative public perceptions about the executive's economic policies, see 'Public Perception of 'New Economy"'; *Korea Focus*, 2:2 (1994), pp.139-140 (originally published as an editorial in the *Maeil Kyunje Shinmun*, Feb.28, 1994).

<sup>516</sup>Interview with Kim Tae Hwan in Seoul, 23 May 2001.

<sup>517</sup>Chung-in Moon and Sang-young Rhyu, 'The state, structural rigidity, and the end of Asian capitalism: a comparative study of Japan and South Korea', in Robinson et al, eds, *Politics and Markets in the Wake of the Asian Crisis*, pp.77-98, p.92. See also Kim Kwang-woong, 'Responsible Administration Needed'; *Korea Focus*, 5:2 (1997), pp.122-4 (originally published in *The Munhwa Ilbo*, March 6, 1997).

<sup>518</sup>Jongryun Mo, 'Political Culture, Democracy and the Economic Crisis in Korea'; *International Studies Review*, 2:1 (1998), 85-100, p.90.

<sup>519</sup>Hahm and Rhyu, 'Democratic Reform and Consolidation in South Korea: The Promise of Democracy', pp.79-80.

**democratic movement for more than three decades, Kim Young Sam assumed the role of moral ruler and chose unilaterally to introduce reforms. Such was the speed of the reforms in the first years of his presidency that Kim began to be viewed as a ‘civilian authoritarian leader’.<sup>520</sup>**

**The moral strategy was, nonetheless, a highly risky strategy, because the capacity of Kim to pursue this reformist project would only go so far as his moral integrity remained unchallenged by the population. As Kang Chun-suk, a political editor of one of the country’s leading newspapers, *The Chosun Ilbo*, points out: ‘Kim Young Sam is a people’s politician, thriving on support from the masses.’<sup>521</sup> One of the major consequences of the country’s democratisation was to open the political arena to new social groups. Among such groups were organisations such as the Coalition for Economic and Social Justice (CCEJ) and the People’s Solidarity for Participatory Democracy (PSPD) that emerged to call for new policies, in particular in the area of economic equity and justice, in the name of public interest.<sup>522</sup> As important, the Korean mass media became important actors in politics and policymaking by offering a more critical reporting of governmental activities.<sup>523</sup> Hence, within this new democratising political scenario, public opinion polls became an object of growing attention by Kim Young Sam.<sup>524</sup>**

**Kim’s rational seemed to have been based on the belief that as long as public opinion was on his side, his reformist policies would be legitimate and did not have to be constrained by the interests of the**

<sup>520</sup>Lee Hae-Han and Rhee In-jae, ‘President Kim Young Sam’s One Hundred Days of Reforms’; *Korea Focus*, 1:3 (1993), p.19 (originally published in *The Chosun Ilbo*, June 1, 1993). Lee Hae-Han for the main opposition Democratic Party (DP) and Rhee In-jae for the ruling Democratic Liberal Party (DLP) were both seen as leading members of the National Assembly.

<sup>521</sup>Kang Chun-suk, ‘First Miles of the “Reform Marathon”’; *Korea Focus*, 1:3 (1993), 67-9, p.68 (originally published in *Weekly Chosun*, May 13).

<sup>522</sup>For an analysis of the development of social movements in Korea from the late 1980s, see Bronwen Dalton and James Cotton, ‘New social movements and the changing nature of political opposition in South Korea’, in Garry Rodan, ed, *Political Oppositions in Industrialising Asia* (London, Routledge, 1996), 272-299.

<sup>523</sup>Moon, ‘Democratization and Globalization as Ideological and Political Foundations of Economic Policy’, p.9.

<sup>524</sup>Hahn Bae-ho, ‘Assessing Kim Young-sam Administration’s First Four Years’; *Korea Focus*, 5:2 (1997), 1-17, pp.6-7 (an abridged version of a paper presented at a symposium in the Seoul’s Youido Institute, Feb. 24, 1997).

**political coalition that had backed his election. The rise of Kim Young Sam to the Korean presidency owed much to the support he received from the ruling party, Democratic Liberal Party (DLP) that strongly financed his presidential campaign.<sup>525</sup> Formed in January 1990, after the merger of the then ruling Democratic Justice Party (DJP) headed by Roh Tae Woo with two opposition parties, the Reunification Democratic Party (RDP) and Democratic Republican Party (DRP) led respectively by Kim Young Sam and Kim Jong Pil, the DLP became known as the 'Grand Conservative Coalition'.<sup>526</sup> Kim's decision to merge his party with the parties of an old guard closely related to the previous military regimes and known to be averse to changes in the institutional status quo was seen by many as no more than a political manoeuvre and strategy to fulfil his power interests, i.e., to become the ruling party's presidential nominee and eventually win the presidential elections. Kim Young Sam, nonetheless, succeeded in separating himself from the conservative image of the DLP and to portray himself as a reformist candidate.<sup>527</sup>**

**Of the three presidential candidates (the others being Kim Dae Jung and Hyundai's founder Chung Ju Yung), Kim seemed to have had the image most acceptable by Korean voters who regarded him as a 'clean, honest, virtuous, sincere and decisive man'.<sup>528</sup> Elected with 42 percent of the votes, Kim Young Sam beat the second most voted candidate Kim Dae Jung. He did this by not only winning the votes, even if slightly, among those in their twenties and thirties that represented 57 percent of the population, but also overwhelmingly winning the votes of voters over 40, who constituted 43 percent of the population. The backbone of the**

<sup>525</sup> John Kie-Chiang Oh, *Korean Politics: The Quest for Democratization and Economic Development* (Ithaca: Cornell University Press, 1999), pp.123-4.

<sup>526</sup> For the rise of the coalition, see Heng Lee, 'Uncertain Promise: Democratic Consolidation in South Korea', in Edward Friedman, ed, *The Politics of Democratization: Generalizing East Asian Experiences* (Boulder, CO: Westview Press, 1994), pp.148-158, pp.151-5.

<sup>527</sup> For an analysis of Kim Young Sam's quest for the presidency, see Manwoo Lee, 'South Korea's Politics of Succession and the December 1992 Presidential Election', in James Cotton, ed, *Politics and Policy in the New Korean State: From Roh Tae-woo to Kim Young-sam* (Melbourne: Longman Australia Pty Ltd, 1995), pp.35-65. See also Lee and Rhee, 'President Kim Young Sam's One Hundred Days of Reforms', p.16. Lee Hae-han points out that the "forces" that were actively involved with the former military regimes and who had "developed a strong hold" on the Korean society were still within the administration of Kim Young Sam, thwarting its reforms.

<sup>528</sup> Lee, 'South Korea's Politics of Succession and the December 1992 Presidential Election', p.52.

**country's middle class, in particular small- and medium-sized business owners, favoured Kim Young Sam over Kim Dae Jung.<sup>529</sup> Regionalism also played a decisive role in the election of Kim Young Sam with voters voting in mass for their native sons. In this case, while Kim Young Sam gained 70 percent of the votes in his home region of Kyongsang, Kim Dae Jung received 91 percent of the votes in Cholla.<sup>530</sup> However, Kim Young Sam had the advantage of more voters in his home region (30 percent of the country's total population against 12 percent in Cholla).**

**From 1996 onwards, however, the moral legitimacy of Kim's leadership was challenged, with the disclosure that his presidential election in late 1992 had received illegal political funds.<sup>531</sup> This was reinforced by the authoritarian ways through which his executive passed new security and labour laws in the National Assembly, and the outbreak of the major Hanbo Steel Corporation bribery scandal involving his second son. The impact of these events seemed to have significantly affected Kim's popularity ratings, as support for his leadership decreased from 88.3 percent in 1993, to 28 percent in 1996 and an even lower 13.9 percent in 1997.<sup>532</sup> As Kim's main political backing, i.e., popular support, began to fall apart, and since he had failed to mobilise a supporting and reform-oriented coalition within the country's elites, Kim's legitimacy and capacity to push for the institutionalisation of his policy innovations were strongly reduced.<sup>533</sup> The reform-oriented policy process became increasingly subjected to inconsistencies which ultimately contributed to the mismanagement of the country's economy.**

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<sup>529</sup>Lee, 'South Korea's Politics of Succession and the December 1992 Presidential Election', p.52.

<sup>530</sup>Lee and Brun, 'Politics and Regions', p.100.

<sup>531</sup>For a full account of these events, see Hahm and Kim, 'Institutional Reforms and Democratization in Korea', pp.484-8.

<sup>532</sup>Hahm and Rhyu, 'Democratic Reform and Consolidation in South Korea: The Promise of Democracy', p.81.

<sup>533</sup>Choi Sang-yong, 'The Bankruptcy of Reform and of Common Sense'; *Korea Focus*, 5:2 (1997), 119-121 (originally published in *The Hankook Ilbo*, March 25, 1997).

### **5.5.1 Bureaucratic Failures, Agency Disputes and Policy Gridlock**

**Since the country's democratisation in the late 1980s, relations between the executive and bureaucracy have significantly changed. As Hahm Sung Deuk points out, during the military regimes, the presidential agenda would easily filter down to the lower levels of the bureaucracy motivated by promotion opportunities: 'We [Hahm who was formerly a government official] believed at the time [that] he [Park Chung Hee] would be permanent. We had to adjust ourselves to the party agenda and policy initiatives.'<sup>534</sup> The democratic constitutional changes in 1987 transformed the executive-bureaucracy dynamics by establishing that presidents could only hold one five-year term. Consequently, Hahm adds, 'young bureaucrats do not know how to accommodate themselves to the command of the president. If they identify themselves with the incumbent president's agenda, what will happen five years later? They will be kicked out by the new president. They will not move now, they do not care now....From middle to the bottom (of the bureaucracy), they are more interested in their organizational interests than in the presidential agenda....so now, we can see inefficiency in the bureaucracy...Now the presidents cannot control the bureaucracy.'<sup>535</sup>**

**The implementation of capital account liberalisation as a prerequisite for the country's accession to the OECD in 1996 is an example of a case where the executive, under a new context of growing bureaucratic leverage, failed to rally the Korean bureaucracy in support of the reform project.<sup>536</sup> One of the main elements of the plan was to implement a sound system of prudential supervision to underpin the safety and soundness of financial institutions and organisations. The example of the non-banking financial institutions (NBFIs) shows, however, how the MOFE fell short of performing its monitoring and supervision role. From 1994, in accordance with the financial liberalisation plan, merchant**

<sup>534</sup> Interview with Hahm Sung Deuk in Seoul, 26 June 2001.

<sup>535</sup> Interview with Hahm Sung Deuk in Seoul, 26 June 2001.

<sup>536</sup> For the characteristics of the plan drafted by the Presidential Commission for Financial Reform formed in 1997, see Jwa and Kim, Korea's Economic Reform', pp.264-6.

**banks were allowed to deal with foreign exchange transactions even though they were inexperienced in international banking and finance.<sup>537</sup> These merchant banks aggressively borrowed short-term loans and invested them in high-risk bonds from Southeast Asia, Russia and Latin America.<sup>538</sup> When the economy of these countries' collapsed, Korean financial institutions lost their money. At the same time, they also lent short-term loans to local *chaebol* for long-term investment projects.<sup>539</sup>**

**As a consequence, short-term loans not only increased faster than long-term loans, but also took a higher share in the country's total foreign debt. This ultimately raised concern over the poor maturity structure of the country's foreign debt. Foreign creditors began to demand higher premiums on Korean financial institutions' borrowing rate in early 1997 to reflect the country's deteriorating credit status. However, it was only in mid-1997 that the regulatory authorities intervened by introducing a rule limiting holdings of long-term assets through short-term borrowings.<sup>540</sup>**

**The reorganisation of the administration launched by Kim Young Sam, while allowing the president to place his allies in key bureaucratic positions through the traditional appointment strategy, was also not without its shortcomings.<sup>541</sup> The merger of the Economic Planning Board (EPB) and the Ministry of Finance (MOF) was supposed to produce more effective policy coordination by creating a super-ministry, the Ministry of Economy and Finance (MOFE). Chung Duck-Koo, who spent twenty years in the MOFE and was Vice Minister of Finance during the presidency of Kim Dae Jung (1998-2002), argues that it was, however, a hasty and**

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<sup>537</sup> Kyung Yoon, *The Role of Government in the Korean Merchant Bank Crisis in 1997*, Master thesis, Graduate School of International Studies (GSIS), Yonsei University, 2000. See also 'Merchant Banks to Be Given More Leeway in Their Business', KT, 30 April 1993, p.9. According to Kang Tae Soo, Policy Research Team, Monetary Policy Department, Bank of Korea (BOK), the merchants succeeded in entering the foreign exchange market, despite their lack of experience, after strongly having lobbied the MOFE. Interview with Kang Tae Soo in Seoul, 23 May 2001.

<sup>538</sup> Moon and Rhyu, 'The state, structural rigidity, and the end of Asian capitalism', p.87.

<sup>539</sup> Asian Development Bank, *Rising to the Challenge in Asia*, p.11 (table 4). As with banks, Korean non-banking financial institutions were used to lend money without necessarily checking the creditworthiness of the industrial conglomerates.

<sup>540</sup> Asian Development Bank, *Rising to the Challenge in Asia*, pp.11-12.

<sup>541</sup> Jung, 'Reforming the Administrative Apparatus in Korea', p.267. See also Kim Kwang-woong, 'Government Restructuring Has Only Begun'; *Korea Focus*, 3:1 (1995), 40-8, pp.46-8 (originally published in *The Shin Dong-a Monthly*, January 1995).

**misguided merger because the government merged the two agencies without first restructuring them.<sup>542</sup> The emergence of the foreign exchange crisis provides a good example of intra-agency fragmentation in policy coordination.**

**While the MOF side of the MOFE was aware of the country's growing foreign exchange crisis and raised the alarm, the EPB side of the MOFE ignored the warnings arguing that the macroeconomic fundamentals were healthy.<sup>543</sup> As Chung-in Moon and Song-min Kim point out, Kim Young Sam was not aware of the severity of the situation until President Bill Clinton phoned him about the need of an IMF rescue plan in late November 1997.<sup>544</sup> Another episode revealing the extent of bureaucratic disputes over policy choices, involved the MOFE and BOK in late 1997.<sup>545</sup> The two got caught up in a dispute over organisational changes proposed in a new law limiting the power and autonomy of the country's central bank.<sup>546</sup> The bureaucratic infighting between two of the most important agencies in charge of economic policy had the impact of producing policy gridlock, at a time when the country was already undergoing the first signs of financial crisis and the state needed to actively intervene to deal with the situation.**

### **5.5.2 Chaebol Resistance and Path-Dependent Relations**

**The 'New Economy Plan' launched in 1993 emphasised deregulation and the autonomy of the private sector. The plan was not without its inconsistencies as the government decided also to include a**

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<sup>542</sup>Interview with Chung Duck-Woo in Seoul, 14 June 2001.

<sup>543</sup>By the end of September, the country's foreign exchange holdings had declined to 30.43 billion US dollars, below the 37 billion-mark, an amount equivalent to the cost of three months' worth of imports, as recommended by the International Monetary Fund. See Min Sang-kee, 'Why the Fuss over Foreign Exchange?'; *Korea Focus*, 5:5 (1997), 136-9 (originally published in *The Chosun Ilbo*, September 1, 1997).

<sup>544</sup>Chung-in Moon and Song-min Kim, 'Democracy and Economic Performance in South Korea', in Larry Diamond and Byung-Kook Kim, eds, *Consolidating Democracy in South Korea*, pp.139-172, p.154.

<sup>545</sup>The dispute over whether or not the central bank should be independent from the government had already, in fact, started from the early days of Kim's presidency. See Chung Un-chan, 'Independence of the Bank of Korea: A Need for Checks and Balances'; *Korea Focus*, 3:2 (1995), pp.133-6 (originally published in *The Chosun Ilbo*, Feb.25, 1995), and Peter McGill, 'Bank of Korea battles for independence', *Euromoney*, September 1995, pp.374-6.

<sup>546</sup>For the episode in late 1997, see Moon and Rhyu, 'The state, structural rigidity, and the end of Asian capitalism', p.94.

**program to force the *chaebol* to specialise in core business as a way to fight their business concentration and improve their international competitiveness.<sup>547</sup> Failing to mobilise the *chaebol* in support of corporate reforms eventually had important consequences for the country's economy in the period right before the 1997 financial crisis. Credit limitations, a much used financial tool by previous regimes to discipline the *chaebol* and induce them to comply with administrative guidance, were ineffective in the face of the availability of alternative financial sources such as: non-banking financial institutions (where the policy did not apply); or overseas financing (further facilitated with financial liberalisation).**

**During the 1990s, the economic conditions of Korean conglomerates began to deteriorate. Evidence of this included: increasing trade disputes with industrialised markets that affected exports; loss of competitiveness due to rising labour costs and land prices; and growing foreign competition. Between 1995 and 1996, Korean terms of trade deteriorated by around 25 percent, thus Korean companies saw their profitability plunge.<sup>548</sup> Kim Jinyong, a researcher at the BOK, argues that, in face of growing foreign competition following the opening of the domestic market, the *chaebol* decided to borrow abroad cheaply to expand and "get bigger to compete".<sup>549</sup> Furthermore, the specialisation policy adopted by the government, and a legacy of the previous**

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<sup>547</sup> For the inconsistencies of the New Economy Plan, see Choi 'From Euphoria to Atrophy', pp.16-17. See also 'Figure in Focus: 'People Need to Share Pains To Achieve Sustained Growth', Lee Kyung-shik', KT, 27 February 1993, p.17. The views of the new Deputy Prime Minister Lee Kyung-shik echoed well the dual-track approach that the government sought to pursue. He stressed that while the *chaebol* were needed to 'survive fierce foreign competition', they were warned against their 'headlong expansion into diverse fields.'

<sup>548</sup> Young Back Choi, 'Financial Crisis And Perspectives on Korean Economic Development', in J.Jay Choi, ed, *Asian Financial Crisis: Financial, Structural and International Dimension Vol.1* (Amsterdam: Elsevier Science Inc., 2000), pp.357-378, p.362. See also G.W.Noble and J. Ravenhill, 'The Good, the Bad and the Ugly? Korea, Taiwan and the Asian Financial Crisis', in Gregory W. Noble and John Ravenhill, eds, *The Asian Financial Crisis and the Architecture of Global Finance* (Cambridge: Cambridge University Press, 2000), pp.80-107, pp.90-1.

<sup>549</sup> Interview with Kim Jinyong, International Finance Team, Research Department, Bank of Korea (BOK), Seoul, 26 June 2001. For the country's decreasing international competitiveness, see Kim Heung-chong, '10 Problems Hindering Transformation of Korean Economy'; *Korea Focus*, 4:4 (1996), 76-85, p.84 (originally published in *The Shing Dong-A Monthly*, August 1996). One of the strategies used by Korean companies to remain competitive in face of rising labour costs and land prices at home, and to fight protectionist measures by developed countries, was to invest abroad, see Park Woo-hee, 'Reckless Overseas Investment'; *Korea Focus*, 4:2 (1996), 149-152 (originally published in *The Munhwa Ilbo*, February 27, 1996), Lee Eu-chul, 'Exodus of Korean Conglomerates'; *Korea Focus*, 4:5 (1996), pp.75-88 (originally published in *Monthly Chosun*, September 1996).

**presidency led by Roh Tae Woo, did not succeed in curbing *chaebol* diversification. The number of subsidiaries controlled by the *chaebol* continued to increase with the government failing to enforce the policy.<sup>550</sup> Simultaneously, the ‘New Economy Plan’ pursued vast deregulation-liberalisation reforms in the areas of licensing, market entry, price and administrative intervention. This only helped to further the economic concentration of the *chaebol*. In 1986, the four largest *chaebol* added 5.7 percent of Korea’s gross national product, but in 1995 their share had increased to 9.3 percent of value-added to GNP.<sup>551</sup>**

**As had occurred earlier with Chun Doo Hwan and Roh Tae Woo, the transformation of the rules of the game in which the system of socialisation of private risk was based during the 1960s and 1970s was a difficult task because of the path-dependent development patterns it had given rise to during past decades. Not only had the *chaebol* built their political leverage through political donations needed for electoral campaigns, but they also played a predominant economic role as the country’s main vehicle for economic recovery and growth.<sup>552</sup> While publicly the executive maintained that it wanted to put an end to the former collusive ties between the state and the private sector, its actions implied the opposite. Despite Kim’s repeated promises that he would not receive any money from businesses during his term in office, his own staff**

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<sup>550</sup>Jae Woo Lee, ‘Chaebol Restructuring Revisited: A Coasian Perspective’, in Sung-Hee Jwa and In Kwon Lee, eds, *Korean Chaebol in Transition: Road Ahead* (Seoul: Korea Economic Research Institute, 2000), pp.151-221, p.162 (table 1). By the end of Kim Young Sam’s mandate in 1997, the number of subsidiaries of Hyundai had increased to 57 from 45 in 1993 (the beginning of Kim Young Sam’s presidency), Daewoo to 30 from 22, Samsung to 80 from 55, SK to 46 from 33. The only exception among the top five was LG that saw the number of subsidiaries decreased from 54 in 1993 to 49 in 1997.

<sup>551</sup>Stephan Haggard and David Kang, ‘The Kim Young Sam Presidency in Comparative Perspective’, in Moon and Mo, *Democratization and Globalization in Korea*, pp.111-131, pp.120-1.

<sup>552</sup>One of the signs that the *chaebol* were becoming increasingly confident about their political and economic leverage, in a pattern that had started in the 1980s, was their public calls for changes in the country’s economic and financial policies in support of less intervention by the state in the activities of the private sector and the banking sector. See ‘FKI Calls on Gov’t To Guarantee Businesses a Free Hand’, KT, 26 February 1993, p.7 and ‘FKI Urges Gov’t to Remove Grips on Banks’, KT, 12 May 1993, p.6. Earlier, during the presidency of Roh Tae Woo, the *chaebol* had already shown that they could fight back government attempts to curb their activities by withdrawing political donations. Koo Ja Kyung, chairman of the Lucky-Goldstar Group, and chairman of the Federation of Korean Industries (FKI) warned politicians from both the ruling and opposition parties that the business sector could retaliate against anti-*chaebol* policies by reconsidering their political donations. In a statement that would represent a turning point in business relations with the government due to its political implications, Koo announced that the FKI would in the future provide donations only to politicians willing to support and protect business freedom. See Chung-in Moon, ‘Changing Patterns of Business-Government Relations in South Korea’, pp.154-5.

**in the Blue House continued with the old practices by receiving almost 4 million US dollars from business as bribes and nearly 3 million US dollars from special interest groups as ‘courtesy’.<sup>553</sup>**

**The investigation of the Hanbo Steel Corporation bribery scandal brought to light the degree of informal ties linking business and government officials. It was discovered that in exchange for pressuring the banks to extend credit to Hanbo, presidential staff members, high-ranking officials and bankers, including the President’s second son, received bribes. Additionally, given the frequency of elections in Korea (there are four elections within the five-year presidential mandate), the executive had constantly to be concerned not only with raising funds for electoral campaigns, but also with short-term economic performance, which both depended strongly on the role played by the *chaebol*. With the *chaebol* resisting the reforms, and the executive increasingly failing to supervise and monitor their activities, the *chaebol* rapidly expanded their investment, which resulted in their over-investment and high indebtedness that eventually undermined the stability of the recently liberalised financial system.**

### **5.5.3 Democratisation, National Assembly and Constrained Reforms**

**Kim Young Sam failed not only to build a supporting coalition within the core group of the system of “socialisation of private risk”, the bureaucracy and *chaebol*, but also with another important actor that had seen its policy influence strongly increased since the country’s democratisation in 1987: the National Assembly. Chang Wook Park points out that since the democratisation in 1987, two images have developed concerning the capacity of the National Assembly to influence policymaking.<sup>554</sup> One is of a weak legislature that has no policy initiative and is unable to exercise policy influence independent of the**

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<sup>553</sup>Hahn and Kim, ‘Institutional Reforms and Democratization in Korea’, p.487.

<sup>554</sup>For an analysis of the role of the National Assembly in a democratic Korea, see Chan Wook Park, ‘The National Assembly in the Newly Democratized Korean Polity’; *The Korean Journal of Policy Studies*, 25 (2000),25-42.

**executive.<sup>555</sup> But the other image is that of a relevant and relatively strong policy actor that can react to the executive's policy initiatives. This is confirmed by Hahm Sung Deuk who points out that in order to manage the government within the new Korean democratic setting, the only way for the president to achieve his goals is through what he calls 'legislative presidency', or to turn a new policy into a law by having it approved in the National Assembly.**

**Once the new policy becomes law, then the bureaucracy will acknowledge that if they do not implement it they might be punished.<sup>556</sup> Therefore, Hahm argues, successful presidencies in democracy will depend on their capability to engage, not only with members of the ruling political party but also with members of other parties represented in the National Assembly: 'the president needs to change from commander to conciliator.'<sup>557</sup> In the case of the reforms pursued by Kim Young Sam, the capacity of the National Assembly to influence policy became clear in November 1997 after blocking the passage of a financial reform bill that proposed the consolidation of the activities of several existing regulatory agencies under a single Financial Supervisory Board (FSB).<sup>558</sup> At issue was whether it would be under the direct control of the Prime Minister's office or under the MOFE. Officials at the BOK, reflecting a long-standing dispute with the MOFE, however, wanted to maintain its authority to regulate commercial banks. The employees of the central bank as well as from the regulatory agencies targeted by the new policy held several demonstrations and threatened to strike immediately if the National Assembly passed the legislation. Although the Minister of Finance and Economy, Kang Kyung Shik, and his staff continually agitated to have the National Assembly vote in favour of the legislation, the Financial and**

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<sup>555</sup> For a discussion on the problems affecting the working of the National Assembly, see Kim Kwang-woong, 'Structural Problems of the National Assembly'; *Korea Focus*, 4:6 (1996), pp.36-46 (originally published in the *Korean Journal of Legislative Studies* vol.2, no.1, 1996).

<sup>556</sup> The National Assembly is constitutionally granted with the power to supervise and control the bureaucracy through annual inspections, specially arranged investigations and interpellation for questioning ministers either orally or in writing. See Park, 'The National Assembly in the Newly Democratized Korean Polity', pp.36-9.

<sup>557</sup> Interview with Hahm Sung Deuk in Seoul, 26 June 2001.

<sup>558</sup> For this episode see Moon and Mo, *Economic Crisis and Structural Reforms in South Korea*, pp.17-18.

**Economy Committee did not send the bills to the floor for discussion. Both the ruling party and the opposition preferred to avoid the issue, fearing the political costs of the passage as the country prepared for new presidential elections set for the end of the year.**

## **5.6 Conclusion**

**For historical institutionalism, policy choices are, on the other hand, the result of the political interaction between leadership and social interests shaped by the institutional setting, ideas and the specific historical context in which they take place. On the other hand, this theoretical framework also stresses that policy outcomes can themselves become sources of political re-arrangements leading to institutional change. When policy feedback generates political conflicts then the existent institutional equilibrium can be challenged and this can open a “window of opportunity” for reform and change. Implementation of new policies, however, is not an easy task. As pointed out in Chapter One, when considering policy changes, policy elites need to consider the feasibility of choices in terms of: what stakes they have in the pursuit of reform; coalition support and opposition to change; the political and bureaucratic resources they hold to maintain such reform initiatives.**

**In the case of Kim Young Sam, his presidency took a risky strategy by relying on the morality of his leadership as the basis of his policy choices. Driven by Confucian moral codes, and the Korean traditional political culture, the presidency led by Kim Young Sam decided to force far-reaching reforms without seeking to reconcile differences and negotiate agreements with bureaucratic, political and economic actors. The rationale behind his approach was then that as long as Kim's moral integrity remained intact and popular support, measured in terms of popularity ratings, maintained high levels, the implementation of reforms could succeed. Thus, the presidency in its early days undertook an anti-corruption campaign, sought to cut ties with past military regimes,**

**introduced new laws to fight manipulation of voters and to promote fairness during the electoral process, and re-organised the bureaucratic machine. But when Kim's moral integrity started to be dented by a series of scandals, his leadership weakened and the implementation of the reforms became more difficult.**

**In terms of coalition support, one of the basic dilemmas in the process of institutional change is that there are strong possibilities that the forces opposing reform will be more influential than those supporting it. Therefore, those who had benefited most from previous policies, and who risk losing most from the reforms, may mobilise to block change and reform in support of maintenance of the *status quo*. Additionally, the beneficiaries of the reforms may not become fully aware of the gains they may get with the changes and consequently fail to manifest their support. In Korea, this was exactly what happened, as bureaucrats, members of the national assembly and *chaebol*, regarded as those most affected by Kim's administrative and economic reforms, moved to constrain the reforms. The administrative and economic reforms pursued by Kim Young Sam represented a threat to the equilibrium and the "spoils" that had long sustained the system of socialisation of private risk. The advocacy of a smaller and less interventionist state, whether through bureaucratic re-organisation or financial liberalisation initiatives, had the effect of weakening the power of the bureaucracy within the system. The reforms not only reduced the capacity of the bureaucracy to manage industrial policy through financial control, but also reduced their power vis-à-vis other social actors. Additionally, it clearly decided to forsake the cooperative ties with the *chaebol* and challenge their role in the country's economy by restraining their economic concentration in response to the society's calls for economic justice.**

**On the other hand, the methods adopted by the government to promote the reforms failed to clearly identify those who would more willingly support the reforms if they were aware of their potential**

**windfalls. This, despite the fact that the majority of the Korean population strongly supported the reform drive by Kim Young Sam as was shown in polls over the first years of the presidential term. In consequence, and in the absence of information on the possible positive impact that reforms could represent for their lives, the potential beneficiaries failed to be convinced and persuaded about the need to support the government in its policy choices.**

**Finally, the weak economic leadership by Kim Young Sam and his inconsistent policy decisions only contributed to negatively exacerbate the situation. Kim's lack of a systematic vision on how to reform the economy became visible during his presidential term. In a political setting as the Korean, the President is supposed to be omnipresent throughout all the policymaking and implementation processes. However, Kim not only preferred to delegate authority to his staff in the Blue House, many times not professionally competent for the task, but also constantly reshuffled the position of DPM, the country's top economic position, which made it practically unfeasible for the MOFE to formulate and implement consistently the reform initiatives. This outcome ultimately contributed to the mismanagement of the economy and the IMF crisis.**

**The following chapter aims to investigate in-depth a specific political and financial policy reform: the Real Name Financial Transaction System in 1993. Regarded by Kim Young as the 'reform of the reforms' of his presidency, it aimed at curbing long-lasting corrupt and informal ties between government officials and business groups. The new policy addressed also the issue of fairness of wealth distribution by seeking changes in the country's tax system. Therefore, Chapter Six seeks to understand why and how President Kim strategically acted to alter an important feature of the system of socialisation of private risk and with what political and economic outcomes.**

## **6. CHAPTER SIX - Reforming the System of Socialisation of Private Risk: The Real Name Financial Transaction System of 1993**

### **6.1 Introduction**

**On 12 August 1993, President Kim Young Sam unexpectedly announced that his government would make the use of real names mandatory in all financial transactions. Addressing the nation, during a broadcasted statement, Kim proclaimed that, 'from this time on, all financial transactions have to be made in real names to realize a clean and just society.'<sup>559</sup> President Kim declared that, in accordance with the Constitution, he was invoking an emergency financial and economic order to implement the real name financial transaction system because it was feared that an open discussion of the new policy would cause a widespread and negative impact on the economy, such as capital flight overseas and real estate speculation. The decree required that holders of all forms of financial transactions - including deposits, instalment savings, checks, certificates of deposits, stocks and bonds - under false names or pseudonyms switch them into real names within a period of two months starting from 8 p.m. on 12 August 1993.<sup>560</sup>**

**Investigations on the source of funds would exclude those who held financial assets up to a maximum of 50 million won under aliases and converted them to real names. The Office of National Tax Administration (ONTA), however, would conduct special tax probes on those who withdrew money in excess of 30 million Won from financial organisations during the two-month period. The decree prohibited, however, the disclosure of financial information to third parties without the consent of the account holder, to protect the confidentiality of financial transactions.**

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<sup>559</sup> 'Real Name Financial System Enforced', KT, 13 August 1993, p.1.

<sup>560</sup> For the main features of the Real Name Financial Transactions System, see Bank of Korea, *The Bank of Korea*, pp.217-218. See also Korea Institute of Finance, 'Recent Financial Reforms in Korea: Real Name Financial System Launched'; *Korean Financial Review* (1993), 3-22, and Jongsoon Lee, 'The Real Name Financial System and The Politics of Economic Reform in the Republic of Korea'; *Pacific Focus*, 10 (1995), 101-128.

**President Kim added that financial incomes would not be levied until a new computerized data system was ready and able to account for all financial incomes. Additionally, a Comprehensive Taxation System for Financial Income, to include unearned income, such as stock or real estate dealings, would come into force in January 1996, to build a more equitable tax system. The new tax system was expected to levy a separate 15 percent tax on financial income, if the combined interest and dividend income of a married couple amounted to less than 40 million Won. However, for amounts above 40 million Won, financial income would be added to other income and a cumulative tax rate of 10-40 percent imposed on taxpayers reaching this category. Finally, and to preserve the stability of the stock market, the government announced that a capital gains tax on stock dealings, would not be introduced during Kim Young Sam's term (1993-1997).**

**In their efforts to prevent damaging side effects to the national economy with the implementation of the system, the government and the country's central bank set up committees to define policies to restrain capital flight and speculation in real estate, painting, antiques and jewellery. Committees were also asked to design measures to stabilize financial markets in case of a massive withdrawal of money deposited in banks, or invested in stock markets. The committees were also expected to formulate measures to provide financial relief to small- and medium-sized firms. It was feared that SMEs could face cash-flow problems due to the paralysis of the informal financial market where most of them secured their corporate capital, following the implementation of the decree. A total of over two trillion Won in government funds were later released as emergency funds to help small- and medium-sized firms and commercial banks were requested by the government to extend their loans and widen their credit limits to these firms.<sup>561</sup>**

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<sup>561</sup>Korea Institute of Finance, 'Recent Financial Reforms in Korea', p.6.

**The Prosecution office and the ONTA announced that they would jointly investigate and take severe measures against speculation in real estate, painting, antiques and jewellery markets. They would also commence close monitoring of overseas transactions by domestic firms to check whether or not they were 'cooking up' export and import invoices to divert funds out of Korea. Banks were also instructed to report individual remittances of 3000 US dollars or more to the ONTA, with the names of those sending more than 10,000 US dollars a year put on a watching list.<sup>562</sup> Meanwhile, the central bank (BOK) expanded its financial support to financial institutions in order to shield them from a possible fund shortage. The BOK added that it would provide 'limitless' funds to banks short of liquidity so that they could in return extend them to non-banking financial institutions (NBFIs). Additionally, the BOK would ease its money supply control and reduce the banks' legal deposit requirements in order to lessen the upwards pressure on money market rates. By the end of 1996, real name confirmation rates had reached 99.2 percent of all such accounts and the transformation of false-name accounts to real name-based deposits recorded 98.8 percent.<sup>563</sup>**

**While the decree had a simple message, in that it demanded the use of a real name in all types of financial transactions, the implications of the financial reform were expected to be far-reaching. The new system was expected to fight the conspicuous corrupt ties between government officials, politicians and businessmen by facilitating the investigation of money flows. The investigation was frequently impaired by the difficulty in tracking down the sources of funds hidden behind false names. The decree also addressed society's growing demands for a more fair distribution of wealth. The country lacked a comprehensive tax system, and with the government sanctioning the use of false names in financial transactions, the 'well-off' could easily hide their gains from financial and property investments under aliases and consequently evade taxation.**

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<sup>562</sup>Korea Institute of Finance, 'Recent Financial Reforms in Korea', p.6.

<sup>563</sup>Bank of Korea, *The Bank of Korea*, p.219.

**Furthermore the old system, by allowing vast amounts of capital flows to remain untraceable, fed a growing informal financial market which affected the government's use of financial policies to control capital allocation according to its industrial goals, due to its secretive nature.**

**As a case-study, this chapter examines the active role of President Kim Young Sam in pushing for the implementation of the real name financial system. It then examines how his choice was moulded by the impact of malpractices, generated by the false name financial system on the country's financial structure, economy and social stability. The policy process and political lessons taken from the failed attempts of Presidents Chun Doo Hwan and Roh Tae Woo to implement the reform, and Kim's ideologically driven approach to the new policy are also explored as shaping Kim's choice to introduce the long-expected policy. In the last section of the chapter, I analyse why the implementation of the policy was, however, only partially successful because of Kim Young Sam's failure to build a reliable and reform-oriented coalition to support his initiative.**

## **6.2 Sculpting a New Financial Policy: False Name Financial System, Presidential Policy Failures and Moral Leadership**

### **6.2.1 The Legacies of the False Name Financial System**

**During the presidency of Park Chung Hee, the government set two main priorities: full state control of the financial system, and the mobilization and allocation of financial resources to strategic industrial sectors. The introduction of a false name financial system or rather, the official sanction of financial accounts under false names or pseudonyms, was allowed in order to maximize domestic capital formation. By attracting savings from those who did not want to have their identities revealed, the policy was expected to increase the rate of domestic savings. This policy, together with interest rate reform in 1965, sought to**

**attract funds from the informal financial market to the country's official financial institutions. The policy seemed to contribute to the government's original goal as domestic savings relative to GNP increased from 7.37 percent in 1965 to 27.2 percent in 1978.<sup>564</sup> According to Nam Duck Woo, Minister of Finance between 1969 and 1974, the government was aware of the consequences that such a policy could have in terms of wealth distribution, but the need to increase capital availability for economic growth and development reasons took precedence. Nam points out that:**

**...the special privilege of nondisclosure of the real name was extended to the owner of financial assets which made tax examination of those assets virtually impossible. Policy makers were fully aware of the implication of such measure with respect to social fairness and justice, but the overriding consideration at the time was that maximizing mobilization of domestic savings was a matter of first priority. Setting the order of priorities in this way may be a necessary evil in a war against poverty.<sup>565</sup>**

**Under the false name financial system, Koreans were not required to present personal identification cards or personal signatures to open bank accounts.<sup>566</sup> They needed only to carry with them initially-registered name seals as an evidence of personal identification. There were three kinds of accounts under the system: (1) 'fictitious names' (literally false names); (2) 'borrowed names' (accounts open under someone else's name – usually of friends, relatives, and employees, supported by their resident registration records, and which tended to be used with their permission); and (3) 'stolen names' (accounts open under names of persons residing in other districts, preferably distant ones and usually in low-income areas, here, their registration records were used without their knowledge and consent).**

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<sup>564</sup> Cole and Park, *Financial Development in Korea 1945-1978*, p.267 (Table 48). For the interest rate reform in 1965, see Chapter Three.

<sup>565</sup> Nam, *Korea's Economic Growth in a Changing World*, p.119.

<sup>566</sup> Lee, 'The Real Name Financial System and The Politics of Economic Reform in the Republic of Korea', p.101.

**The false name financial system, in conjunction with the interest rate reform, seemingly boosted domestic savings, and its success owed much to the fact that capital controls restrained overseas flight of capital. Inversely, the system was also the catalyst for serious domestic political and economic malpractices over the years.<sup>567</sup> Tax evasion became the most common problem associated with the false name financial system. Under the system, wealthy individuals could resort to false name accounts to evade inheritance and gift taxes, corporate taxes as well as value-added taxes. High-income individuals, such as lawyers and doctors, evaded taxes by fabricating their income statements in the absence of a real name financial system.<sup>568</sup> Companies could easily hide their sales revenues under false name accounts to make their business volumes appear smaller and avoid tax authorities. The false name financial system allowed wealthy businessmen to easily violate fair trade and security laws by holding a large number of shares of their own and other companies stocks in excess of legal restrictions.<sup>569</sup> This offered not only the capacity to control these firms, but also, during timely periods, and with access to insider's information, the possibility to rapidly reap huge profits by buying or selling stocks from their own companies.**

**By offering anonymity, false name accounts became a sanctuary for wealth obtained through illicit means, such as bribery, political contributions, embezzlement and real estate speculation.<sup>570</sup> It was not uncommon for the *chaebol*, to use false name accounts as a conduit for slush funds to back these illegitimate activities. Park Byung Ok and Ko Kye Hyun, from the Citizens' Coalition for Economic Justice (CCEJ) claim that businessmen resorted to several means to establish the 'slush**

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<sup>567</sup>Lee, 'The Real Name Financial System and The Politics of Economic Reform in the Republic of Korea', pp.102-3.

<sup>568</sup>'Real Name Financial System: President Kim's Biggest Gamble', Business Korea, Septembre 1993, pp.27-9.

<sup>569</sup>Lee, 'The Real Name Financial System and The Politics of Economic Reform in the Republic of Korea', pp.101-3.

<sup>570</sup>One of the most common ways to buy land and hide the identity was to do it in the name of minors. See 'Land Transactions in Name of Minors Reach 83,179 Cases During '86-88'', KT, 6 October 1989, p.2.

**funds'.<sup>571</sup> One of the cases, would be to request from the state-controlled financial institutions, for example, 200 million US dollars to buy some new equipment when in fact the real cost was only 100 million US dollars. The difference between the capital provided by the financial institutions and the real cost of the equipment would then be used as slush funds. Another mechanism would involve the application for financial aid to set up a branch or office abroad. However, this operation would only occur formally on paper, with the funds allocated by the financial institutions stashed under false name accounts to be managed for other, not always legitimate, purposes.**

**It is difficult to offer accurate figures for slush funds operated by private companies, but a report by the Committee for the Prevention of Corruption in 1996 claimed that slush funds represented five to seven percent of the total underground economy, or 0.5 to 5.25 percent of the gross national product.<sup>572</sup> This environment led to the impression that credit fungibility, i.e., 'the inability to track the flow of credit to a specific use', was a common feature in the Korean financial system, in particular during the regime of Park Chung Hee.<sup>573</sup> For Park Yung Chul, a former economic advisor to President Chun Doo Hwan and head of the Korea Institute of Finance, the fungibility issue in Korea can be examined at two stages in the credit allocation process.**

**In the first stage, related to lending behaviour, financial institutions could evade or ignore government directives or guidelines. However, and due to the government's close supervision of their daily operations, Park argues that this did not seem to be a problem in Korea. The second stage**

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<sup>571</sup> Interview with Park Byung Ok and Ko Kye Hyun in Seoul, 8 June 2001. Park Byung Ok and Ko Kye Hyun Ko are the executive director and director of the Citizens' Coalition for Economic Justice (CCEJ). The CCEJ was founded in 1989 by some 500 people, including academics, lawyers, housewives, students, and businessmen. The movement's main goal was to fight economic inequality in the Korean society. CCEJ gained national recognition after its efforts to get legislation implementing and enforcing the use of real names for financial and real estate transactions.

<sup>572</sup> The report is quoted in Kim Taewon, 'Korea: Economic Consequences of Corruption in Korea'; *Asia Solidarity Quarterly*, 3 (2001), 68-90, p.73.

<sup>573</sup> For an analysis on credit fungibility in Korea, see Park, 'The Development of Financial Institutions and the Role of Government in Credit Allocation', pp.65-8.

**is related with borrowers' behaviour. Here, Park is clear: 'it is quite conceivable that a large part of bank credit was diverted to uses other than those predesignated by the government.'<sup>574</sup>Credit diversion would be possible not only because Korean financial intermediaries lacked an effective system to supervise the use of credit, but bank managers without autonomy felt no responsibility to assess the actual uses of bank credits.<sup>575</sup>According to Kang Tae Soo, from the Bank of Korea, before the financial crisis in 1997, Korean banks had a loan officer formally in charge of checking regularly if the corporations would use the loans according to plans. However, he points out, 'it was fairly not like that', because since lending was based on collateral, banks did not have any incentive to supervise their loan portfolio.<sup>576</sup>The existence of a large unregulated money market in Korea during the 1960s and 1970s can be seen as evidence of a considerable degree of credit fungibility in Korea.<sup>577</sup>**

**It served as a short-term money market for large business borrowers, when they needed a quick loan, free from paper work and with a fast turnaround time. It also served as a retail money market for consumers and SMEs that had difficulties accessing bank loans, due to government credit restrictions. One of the common practices in this unregulated money market, were the so-called 'disguised informal loans' in which some owners of private firms would lend personal funds, deposited in banks under false names, to their own firms as informal loans. This scheme allowed the owners to take advantage of the corporate tax system and the higher interest rates in the unregulated money market, also known as the curb market.<sup>578</sup>The transaction was made possible because it was not uncommon for bank managers to be involved as curb market brokers. David Cole and Yung Chul Park point out, however, that it was not so much the commission received for helping**

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<sup>574</sup>Park, 'The Development of Financial Institutions and the Role of Government in Credit Allocation', p.66.

<sup>575</sup>Park, 'The Development of Financial Institutions and the Role of Government in Credit Allocation', pp.66-7.

<sup>576</sup>Interview with Kang Tae Soo, staff member of the Policy Research Team, Monetary Policy Department, Bank of Korea (BOK) in Seoul, 23 May 2001.

<sup>577</sup>Park, 'The Development of Financial Institutions and the Role of Government in Credit Allocation', p.67.

<sup>578</sup>Cole and Park, *Financial Development in Korea 1945-1978*, pp.162-3. See Chapter Four for a discussion on curb market.

**with the deal that attracted the bank managers, but the fact that these transactions were ‘means of expanding their deposits and meeting the deposit quotas or targets often assigned to them’.<sup>579</sup> After the Presidential Emergency Order on Economic Stabilization and Growth on August 3, 1972, around 113.7 billion won, or one third of the total amount of reported private loans, were found to be ‘disguised informal loans’.<sup>580</sup>**

**In sum, the unregulated money market complemented the state-controlled official market to facilitate capital flows to those excluded by the government guidelines. Ultimately, the curb market was regarded “as a lubricant for business operations by bridging the money flow gap mainly caused by the inadequate supply of credit from the established banking institutions”.<sup>581</sup> By legally sanctioning the false name financial system, the government helped the growth of the curb market and the development of a two-tiered financial system in the country. Over time, the unregulated money market grew to form the so-called ‘underground economy’ defined as income or wealth not reported to authorities for tax assessments or income that rests outside official estimates of GNP.<sup>582</sup> After the implementation of the real name financial system, a study by the Korea Institute of Public Finance released in 1996 claimed that the size of the underground economy (in terms of GNP) had decreased from 16.6 percent in 1972 to 8.8 percent in 1994.<sup>583</sup> Yi Insill, director of the Centre for Finance and Tax at the Korea Economic Research Institute, and who advised the ONTA during the implementation of the real name financial system, states that tax evasion in fact had become one of the country’s major problems.<sup>584</sup> Park Yung Chul adds that as long as the false name financial system continued:**

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<sup>579</sup> Cole and Park, *Financial Development in Korea 1945-1978*, p.322 (fn.20).

<sup>580</sup> Cole and Park, *Financial Development in Korea 1945-1978*, p.163.

<sup>581</sup> ‘What is the curb money market’, KH, 4 July 1982, p.2.

<sup>582</sup> Lee, ‘The Development of Financial Institutions and the Role of Government in Credit Allocation’, p.106.

<sup>583</sup> The figures are quoted by Kim, ‘Korea: Economic Consequences of Corruption in Korea’, p.72.

<sup>584</sup> Interview with Yi Insill in Seoul, 20 June 2001. The Korean Economic Research Institute is an affiliated think-tank with the Federation of Korean Industries (FKI), the lobby group for the country’s major conglomerates.

**...there was no way of stopping money laundering or financial transactions related to underground and often criminal activities. Because of anonymous transactions the monetary authorities felt they were deprived of essential information needed for safeguarding financial institutions and conducting monetary policy. Specifically, they claimed it was difficult to monitor the flow of funds between markets, institutions, and businesses.”**

**The false name financial system was a way to maximise the mobilisation of domestic savings and contributed to fulfilling one of Park's goals for the Korean state within the system of socialisation of private risk. Despite its negative side effects, this officially sanctioned financial policy was nonetheless tolerated as a 'necessary evil'. The view among the authorities began, however, to change in the early 1980s following a major financial scandal that highlighted the malpractices nurtured by the system and its negative impact on the country's financial system, economy and social stability.**

#### **6.2.2 Presidential Policy Failures, Vested Interests and Political Funds (1980-1993)**

**The first debate on the implementation of the real name financial system emerged during the presidency of Chun Doo Hwan (1981-1987) following a major financial scandal in May 1982. The episode involved a famous couple on the Korean social scene, Chang Yong Ja and her husband Lee Chol Hi, a former National Assembly member and deputy head of the Korean Central Intelligence Agency (KCIA). The couple, claiming family ties with the acting President Chun Doo Hwan, succeeded in building an informal loan scheme.<sup>585</sup> The couple, also known as 'Madame' Chang and 'General' Lee lent money to companies at low**

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<sup>585</sup>Yung-Chul Park, 'Korea: Development and Structural Change of the Financial System', in Hugh T. Patrick and Yung Chul Park, eds, *The Financial Development of Japan, Korea, and Taiwan: Growth, Repression and Liberalization* (New York and Oxford: Oxford University Press, 1994), pp.129-172, p.158.

<sup>586</sup>'Businessman Couple Held for Flight of \$400,000 to US', KT, 8 May 1982, p.1, and 'Loan Scandal Probe Focused on Fraud', KT, 11 May 1982, p.3.

**interest rates under good repayment schedules in exchange for letters of credit usually twice the value of the actual loans.<sup>587</sup> As the government pursued its tight monetary policy as part of a stabilisation program, firms began to experience liquidity problems and turned to the informal market to meet their short-term funding shortages.**

**The letters of credit or promissory notes were the most common tool used by curb market lenders to secure a loan, with the notes usually cashed in before their due date. However, there was also a secondary market for these notes, since they could be discounted at banks through money brokers. Companies tended to trust the couple who boasted about ties with the Blue House and vaunted their wealth by throwing expensive parties.<sup>588</sup> The couple succeeded in obtaining letters of credit from firms worth 640 billion Won or about 800 million US dollars as collateral for bank loans. In addition, they obtained some 170 billion Won (about 213 million US dollars) from former brokers of the previous Park government by offering them a commission of 500,000 Won per 10 million won of their funds.<sup>589</sup> The couple invested these funds in the stock market, but as they began to suffer losses with their equity investments, 'Madame' Chang and 'General' Lee sold the letters of credit, breaking the promise not to circulate and discount them until the loan term expired. Furthermore, even though they had already sold the promissory notes, Chang and Lee continued to take repayments from the firms.**

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<sup>587</sup> The loans could be paid in five-years, including two-year grace period and at an annual interest rate of 20 percent, in contrast with the official market for commercial bills with interest rates at 35 percent and to be repaid in three months. See 'Probe Result Still Leaves Many Questions Unanswered', KT, 13 May 1982, p.6.

<sup>588</sup> The couple liked, in particular, to spread around their close relationship with Lee Kyu-kwang, president of the Korea Mining Promotion Corp, the husband of "Madame" Chang's elder sister, and more importantly uncle of the First Lady Lee Soon Ja. The prosecutor, quoted by the Korea Times, said that:

By pretending to be in close relation with the Lees, Mrs. Chang earned the trust of business circles and was able to get the huge amounts of bills from financially unstable firms after making cash loans to them (...) Even some bankers extended loans to the couple without mortgage and provided them with forms of promissory notes in the wrong belief about their backgrounds, thus helping their fraudulent activities...

See 'Lee-Chang Couple Accused of Fraud in Loan Scandal', KT, 12 May 1982, p1.

<sup>589</sup> Lee, 'The Development of Financial Institutions and the Role of Government in Credit Allocation', pp.107-8.

**The scheme amplified as the couple bribed officials in two of the country's main financial institutions, the Commercial Bank of Korea and the Cho-Hung Bank, to provide loans to the firms they lent to.<sup>590</sup> Additionally, they borrowed money at preferential interest rates from the banks by playing up their connections in the Blue House, and lent the money, at higher rates, in the curb market, to companies that could not borrow from banks because they did not have enough influence or collateral. The scheme collapsed when a small company complained to the authorities that their promissory notes were still in circulation although they had repaid their loans to the couple.<sup>591</sup> The repercussions of the scandal on the financial system were tremendous. One of the country's leading steel companies, Ilssin Steel Co., went bankrupt overnight, a major construction company involved in overseas projects, Kongyung Construction Co., went into court-appointed management, and banks were asked to honour the letters of credit issued by four other firms involved in the scandal.**

**The damage to Korea's financial system would have been far worse had the government not acted quickly to inject liquidity into the market. Businesses were expected to face fund shortages. The curb market, a major credit instrument for working capital, had been disrupted and its activities were practically frozen in the wake of scandal.<sup>592</sup> Papers submitted to the National Assembly by the Ministry of Finance, showed that the six companies involved in the scandal owed banks 939 billion**

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<sup>590</sup> 'Lees gave 8.7 billion won in commissions to bankers', KT, 13 May 1982, p.2. See also 'Lees Draw W10 Bil. Loans in 3-4 Hours', KT, 13 May 1982, p.7.

<sup>591</sup> Clifford, *Troubled Tiger*, p.195.

<sup>592</sup> On the freeze of the curb market and impact on firms, see 'Drain of Curb Loan Mart Plagues Business Firms', KT, 18 May 1982, p.7. On the government's rescue measures, see 'BOK allocates W100 bil. relief funds in wake of FX scandal', KH, 12 May 1982, p.7, 'Gov't increases business funds', KH, 18 May 1982, 'W20 bil. More To Stimulate Financial Mart', KT, 18 May 1982, p.1, 'W420 bil. fund to shore up farmers, small businesses', KH, 19 May 1982, p.1, 'Gov't efforts bring about rapid money mart stability', KH, 30 May 1982, p.9, 'Small industries to get 183 billion won in relief funds', KH, 10 June 1982, p.9. Due to the importance of the curb market for the country's economy, its disruption was seen as negatively affecting business transactions. In a report released in May 1982 right after the scandal, the Bank of Korea revealed that the curb market was estimated at between 603 billion Won and one trillion Won, or 16 to 25 percent of the total money in circulation. Bank officials, however, contested the report, claiming instead that the curb market could total more than two trillion won. They based their estimation on the fact that a big share of the money deposited in banks and other short-term financial institutions were de facto private loans. See 'Curb market accounts for 16-25% of nation's total money circulation', KH, 21 May 1982, p.7.

**Won, despite the fact that their collateral held by the banks totalled only 226.2 billion Won. The most striking cases were Kongyung Construction Co. and Iissin Steel Co. The first owed 306 billion Won. Yet it had only provided 8.1 billion Won in collateral. The latter owed 202.1 billion Won with 85.7 billion Won in collateral.<sup>593</sup>**

**In the aftermath of the scandal, police arrested 32 persons including an uncle-in-law of the President as well as several top bank executives, including the two former presidents of two of the country's major banks, Cho Hung Bank and Commercial Bank of Korea.<sup>594</sup> When the prosecutors raided the couple's mansion in one of the most expensive areas in Seoul, they found what could be characterised as a primitive bank. Among the findings were 400,000 US dollars, 37 kilograms of gold bullion, 1.3 billion won in jewellery, a 1,500-piece antique collection, and three Mercedes-Benzes. 'Madame' Chang was also said to own some 600 pieces of property across the country worth 32 billion won.<sup>595</sup> Yet, despite all the wealth, for the past years, the couple had only paid a very low income tax.<sup>596</sup> Such was the gravity of the episode that Prime-Minister Yoo Chang Soon and the entire cabinet offered their resignations to take political and moral responsibility for the curb market scandal.**

**Simultaneously, the ruling Democratic Justice Party (DJP) led by President Chun, and launched in 1981 with a goal to create a 'just society', in a move seen as aimed at regaining public confidence, reshuffled some of its key officers, including the secretary-general, the chief policymaker, and the spokesman.<sup>597</sup> No public accusation came forward against the President and his wife. However, the scandal highlighted what was already known among the country's elite about the illicit deals within the**

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<sup>593</sup>'6 companies mired in recent scandal owe banks 939 bil.won', KH, 16 May 1982, p.9..

<sup>594</sup>For an excerpt of the verdict delivered by a judicial panel against the couple and the others involved in the scandal, see 'Lee couple victimized entire people', KH, 10 August 1982, p.10, and 'Couple Given 15 Yrs in Jail', KH, 10 August 1982, p.8

<sup>595</sup>Clifford, *Troubled Tiger*, p.196.

<sup>596</sup>'Chang Only Pays W4.2 Mil. In Income Tax Since '80', KT, 15 May 1982, p.8.

<sup>597</sup>'Premier Yoo, cabinet members tender resignations en bloc', and 'DJP hierarchy reorganized', KH, 21 May 1982, p.1 and 'Cabinet Refreshed, and Reshuffle to restore public confidence', KH, 22 May 1982, p.4..

**ruling presidential families (Chun and Lee). However, it also led the general public to start associating the Fifth Republic with corruption.<sup>598</sup> In an attempt to show that there were no 'privileged persons' during the Chun presidency and to remove relatives from influential positions, the First Lady's uncle-in-law was arrested, her father, and brother of Lee Kyu Kwang, resigned from his position as head of the Korean Senior Citizens Association, and the president's younger brother also offered his resignation from one of his minor posts. Heavy doubts remained, nonetheless, about the *de facto* role played by the Blue House in the couple's deals.<sup>599</sup> The magnitude of the scandal highlighted two main features of the Korean financial system.**

**First, government-run, Korean financial institutions revealed themselves to be backward, with poor intermediation capacity and financial technology.<sup>600</sup> They had also failed to respond to the changing financial market conditions and needs of the real economy. During Park Chung Hee's reign, as part of the role of the Korean state within the system of socialisation of private risk, financial resources were tightly controlled and had to be allocated to productive investment. Hence, available funds would be mainly used for fixed investment. The only way a firm could obtain a loan to finance daily operations was to offer land as collateral. In principle, working capital was expected to come from the investors' original capital or from profits. However these funds were insufficient to respond to any cash shortages. Also these funds did not meet the financial needs of firms seeking to invest in new ventures in the**

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<sup>598</sup>'Probe Result Still Leaves Many Questions Unanswered' and 'Highly-Placed Official Involvement Denied', KT, 13 May 1982, p.6 The prosecution denied the involvement of any high-placed government official, but those who attended the couple's wedding in early 1982 recalled that among the guests were many known figures in the financial and political arenas, and this always raised suspicions of influence-peddling.

<sup>599</sup>'Lee arrest attests to gov't desire for just society', KH, 9 May 1982, p.1. See 'More Side Effects Seen in Biz World', KT, 13 May 1982, p.1.

<sup>600</sup>This aspect was particularly important during the investigation of the scandal, with then Minister of Finance Rha Woong Bae, who for the first time mentioned the need of real names in the financial system. He claimed that the inexistence of a comprehensive information system did not allow banking institutions to exchange data on firms, and stopped them from obtaining correct figures on money flows in the insurance, short-term finance, stock and curb loan markets. See 'Gov't May Name Depositors At Banks, Finance Firms', KT, 14 May 1982, p.1.

**rapidly growing Korean economy. For firms, a private loan from the curb market became a 'necessary evil'.<sup>601</sup>**

**The second feature was that the government's policy of financial restriction revealed itself to be an invitation for fraud. Anyone who could obtain capital from banks at below-market interest rates and then lend them in the curb market under aliases was sure to gain hefty profits, as 'Madame' Chang and 'General' Lee did. The likelihood of fraud in the country's financial system was further increased due to the administrative sanction allowing the use of false names in real estate, securities and bank transactions. The scandal also revealed how the search for cheap bank credit had led to the development of influence-peddling and rent-seeking ties between public officials and private businessmen. In sum, this case only served to reveal that the government-controlled banking sector was not only failing to perform an efficient role as an intermediary, but it was also nurturing the growth of an enormous unregulated money market as well as corrupt ties between government officials, bankers and businessmen.**

**In response to the unexpected scandal, and its far-reaching financial and economic consequences, the government of Chun Doo Hwan announced on 3 July 1982, the so-called '7.3' measure (seven indicating the month of the year and, three the day of the announcement). The '7.3' measure was a major reform of the financial system, requiring the use of real names in all financial transactions from July 1983, and the application of progressive income taxes to financial income, which would include capital gains from interest income.<sup>602</sup> In an effort to fight tax evasion, the new measure also planned a reduction of the global income tax rate to 50 percent from the previous 76.5 percent. According to the acting Minister of Finance Kang Kyung Shik the '7.3' measure was devised**

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<sup>601</sup>'Private money mart considered 'necessary evil' among businessmen', KH, 14 May 1982, p.9.

<sup>602</sup>For the announcement of the new measure on July 3, see 'Anonymous bank accounts banned effectively July'1983', KH, 4 July 1982, p.1 and 'All Financial Transactions to Need Use of Real Names', KT, 4 July 1982, p.1.

**to establish a new order aimed at the construction of a just society. In an expression of his confidence in its implementation, he stated that 'there will be no one to oppose the cause and the basic spirit of the government measures.'**<sup>603</sup> To become effective, the new measure had to be voted and approved by the National Assembly.

However, the country's political establishment soon began to express their opposition to the new measure.<sup>604</sup> The financial committee of the ruling Democratic Justice Party (DJP) argued that the measures 'would shock the national economy greatly and they were drafted too hastily without sufficient prior examination.' It also pointed out that the administration lacked the electronic-data processing systems necessary to cover all businesses, as required by the new taxation procedures. Instead of an immediate implementation, as proposed by the government, the DJP called for a gradual process. Political pressure continued throughout the summer, with the ruling party announcing that it would formulate 'alternative compensatory measures', such as keeping individual bank deposits in secrecy and limiting inquiries into the source of bank deposits to the only purpose of preventing overseas flight of capital.<sup>605</sup>

Along with the political establishment, the business sector voiced its concern with the side effects that could be caused by the measure, specifically, decreasing savings and speculative investment in real estate.<sup>606</sup> The Federation of Korean Industries (FKI), the main lobby group for the *chaebol*, issued a position paper on the measure in late July, calling for a gradual implementation of the real name financial system, suspension of the comprehensive income taxation and maintenance of the separate taxation system which charged a relatively low tax rate for

<sup>603</sup> 'Changes Necessary to Hike Development (interview to Kang Kyong-shik)', KT, 7 July 1982, p.7. See also 'Financial reforms stir pros and cons', KH, 21 July 1982, p.5..

<sup>604</sup> 'Parties Urge Gov't to Put Off July 3 Economic Steps', KT, 14 July 1982, p.1. and 'Real Name Requirement Toc Hasty, Parties Say', KT, 18 July 1982, p.4.

<sup>605</sup> 'DJP to formulate "July 3" alternatives', KH, 21 July 1982, p.1.

<sup>606</sup> 'Biz Circles Fear Rise In Speculation', KT 4 July 1982, p.9.

**financial income. It argued that 'enforcing the real-name system by administrative force seems likely to chase away the financial assets, from the institutional financial market and disturb the existing financial order, adding to the difficulties in business financing.<sup>607</sup>**

**On 17 August 1982, the DJP presented what it called a 'comprehensive compensatory package' to the real name financial system, saying that it had already been agreed with the government. The package, however, diluted the goal of the original measure. It not only stated that the sources of the false bank accounts and securities should not be investigated if the latter were changed into real name ones by July 1, 1983, but also proposed the postponement of the comprehensive taxation system, to be 'reserved for a considerable time'.<sup>608</sup> By the end of December 1982, already with the consent of the executive, the ruling party won a vote in the National Assembly supporting its modified version for the new measure calling for the full enforcement of the real name financial system only after January 1, 1986, instead of the originally projected January 1, 1983.<sup>609</sup>**

**Five years later, in October 1987, the new democratically-elected presidency of Roh Tae Woo brought back the reformist initiative by announcing that the implementation of the real name financial system and a progressive income taxation scheme to include financial incomes from 1991. Deputy Prime Minister Cho Soon emerged as the major force pushing for the implementation of the system. In early January 1990, the Ministry of Finance announced that it had already drafted a series of measures to mitigate the aftershocks that, such as depression of the curb market or intensification of real estate speculation, could be caused during the implementation of the real name financial transaction**

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<sup>607</sup>'FKI argues for gradual real-name system implementation', KH, 30 July 1982, p.3.

<sup>608</sup>'Gov't, DJP Agree Not to Trace Origin of Deposits, Securities', KT, 18 August 1982, p.1, and 'Sources of deposits won't be traced: DJP', KH, 18 August 1982, p.1.

<sup>609</sup>'Enforcement of real-name plan put off till after Jan.1, 1986', KH, 14 December 1982, p.1, and 'Real Name Deal Endorsed to Be Enforced After '86', KT 14 December 1982, p.1.

**system.<sup>610</sup> However, as had happened earlier with Chun Doo Hwan, the reformist initiative came under threat and was eventually postponed. On 22 January 1990, the ruling DJP merged with two opposition parties (Reunification Democratic Party led by Kim Young Sam and the Democratic Republican Party headed by Kim Jong-pil) to form the 'Grand Conservative Coalition' under the name of Democratic Liberal Party (DLP). Kim's move to join the coalition seemed to have been the strategy he found to become the ruling party's presidential nominee and finally succeed in his bid to become Korea's president.<sup>611</sup> The emergence of this coalition changed the country's political dynamics.<sup>612</sup> As the coalition took shape, voices began to surface in political and business circles calling for a reconsideration of the implementation terms of the new policy.**

**Politicians, while claiming that the new system could lead to overseas capital flight and real estate speculation, were more concerned that the implementation of the new measure would severely jeopardise their political activities since they were the major beneficiaries of political contributions, bribes, financial and real estate speculation under false names.<sup>613</sup> Members of the formerly ruling DJP, such as Park Tae Joon, DJP's chairman, and Lee Seung Hoon, DJP's chairman of policy research, supported postponement of the new policy, and the chairman of the FKI, Yoo Chang Soon, while officially supporting the policy, called upon the government to implement it on a gradual basis.<sup>614</sup> Deputy Prime Minister Cho Soon also denied reports suggesting the postponement of the new system, and told reporters that, 'the government has no intention to ease**

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<sup>610</sup> 'Ministry Drafts Measures to cushion Impacts of Real Name Reform System', KT, 12 January 1990, p.9.

<sup>611</sup> Lee, 'South Korea's Politics of Succession and the December 1992 Presidential Election', pp.40-50.

<sup>612</sup> Lee, 'Uncertain Promise'.

<sup>613</sup> Shin Sang Min, 'Dispute for 8 Years Between Chungwadae, Ministry of Finance, and Ruling Party Members over Implementing or Postponing Real Name Act', Monthly Chosun, May 1990, pp.290-303. The author quotes a governmental official claiming that what drove the politicians to oppose the reform was the possibility of having the sources of their political funds revealed and this would not only bring problems for the business concerns but also affect the politicians' activities. Additionally, most politicians did not seem to believe the government's assurances that if the new system would go ahead, the government would restrain from investigating the sources of the funds.

<sup>614</sup> 'FKI Supports Public Concept of Land Ownership', KT, 16 February 1990, p.6.

**or postpone on-going economic reforms. It will not be affected by the merger of the ruling party with two conservative political parties.<sup>615</sup>**

**But in March 1990, only two months after the formation of the coalition, a cabinet reshuffle led to the departure of Cho Soon, who was replaced by Lee Seung Hoo. The appointment of an open opponent of the reform for one of the country's leading economic decision-making positions was the first sign that the implementation of the real name financial system was under threat. The official confirmation of the postponement came on 4 April 1990 following declarations by Lee Seung Hoon about the dangers the system could have for the country's economy.<sup>616</sup> After the postponement of the real name financial system, a major land scam emerged in July 1992. This time, the scam involved officials at the Defence Ministry, real estate brokers, bank officials and the country's fifth biggest insurance company.<sup>617</sup> During the investigation, the OBSE discovered more than 80 bank accounts used by the culprits of which only 20 were under real names. The land scam illustrated that the absence of such a system continued to provide opportunities for the flourishing of the curb market and further financial frauds. In the wake of the land scam, and with presidential elections scheduled for December, the real name financial system became again a topical issue during the campaign.<sup>618</sup>**

**In the wake of the financial and fraud scandals emerging during their presidencies, the implementation of the real name financial system was an opportunity to boost the political legitimacy within Korean society for Presidents Chun Doo Hwan and Roh Tae Woo. Since both Chun and**

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<sup>615</sup>‘New Land Policy, Real Name Financial Transaction Will Be Enforced as Scheduled: Cho’, KT, 31 January 1990, p.8.

<sup>616</sup>For the declarations of Lee Seung Hoon, see ‘Ruling Camp to Shelve Real Name System’, KT, 24 March 1990, p.1. See also ‘Real-Name Transaction Likely to Be Shelved’, KT, 21 March 1990, p.1.

<sup>617</sup>For the land fraud scam, see ‘Bank Official Swindles W23 billion’, KT, 5 July 1992, p.3., ‘JCS Employee Detained for Questioning’, KT, 7 July 1992, p.3, ‘Ex-JCS Employee Kim Received W8.1 Billion’, KT, 8 July 1992, p.3, ‘Land Scam Engineered by Chongs, Kim YH’, KT, 9 July 1992, p.3, ‘Kim Yong-ho Viewed as Prime Culprit in Land Scam’ and ‘Land Scandal Feared to Slow Financial Liberalization Pace’, KT, 17 July 1992, p.10, ‘Prosecutors Confirm Double Fraud in JCS Land Scam’, KT, 18 July 1992, p.3, ‘Prosecutors Locate Flow of W63 Bil. From Insurance Co.’, KT, 19 July 1992, p.9, ‘W2 Bil. in Land Scam Unaccounted for’, KT, 21 July 1992, p.3, and ‘Broker Im Forged Contract for Military Real Estate Sale’, KT, 22 July 1992, p.6.

<sup>618</sup>‘In Wake of Land Scam: Real Name Deposit System Emerges as Hot Topic’, KT, 21 July 1992, p.9.

**Roh were not known for being very confident in handling economic policy matters, it was thought that the initiative to implement the real name financial transaction system had been first brought up by their chief economic secretaries or deputy prime ministers.<sup>619</sup> In the case of Chun, Chief Economic Secretary Kim Jae Ik was seen as the main architect behind the reform, while during Roh Tae Woo's administration, Deputy Prime Minister Cho Soon emerged as the leader of the initiative.<sup>620</sup> Yet, both presidents who had earlier tacitly approved the reform later decided to postpone its implementation. What seemed to have particularly determined their change of view was the behind the scene manoeuvres in which they were warned about the negative impact the reform could have on flows of political funds.**

**One of Korea's leading finance professors, Kim Pyung Joo, argues that Chun Doo Hwan reversed his earlier backing for the financial reform after he was convinced by Lee Won Jo, a long-term friend from the same region (Taegu), and who served as chief presidential financial secretary and head of the Office of Bank Supervision and Examination (OBSE) during his presidency.<sup>621</sup> According to Kim, Lee warned the president that if he endorsed the new system his own political slush funds could one day be exposed. Kim also claimed that the same Lee, who later became a member of the National Assembly for the ruling party under Roh Tae Woo, together with Kim Chong In, then Presidential Chief Economic Secretary, used the same argument to push for the postponement of the new system during the Sixth Republic (1988-1992).**

**Lee Won Jo, who was known as the 'crown prince of banking', was one of the most important figures in the ruling party due precisely to his role in collecting political funds, as attested by investigations undertaken**

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<sup>619</sup> Interview with Nam Duck Woo and Chung Duck Woo in Seoul, 30 May and 14 June 2001, respectively.

<sup>620</sup> For Chun Doo Hwan, see Shin, 'Dispute for 8 Years Between Chungwadae, Ministry of Finance, and Ruling Party Members over Implementing or Postponing Real Name Act'. For Roh Tae Woo, see Lee Song Ho, 'Policy Conflict and Its Settlement in Korea: The Case of Regulatory Reform'; *The Korean Journal of Policy Studies*, 8 (1993), 33-57.

<sup>621</sup> Interview with Kim Pyung Joo in Seoul, 7 June 2001.

**by prosecutors in 1989 and 1993.<sup>622</sup> In January 1989, as the National Assembly began to push for investigations on irregularities committed during the Fifth Republic. The prosecution questioned Lee Won Jo on allegations that, while in the Blue House, he had diverted part of the 3.7 billion Won-Petroleum Development Fund, consisted of revenues from imported oil, to be used as political funds.<sup>623</sup> Additionally, there were also suspicions that during his tenure as president of the OBSE he had provided large amounts of bank loans to debt-ridden business groups in return for political funds. In what was seen as a controversial ending to the investigation, raising doubts about the prosecution's work, Lee Won Jo was released after two days of questioning, as the authorities could not bring charges against him.<sup>624</sup> Later in October 1989, the government and the ruling party announced that they would seek his resignation, but Roh Tae Woo backed down since Lee's political sacrifice could have lead him to go public and reveal all he knew about political funds in the Sixth Republic. As he did during Chun's regime, Lee Won Jo had helped raise funds for Roh's own 1987 presidential campaign.<sup>625</sup>**

**In April 1993, during the first months of the Kim Young Sam presidency, the name of Lee Won Jo emerged again linked with a financial scandal in the sequence of Kim's anti-corruption measures. The scandal involved the chairman of the private Donghwa Bank who was accused of having offered a total of 2.27 billion Won to Roh's close associates on several occasions from 1989 to late 1992. According to the Prosecutors' Office, the chairman of the bank, Ahn Young Mo, said that he had given Lee Won Jo a total of 880 million Won on 10 occasions since November**

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<sup>622</sup>For investigation in 1989, see 'DJP Rep. Lee WJ Faces Arrest For Petroleum Fund Diversion', KT, 14 January 1989, p.3, and '47 Arrested in Probe of Past Regime's Scandals', KT, 1 February 1989, p.1. For investigations in 1993, see 'Donghwa Bank Pres. Ahn Arrested For Taking Bribes In Return for Loans', KT, 23 April 1993, p.3, 'Illegal Commissions to Donghwa Bank Pres. Presumed to Exceed W10 Billion', KT, 25 April 1993, p.3, and 'Ex-Pres. Roh's Aides bribed by Donghwa Bank', KT, 4 May 1993, p.3, 'Authorities Seek Return of Rep. Lee Ex-Finance Min. Rhee From Japan', KT, 5 May 5, 1993, p.3, and 'Peter's Denial and Bureaucrats' Passivism', KT, 25 May 1993, p.7.

<sup>623</sup>'DJP Rep. Lee WJ Faces Arrest For Petroleum Fund Diversion', KT, 14 January 1989, p.3.

<sup>624</sup>'47 Arrested in Probe of Past Regime's Scandals', p.1.

<sup>625</sup>'DJP Seeks 2 Reps.' Resignation To Put End to Past Legacies', KT, 3 October 1989, p.2, and 'Roh has failed to get the Chun years behind him: Small Steps Forward', Far Eastern Economic Review, 12 October 1989, pp.40-2.

**1989 shortly after the foundation of the bank, and a total of 400 million Won on two occasions to Kim Chong In, now a member of the National Assembly. The prosecutors believed that Ahn gave the money in return for their help launching the bank during Roh's administration and other financial favours from the government. The Donghwa Bank was established by citizens and businessmen whose hometowns were in North Korea. With Lee Won Jo said to be under treatment in Tokyo, the prosecution came under attack for not doing enough to fully disclose his involvement in these illicit deals.<sup>626</sup>The policy process and the political lessons of the failed attempts by Presidents Chun and Roh to implement the real name financial system is seen here as important policy feedback, which contributed to shaping Kim's own approach to the reform.**

#### **6.2.3 Clean Politics, Just Society and Moral Leadership**

**As a leader seeking to legitimise his leadership on the Confucian political tradition of 'rule of man', the surprising announcement of the real name financial transaction well reflected the ideological motivation driving Kim Young Sam's political behaviour.<sup>627</sup>Soon after his victory, Kim Young Sam distanced himself from former President Roh, whom he blamed for lacking leadership and for administrative incompetence in dealing with the 'country's rampant corruption and moral decay'. Hahm Sung Deuk claims that Kim Young Sam 'truly' identified himself as a reformist leader and that in order to reform Korean society, the former President 'strongly' believed in the need to implement the real name financial system. This, Hahm says, explains why he adopted a top-down strategy to push for the reform.<sup>628</sup>Kim Young Sam's political history seems to confirm his conviction for the need of this reform. After the emergence of the ruling coalition Democratic Liberal Party (DLP) and the postponement of the real name financial system in 1990, Kim and his**

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<sup>626</sup>'Donghwa Bank Pres. Ahn Arrested For Taking Bribes In Return for Loans', p.3, 'Illegal Commissions to Donghwa Bank Pres. Presumed to Exceed W10 Billion', p.3, and 'Ex-Pres. Roh's Aides bribed by Donghwa Bank',p.3, 'Authorities Seek Return of Rep.Lee Ex-Finance Min. Rhee From Japan', p.3, and 'Peter's Denial and Bureaucrats' Passivism', p.7.

<sup>627</sup>See Chapter Five.

<sup>628</sup>Interview with Hahm Sung Deuk in Seoul, 26 June 2001.

**political faction within the DLP continued to support the implementation of the system and publicly voiced their opposition to the decision taken by Roh's executive.<sup>629</sup>**

**As the first democratically-elected civilian president since the 1960s, Kim Young Sam championed the principle of civilian authority over the military, which over the past three decades, had dominated Korean politics. Simultaneously, as the new head of a state, that for three decades had grown accustomed to collusion between government officials and businesses, Kim not only voluntarily disclosed his personal assets to the public but also vowed that he would not accept any political donations. By deciding on this approach, Kim Young Sam emerged as a moral ruler seeking to build a 'New Korea' with clean politics and a just society. As President Kim Young Sam stated when he announced the decree: 'without the implementation of the real name system, corruption and irregularities on this soil cannot be uprooted and the chronic tie-in between political power and the business circles cannot be severed. The real-name system is a more important reform than any others in building a new Korea. This is the reform of reforms and the core and the spine of reforms in our era.'<sup>630</sup>**

**The impact of malpractices facilitated by the false name financial system on the country's financial structure, economy and social stability, the policy process and political lessons taken from the failed attempts of Presidents Chun Doo Hwan and Roh Tae Woo to implement the reform and Kim's ideological motivations are here regarded as the major variables that contributed to shape his choice and approach to implement the real name financial system. Yet, the reform was only partially successful. By assuming the posture of a moral ruler and pursuing a 'top-down' approach to reform, Kim Young Sam committed two strategic failures.**

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<sup>629</sup> 'Criticisms Voiced Within DLP Over Deferment of 'Real Name' System', KT, 22 March 1993, p.2.

<sup>630</sup> 'Real Name Financial System Enforced', KT, 13 August 1993, p.1.

**First, for the legitimacy of his leadership and reforms to succeed he needed to maintain and consolidate popular support. However the moral legitimacy of Kim's leadership began to be challenged, not only by a series of scandals but also due to the inconsistencies of economic policies. Popular support for his presidency subsequently began to rapidly tumble. This undermined Kim's leadership and the capacity to push further for his reformist program.**

**Second, any effort to force institutional change would be an exigent task in face of the built-in political and economic path-dependences inherited from Park Chung Hee, as the former governments of Chun and Roh learned. The Korean political system does concentrate power in the executive. However, the strength of the system of socialisation of private risk has rested on the structurally interdependent and dynamic ties especially between the executive, bureaucrats and businessmen. The country's democratisation added a fourth actor to the system by formally increasing its policy power: the National Assembly.**

**Therefore, any attempts to alter the rules of the game within the system, in particular its informal side as would happen with the implementation of the real name financial transaction system, required some type of negotiation and agreement with the other actors within the system in face of their potential resistance and opposition. The reform was, in fact, expected to negatively affect government officials, businessmen and politicians, especially in terms of taxation and political funds. But its implementation was also positively seen by certain sectors within the bureaucracy and business as well as by the vast majority of the Korean population.**

**The new system was favoured by the monetary authorities as it would bring more transparency to the financial system helping them to investigate illicit financial flows, fight money laundering or other financial transactions related to the underground economy. Some businessmen**

**also saw in the new system the opportunity to avoid being forced into providing political funds due to the possible tax investigations. For the majority of the Korean population, the new system was expected to address calls for a more fair distribution of wealth. Under the false name financial system, the country's wealthy groups could hide their gains from financial and property investments under aliases and easily evade taxation.**

**Yet, Kim Young Sam's government methods to promote important reforms, including the real name financial transaction system, failed to gain the support of what could be their major beneficiaries. As Hahn Bae-ho, the president of one of Korea's leading research institutions, Sejong Institute, puts it: '...prior to and during the implementation phase, the administration failed to provide adequate information about the reforms and persuade people of their importance. The government did not make an effort to clearly identify who the beneficiaries would be in order to recruit them as a base of support for the reforms.'<sup>631</sup> This became evident following the introduction of the reform with the country's middle-class, i.e., the political base of Kim's administration, said to be anxious about the implications of the new system.<sup>632</sup> For example, owners of SMEs, in particular, and who had favoured Kim Young Sam during the presidential elections in 1992, feared that the full exposure of their finances would lead to a two or three-fold tax increase.<sup>633</sup> Since Kim decided to push the financial policy by administrative fiat without building a reform-oriented alliance, the Korean state capacity to fully institutionalise the real name financial transaction system became more difficult.**

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<sup>631</sup>Hahn, 'Assessing Kim Young-sam Administration's First Four Years', p.13.

<sup>632</sup>Nam Si-uk, 'Don't Make the Middle Class Nervous'; *Korea Focus* 1:5 (1993), 114-6 (originally published in The Dong-A Ilbo, September 7, 1993). See also Hahn Chaibong, 'Future of Korean Political Reform Drive'; *Korea Focus* 4:1 (1996), 5-11 (originally published in *Reform*, December 1995).

<sup>633</sup>In fact, some like Kim Jong In, a former Minister of Finance during the presidency of Roh Tae Woo, claimed that due to their dependence on the curb market, the SMEs faced a shortage of funds following the adoption of the real name financial transaction system, leading many to bankruptcy which ultimately open the way for the country's financial crisis in 1997. See Kim Yong-sam, 'Roh Tae Woo Memoirs: 6<sup>th</sup> Republic Hidden Stories on Economic Policies – Chaebol Reform and Resistance of Chaebol Leaders', Monthly Chosun, July 1999, pp.422-459.

### **6.3 Implementing Real Name Financial Transaction System: Business Resistance and Politicians' Opposition**

**The events prior to the announcement of the real name financial transaction system illustrate well how Kim's 'reform from above' was often accompanied by an element of surprise as he succeeded in keeping secret a task force to draft the new policy.<sup>634</sup> After Kim's inauguration, the implementation of the real name financial system rapidly emerged as one of the goals of the new administration. However, within an economic scenario exhibiting low growth, decreasing exports, industrial activity at record lows, and an unemployment rate expected to rise with increasing corporate bankruptcies, the debate on the reform was blamed for having a negative impact in the already struggling economy.<sup>635</sup> Facing this economic scenario, government officials began to retreat from their earlier positions stating that the implementation of the real name financial system would occur in the first half of the year.<sup>636</sup>**

**Despite his continuous vow that the real name financial system would come into force as early as possible, the President started to say that it would be implemented only after an improvement in the country's economic situation.<sup>637</sup> By March 1993, in face of what had earlier happened in 1982 and 1989, there was a mounting public belief that the government had decided to postpone the financial reform.<sup>638</sup> In April 1993, the government and the ruling party agreed to put off the introduction of the**

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<sup>634</sup> 'When Drawing Up Real Name System: Pres.Kim Most Concerned About Leakage', KT, 14 August 1993, p.2.

<sup>635</sup> 'With No Sign of Improvement: Korean Economy Heading for Worst in A Decade', KT, 5 February 1993, p.9, and 'Investors Withdrawing Money from Stock Market', KT, 20 February 1993, p.9. Following Kim Young Sam's statement that the policy would be adopted in his first year in office, the stock market plunged allegedly as wealthy businessmen and big stock investors decided to withdraw their money from the market fearing tax investigations associated with the real name financial transaction system.

<sup>636</sup> 'Gov't May Put Off Use of Real Name in Financial Transactions', KT, 16 March 1993, p.1, 'Use of Real Name System Depends on Economy's State', KT, 17 March 1993, p.9, 'Kim YS Fails to Keep Election Campaign Pledges', KT, 18 March 1993, p.8, 'Investors Withdrawing Money from Stock Market', p.9.

<sup>637</sup> 'Economic Burden Forces Real Name System Into Mouthballs', KT, 20 March 1993, p.9, and 'Real Name System to Follow Economic Recovery', KT, 25 March 1993, p.3.

<sup>638</sup> 'Finance Minister Hong Accents Economic Revitalization Before Financial Reform', KT, 18 March 1993, p.9, and 'DPM Lee Vows Real-Name Financial Transaction System Will Be Put Into Action', KT, 27 March 1993, p.16.

**real name financial transaction system.<sup>639</sup> But on 3 August 1993, in a surprising move, Kim Young Sam announced the Presidential Emergency Order on Real Name Financial Transactions and Protection of Their Confidentiality. By resorting to an emergency order, Kim seemed to have learned from the past experiences of Chun and Roh, and aimed to prevent legislative debate that could lead to revisions of his original plan. According to the Constitution, the National Assembly could only reject or endorse an emergency order, but had no power to amend it.<sup>640</sup>**

**The announcement of the real name financial system boosted Kim Young Sam's popular ratings with 88 percent of the population showing a positive view of the President by the end of 1993.<sup>641</sup> Most citizens saw the reform program as the way forward to help end the endemic corruption affecting the country and growing economic inequalities.<sup>642</sup> Members of the CCEJ, after years of campaigning for the introduction of the real names in financial transactions, celebrated in their office in Seoul the realization of one of the organization's main goals. They blamed the old system for a series of bribery and banking scandals that had hit the country's financial system hard, and increased national economic disparities.<sup>643</sup> The decree went into effect immediately after its approval on 19 August 1993 by the whole National Assembly.<sup>644</sup>**

**Financial sources quoted by a local newspaper claimed that out of total deposits of about 73.2 trillion Won in savings accounts at banks (excluding foreign banks), about one trillion Won or 1.4 percent was in false names at the end of June 1992.<sup>645</sup> This seems to confirm the claims by Park Byung Ok and Ko Kye Hyun from the CCEJ that only a small minority of the population (five percent) resorted to the use of false name**

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<sup>639</sup>'DLP, Cabinet Agree to Put on Hold Implementation of Real Name System', KT, 7 April 1993, p.2.

<sup>640</sup>Lee, 'The Development of Financial Institutions and the Role of Government in Credit Allocation', pp.117-8.

<sup>641</sup>Hahn and Rhyu, 'Democratic Reform and Consolidation in Korea', p.81.

<sup>642</sup>'Real Name New Base for 2<sup>nd</sup> Take Off', KT, 25 August 1993, p.6.

<sup>643</sup>'After 4-Year Efforts for Economic Reform: CCEJ Celebrates 'Real Name Triumph'', KT, 14 August 1993, p.1.

<sup>644</sup>'Nat'l Assembly Passes Presidential Order Enforcing Real-Name System', KT, 20 August 1993, p.2.

<sup>645</sup>'When Will the Real Name System Come?', KT, 1 January 1993, p.3.

**systems, though certainly a very wealthy minority.<sup>646</sup> A study by the Korea Institute of Public Finance in 1996 claimed that the size of the underground economy in terms of GNP had decreased from 16.6 percent in 1972 to 8.8 percent in 1994 following the implementation of the real name financial system.<sup>647</sup> Additionally, was it not for the reform, the arrest of former Presidents Chun and Roh, as well as several other politicians and businessmen on corruption charges would probably not have occurred.**

**However, as Hahm Sung Deuk argues, the problem with Kim's strategy to push for 'reform from above' was that once the President began to lose popularity following a series of scandals his political capacity was also weakened.<sup>648</sup> Under these conditions, it became increasingly difficult for him to stand for policy reform and much easier for those opposing the reform to react and try to slow the institutionalisation of the new system.<sup>649</sup> Meanwhile, Kim failed to mobilise a supporting alliance within the important core group of the system of socialisation of private risk to spearhead the reform. One of the basic dilemmas of the reform process is that the chances are high that the forces opposing reform will be more influential than those supporting reform. It may happen that those who had benefited most from the previous policies, and who tend to loose most from the reforms, by feeling a strong sense of dispossession mobilise in support of program maintenance rather than change and reform. This situation arises because institutional change of any type tends usually to redefine the power relations between various social actors. Furthermore, the beneficiaries of the reforms may not become fully aware of the advantages because their impacts may be dispersed, and consequently fail to manifest their support for the ongoing reforms. In face of no visible**

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<sup>646</sup> Interview with Park Byun Ok and Ko Kye Hyun in Seoul, 8 June 2001.

<sup>647</sup> The figures are quoted by Kim, 'Korea: Economic Consequences of Corruption in Korea', p.72.

<sup>648</sup> For scandals, see Chapter Five.

<sup>649</sup> Interview with Hahm Sung Deuk in Seoul, 26 June 2001.

**support from the society, the implementation, whether partial or full, of the reforms may potentially run into trouble.**

**In Korea, the main opposition, although divided, to the real name financial transaction system came from businessmen and the ruling party's politicians, two of the forces that had benefited most from the previous policy in particular in terms of taxation and political funding.**

#### **6.3.1 Business Resistance and Keeping Up Old Practices**

**For the business sector, and in particular the *chaebol*, the maintenance of the old system was preferable since it offered the opportunity to evade high taxation and pay lower taxes on financial income. Additionally, in a country where the state was in control of capital allocation, the old system served the *chaebol* well. They could buy, more easily and in an anonymous manner, favours from bureaucrats and politicians. Favours included access to policy loans, the acquisition of licences to participate in highly profitable government-regulated sectors and the right to take part in bidding and land contracts on public projects. Yi Insill pointed out that the selection of companies to undertake investments in certain business sectors depended on the will of politicians and bureaucrats, and consequently, if businesses were on good terms with bureaucrats they could be picked up as long as they paid a commission usually estimated at 10 percent of the value involved in the deal.<sup>650</sup>**

**Yi Insill, nonetheless, found out in conversations with business leaders before the implementation of the system in 1993 that while some were against the new policy, others supported it due to the impact in terms of political funds. This seems to be confirmed by newspaper reports describing conflicts within the Federation of Korean Industries (FKI) over**

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<sup>650</sup>Interview with Yi Insill in Seoul, 20 June 2001.

**the reform before its implementation.<sup>651</sup> While the chairmen of Hyundai, Lucky-Goldstar and Kumho supported its implementation, the chairmen of Daewoo, Sunkyong and Samyang argued that it was still premature to put the system in effect. For the former, as long as the old system was in place, the high costs associated with the need to provide political funds to parties would remain. But, if they could tell political parties that the new system forced them to report to the tax office how much money they donated as political funds, politicians would not be so eager to request vast amounts of money.<sup>652</sup>**

**After the election of Kim Young Sam, the FKI, under a new leader, Chey Jong Hyon, the chairman of Sunkyong, one of Korea's largest chaebol, reaffirmed its opposition to an early implementation of the reform.<sup>653</sup> Likewise, the Korea Chamber of Commerce and Industry (KCCI) also proposed the gradual implementation of the real name financial transaction system. The KCCI claimed that if the system was introduced suddenly during a time of economic lethargy, the curb market would freeze and many small and medium-sized firms, i.e., the major client of the curb market, would go bankrupt and money market rates would again rise.<sup>654</sup> Despite the business view, Kim Young Sam decided to go ahead with the decree. However, evidence that the business sector would not**

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<sup>651</sup>‘Real Name financial trading system splits business leaders’, KH, 14 August 1992, p.6, and ‘Polemics Over Real Name System’, KT, 14 August 1992, p.3.

<sup>652</sup>Interview with Yi Insill, Seoul, 20 June 2001. The problem, however, with this view is that businessmen could hardly trust the tax office which was not uncommonly used by the President (who happened to be also the chairman of the ruling party) to prosecute firms that would lose political favour with the leadership at the time. See for example the case of Hyundai during the presidency of Roh Tae Woo. See ‘Hyundai's Chung M.H. gets suspended term’, KH, 15 August 1992, p.3. Hyundai's Chung Mong Hun was arrested on charges of evading 5.8 billion Won in taxes and using forged documents to divert company funds totalling 11.2 billion Won into secret bank accounts. He was accused of ordering his assistants to forge income records and shipping charges to cover up the secret funds. On the other side, the tax office could also be used to let tax evasion go unpunished to benefit political allies, as also happened during Roh. In May 1990, a former inspector at the Board of Audit and Inspection (BAI), under the direct jurisdiction of the president and in charge of examining the settlement of revenues and expenditures of the state, told a local newspaper that BAI had suspended investigations on tax irregularities by major chaebol due to what he called “higher” pressures. Lee Mun Ok alleged that while Samsung Life Insurance Co was supposed to pay 300 billion Won in taxes, it paid only 8 billion. He also said that tax investigations of the Sunkyong Group had been suspended on grounds that the group was owned by a relative by marriage of President Roh Tae Woo. Lee was later arrested accused of leaking secrets of his official duties to the press. The court said the content of the stories revealed by Lee were judged to be “official secrets” whose leakage constituted a law violation. See ‘Lee's Act of Revealing BAI Data To Press Illegal, Court Rules’ and ‘BAI Official's Allegations’, KT, 25 May 1990, p.3 and p.4, respectively.

<sup>653</sup>‘FKI Chairman Voices Concern Over Early Use of Real Name System’, KT, 5 March 1993, p.9.

<sup>654</sup>‘KCCI Proposes Gradual Use of Real Names’, KT, 5 March 1993, p.9.

**willingly cooperate with the institutionalisation of the new financial policy emerged right after the announcement of the decree, as companies were reported to have rapidly begun to look for loopholes in the system.<sup>655</sup>**

**One popular measure to manage secret funds was to borrow names for bank deposits. According to a newspaper report, in deals usually involving the top managers of companies or their confidants and senior officials of banks, companies would withdraw money deposited in false name accounts and deposit them again with borrowed names one after another.<sup>656</sup> Banks cooperate with these practices in order to maintain their level of deposits. According to Park Byung Ok and Ko Kye Hun, while the reform banned the use of pseudonyms, people could still use borrowed names and the new system does not include any provision to probe this. Additionally, these practices, contrary to common belief, are well protected by privacy rights, and these two members of the CCEJ argue that even if there is a crime it is very difficult to investigate.<sup>657</sup>**

### **6.3.2 Politicians' Opposition and Slowing Down the Real Name Financial System**

**In Korea, the president, members of the National Assembly, and heads of local governments tend to be career politicians.<sup>658</sup> The cost of maintaining a local office in one's constituency, keeping up with the political status and cultivating social relations with his or her constituents easily exceeds the salary and allowance received from the state as a member of the National Assembly.<sup>659</sup> Hence, Korean politicians need large amounts of money to remain in politics. Except for a small minority of wealthy ones, Korean politicians find it difficult to avoid**

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<sup>655</sup> Companies Rack Brains to Find How to Create 'Secret Funds', KT, 17 August 1993, p.8 and 'Techniques to Cheat New System Prevalent', KT, 23 August 1993, p.9.

<sup>656</sup> Companies Rack Brains to Find How to Create 'Secret Funds', p.8.

<sup>657</sup> Interview with Park Byung Ok and Ko Kye Hyun in Seoul, 8 June 2001.

<sup>658</sup> Kim Myoung-soo, 'Causes of Corruption and Irregularities'; *Korea Focus*, 8:1 (2000), 37-47 (originally published in a book in 1999 by the Center for International Studies, Policy Research Series, Yonsei University).

<sup>659</sup> 'Parties Try to Conform to Post 'Real Name' Political Culture', KT, 21 August 1993, p.2. It reports that in 1993 while most members of the National Assembly need some 20 million won a month on average for management of their district offices, they receive for their assembly activities little more than 5 million won.

accepting the so-called 'black funds', i.e., bribes in return for economic favours from the authorities.<sup>660</sup> The adoption of the real name financial transaction would simply threaten their political livelihood. As Kang Tae Soo points out, the resistance to the new financial policy by most Korean politicians is understood because they would receive their funds from various bank accounts whose holders could hide their identities behind the false name registration.<sup>661</sup> With the real name financial system, the sources of these funds could be tracked down and reveal the illicit ties and jeopardize their political activities. Despite the agreement set with the ruling party that the real name financial system would be postponed, Kim Young Sam opted to issue the new financial policy by surprise.

The behaviour of the ruling DJP and how it rapidly moved to alter and postpone the implementation of the financial reform during the presidencies of Chun Doo Hwan and Roh Tae Woo cannot be ruled out as policy lessons for Kim Young Sam.<sup>662</sup> By pushing the reform through administrative fiat, he attempted to avoid the resistance from many politicians at the National Assembly, especially from the ruling DLP. The DLP, although it had supported Kim's election, was still made up of many members of the former DJP still opposed to the real name financial transaction system with only a small minority supporting Kim Young Sam's initiative.<sup>663</sup> In fact, Kim's anti-corruption measures were seen as an attempt to prosecute the 'old guard' of the ruling DLP with ties with the past military regimes.<sup>664</sup> An example was the investigation of irregularities committed by the already mentioned Park Tae-Joo, then chairman of the DLP and honorary chairman of Pohang Iron and Steel Co.<sup>665</sup> The National Assembly, nonetheless, succeeded in slowing down the

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<sup>660</sup>Kim, 'Causes of Corruption and Irregularities', p.41.

<sup>661</sup>Interview with Kang Tae Soo in Seoul, 23 May 2001.

<sup>662</sup>For the reactions within the ruling party in face of top-down reform strategy undertaken by President Kim, see 'Ruling Party Alienated From Important Decision-Making', KH, 23 August 1993, p.3.

<sup>663</sup>Interview with Park Byung-Ok and Ko Kye-Hyun, Seoul, June 8, 2001. For the factional divisions within the ruling DLP, see 'Jockeying for Power', Far Eastern Economic Review, 25 January 1990, pp.22-5, and 'DLP Lawmakers Alarmed About Property Disclosure', KT, 9 March 1993, p.3.

<sup>664</sup>'DLP Old Guard Feels End Closing In', KT, 25 March 1993, p.2, and 'Pres. Kim's Unswerving Reform Drive Leaves DLP Old Guard Out in Cold', KT, 14 April 1993, p.2.

<sup>665</sup>Yonhap News Agency, *Korea Annual 1994*, pp.64-5.

**institutionalisation of the real name financial transaction system and politicians seem to have found ways to evade the system.**

**Firstly, the presidential emergency order remained as such for four years until it was finally voted as a law by the National Assembly in 1997 in a process seen as irregular. According to Park Byung Ok and Ko Kye Hyun, the emergency decree has a limited duration, and legally after that period it should have been institutionalised into the system or abolished.<sup>666</sup> However, that did not happen because of opposition within the National Assembly. Since the National Assembly had already been “pressed” to endorse the new system despite vast opposition among its members, what it could still do was delay its institutionalisation. The National Assembly legalised the emergency order in 1997 only after a growing feeling within the public opinion that the postponement, due to its implications in terms of financial transparency, had in fact been responsible for the country’s financial crisis.<sup>667</sup> Secondly, after the 1997 financial crisis, the comprehensive taxation system was postponed until 2002 due to opposition from the United Liberal Democrats (ULD) of Kim Jong Pil. The party argued that the implementation of the new tax system, in times of crisis, would have a negative impact on the country’s financial market and economy.<sup>668</sup> Finally, the system did not seem to have decreased illegal political funds. As Sohn Hyuk Jae, Deputy Secretary General of the People’s Solidarity for Participatory Democracy (PSPD), points out what the new system added was more inconvenience in the process of operating political funds. Now, instead of using bank accounts under false names, cash is being used, as evidenced by the case of the apple boxes full of money that were found in the possession of Chun Doo Hwan.<sup>669</sup>**

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<sup>666</sup> Interview with Park Byung Ok and Ko Kye Hyun, Seoul, 8 June 2001.

<sup>667</sup> Interview with Park Byung Ok and Ko Kye Hyun, Seoul, 8 June 2001.

<sup>668</sup> Interview with Yi Insill in Seoul, 20 June 2001.

<sup>669</sup> Interview with Hyuk Jae Sohn in Seoul, 3 July 2001. The PSPD is a non-profit, non-partisan civic organisation dedicated to the promotion of participatory democracy and securing human rights in Korea. Founded on September 10, 1994, the PSPD seeks to prevent abuse of power by the government, judiciary, and business through advocacy of social justice, presentation of alternative policies, and encouragement of social participation by the population. Seoul, July 3, 2001.

#### 6.4 Conclusion

**The real name financial transaction system represented a policy reform that would significantly transform the nature and the relationships within the system of socialisation of private risk. By introducing a more comprehensive taxation system, the system addressed the society's growing demands for a more equitable distribution of wealth. Additionally, the false name financial system created the conditions for the growth of an informal and unregulated financial market that due to its secretive and difficult to trace nature, negatively affected the government's capacity to implement financial policies. But by increasing transparency in the financial system, a major impact of the new system would be to empower the authorities to investigate the sources of funds hidden behind false names usually at the basis of corrupt ties developed between government officials, politicians and businessmen. Since the 1980s there have been attempts to deal with the negative outcomes of the false name financial system, ironically not forbidden but legally sanctioned by the government of Park Chung Hee, not only to encourage greater financial transparency but also to promote a more equitable distribution of wealth.**

**I argue that Kim Young Sam's choice to implement the new financial policy was shaped by the legacies of the false name financial system, the policy process and political lessons from the failed attempts by Chun Doo Hwan and Roh Tae Woo, and his ideological and moral motivations. However, any effort to change the rules of the game within the system, in particular its informal side necessitated some type of negotiation and deal settlement with other participants in the system in the face of their potential resistance and opposition. By targeting tax evasion and illicit political funds, the reform was, in fact, expected to directly affect government officials, businessmen and politicians, core members of the system of socialisation of private risk. Since Kim decided to force the financial policy by administrative fiat without building a reform-oriented alliance within this core group, the president committed a**

**strategic failure as the Korean state capacity to fully institutionalise the real name financial transaction system became more difficult. The case of real name financial transaction system represents a good example of how a necessary policy innovation without the right political support has faced resistance to change from vested interests that have been ingrained with a series of path-dependent malpractices developed and consolidated within the system of socialisation of private risk during the 1960s and 1970s.**

**Additionally, this case study reveals well how the issue of the curb market was dealt differently by the presidencies of Park Chung Hee and Kim Young Sam due to their divergent commitments to the system of socialisation of private risk. Park Chung Hee strategically acted to freeze the curb market in the early 1970s to rescue a debt-ridden business sector that had borrowed strongly from the unregulated financial market. The strategy not only aimed at alleviating the business sector's financial problems, but also at consolidating ties between the government and the country's major firms within the system. Conversely, by strategically acting to undermine the workings of the curb market in 1993 with the announcement of the real name financial transaction system, Kim intended to seriously damage the corrupt ties that had developed between politicians, businessmen and bureaucrats since the regime of Park Chung Hee. Unlike Park, Kim sought to end the close ties between government and businesses and radically transform of the *status quo* within the system of socialisation of private risk.**

## **7. CHAPTER SEVEN – Conclusion**

**For nearly four decades, Korea's remarkable economic performance has attracted international attention. Leading this economic success has been the 'visible hand' of a strong, interventionist, and developmental state that was capable of promoting fast economic growth by: identifying strategic industrial sectors; providing preferential allocation of resources to those sectors; and reducing collective action dilemmas unlike those experienced by most developing countries. The ultimate consequence of this intervention was the institutionalisation of a system of socialisation of private risk, in which the state supported the potential risks associated with industrial ventures undertaken by the private sector. This socialised risk took several forms such as deposit guarantee; lender-of-last-resort; state guarantees; and financial rescue of debt-ridden corporations. Conversely, this socialised private risk was balanced by the state's disciplinarian capacity through its control of financial flows. The system of socialisation of private risk encouraged private investment. However, the Korean state also imposed performance standards in exchange for access to financial support. The developmental state literature has offered convincing evidence illustrating the high degree of intervention by the Korean state in the workings of the market. Yet, how the developmental state's policy goals were designed, negotiated and implemented remained much of a 'black box' in this literature.**

**In the case of Korea, the President and his staff at the presidential office have been the central figures in the process of decision-making, to the extent that the country's presidency is usually regarded as an 'imperial presidency'. Korean presidents are usually expected to be active players in the process of decision-making through their involvement in the design, negotiation, implementation and monitoring of public policies. This thesis was particularly interested in understanding the role of Korean leaders in the policy process and how they attempt to bring about**

**institutional change. To accomplish this, a polished version of historical institutionalism as the theoretical framework underpinning the research was introduced. Five main propositions are at the core of this theoretical framework:**

- 1) Institutions are relevant not only because they impose constraints but also because they open opportunities for political behaviour;**
- 2) Political actors are both subjects and agents of historical change, in the sense that they can act strategically to define, pursue and achieve institutional change;**
- 3) Political strategy is moulded by the institutional setting in which actors are embedded, as well as by ideas and the specific historical context within which the action takes place;**
- 4) Policies are sources of political rearrangements that ultimately may generate institutional change; and**
- 5) The interaction of formal and informal politics is relevant to the understanding not only of 'who gets what, when, how, at whose expense', but also to evaluate how these patterns of political behaviour influence patterns of institutional change.**

**From this theoretical framework, this study has opened the developmental state 'black box', to understand two major issues: firstly, how the policy choices of Korean leaders are shaped by the interaction of institutional constraints and opportunities, the domestic and international context, ideas and coalition politics; and secondly, how Korean leaders act strategically to implement their policy choices.**

**To realise this research objective, I focused my analysis on the political, economic and social dynamics behind the creation, consolidation and transformation of the rules embedded in the system of socialisation of private risk, at the core of the Korean developmental state. Underlying the analysis were four major questions:**

- (1) What drove Korean political leaders during the early 1960s to create and develop the system of socialisation of private risk, which became associated with the country's successful economic performance?**
- (2) How did the rules sustaining the system mould the behaviour of contending groups in Korean society, in particular the Korean executive?**
- (3) How did these rules influence the distribution of power and, with what consequences in terms of policy and political outcomes?**
- (4) Why and how did Korean leaders since the early 1990s move to transform the rules of the game of the system, and with what policy and political consequences?**

**This study then looked at two major periods where Korean Presidents actively pursued institutional change with a major impact on the country's economic growth and development. The first period covered the presidency of Park Chung Hee (1961-1979) where I examined the formation and consolidation of the system of socialisation of private risk. The second period encompassed the presidency of Kim Young Sam (1993-1997) where I explored Kim's initiatives to transform the rules of the game embedded in this system in the period preceding the IMF crisis in 1997.**

**The discussion of the pre-1980s period was seen as important to highlight the significant features and institutional path dependencies built in the previous two decades and how their outcomes eventually moulded Kim Young Sam's policy choices as he sought to reform the Korean developmental state.**

**I took a three-tiered approach to examine the policy process in each period. First, I described the features of the institutional and policy reforms undertaken during the presidencies of Park Chung Hee and Kim Young Sam, respectively. In the second tier, I explored the decision-making process and how the strategies and choices of these Korean leaders to pursue such reforms were shaped by the interaction of institutions, history, context and ideas. Finally, at the third tier, I analysed the implementation phase and the strategies configured by Park and Kim to put into effect the reformist initiatives. For each presidency, I use a case study to trace how the decision was designed, negotiated and implemented.**

**The first period, covering the presidency of Park Chung Hee (1961-1979) was examined in Chapters Three and Four. In Chapter Three, I showed how Park Chung Hee behaved as an agent of historical change by actively seeking the formation of the system of socialisation of private risk. I argued that shaping Park's political strategy to form the system of socialisation of private risk was: (1) the institutional legacies of Syngman Rhee and Chang Myon; (2) the country's difficult economic conditions and U.S pressure for economic reform; and (3) the ideological motivation to pursue state-led economic nationalism and a 'growth-first' economic policy.**

**Thus, Park created the system by redefining the role of the Korean state and strengthening his autonomy and capacity through four main strategies: (1) the concentration of power in the executive; (2) the development of effective clusters embracing professional economic**

**bureaucrats; (3) state control of the financial system; and (4) an alliance with bureaucrats, farmers and business groups. The institutionalisation of the system, however, rested on the capacity of Park Chung Hee to maintain the system through a credible commitment to an alliance with bureaucrats, farmers and the *chaebol*. This credible commitment was comprised of more than incentives. Penalties would also be applied if, for example, bureaucrats or *chaebol* failed to attain, or comply with, certain planned targets or guidelines.**

**Chapter Four assessed a particular case of policy reform, the heavy and chemical industrialisation in the 1970s, as a way to trace in detail why and how President Park behaved strategically to design, negotiate and implement the HCI and with what political and economic consequences. First, I argued that Park Chung Hee's decision to push for HCI was moulded by: growing domestic economic and political problems; rising international protectionism and competition; a changing security environment and; a nationalistic-oriented ideological drive to develop a rich nation with a strong army. Afterwards, I showed how the need to pursue and implement HCI during the 1970s led Park Chung Hee to act strategically to consolidate the system of socialisation of private risk". In this sense, the system served well as an institutional opportunity to help reshape the country's industrial structure.**

**The consolidation of the system involved guaranteeing the cooperation of the bureaucracy and the *chaebol*. Park not only succeeded in rallying the economic bureaucracy, but also the *chaebol* in support of the new industrial strategy. The cooperation of the latter only emerged after Park managed to overcome the *chaebol's* initial resistance born from the fact that they saw their inexperience in the sector as a potential financial and economic liability. The regime led by Park showed that it was ready to respect its role within the system of socialisation of private risk. Park did this by rescuing the debt-ridden corporate sector (through an emergency order) and offering them financial benefits to get involved in the HCI. Nonetheless, the concentration of the country's resources in**

**the HCI and in the *chaebol* that had been selected to participate in the new industrial strategy produced significant policy and political outcomes, especially in terms of power distribution within the system. Ultimately, the new industrial strategy pursued by the Korean state made the country's economy structurally dependent on the *chaebol's* economic performance.**

**Within this context, the *chaebol's* capacity to negotiate the rules of the game within the system of socialisation of private risk increased vis-à-vis the state. This was further exacerbated by the *chaebol's* growing control of non-banking financial institutions (NBFIs) that began to surface in the early 1970s, following the emergency order to deal with the curb market. Since the NBFIs were given greater freedom in the management of their financial resources, *chaebol's* access to these financial institutions reduced the conglomerates' dependence on state-controlled banks. This allowed the *chaebol* to escape the disciplinarian measures of the Korean state (usually based on the threat to block access to state-controlled finance). Additionally, fearing the potential credit penalties less, the *chaebol* became less restrained by the executive's economic guidelines. In sum, policy and political outcomes of the HCI represented the first signs of a shifting in the power equilibrium within the system and in political rearrangements that eventually led to institutional change. As shown in Chapters Five and Six, as the *chaebol* strengthened their power vis-à-vis the Korean state, their growing economic concentration began to emerge in the early 1980s as a thorny issue. The country's policymakers increasingly saw the need to deal with the situation, not only due to the economic imbalances it had produced but also in response to the society's demands for a more fair distribution of wealth.**

**The second period covered by this thesis examined the presidency of Kim Young Sam (1993-1997) in Chapters Five and Six. In Chapter Five I showed why and how President Kim Young Sam, as an agent of historical change actively sought to transform the Korean developmental state and**

**with what political and economic consequences. He pursued an anti-corruption campaign, sought to cut ties with past military regimes, attempted to forge new laws to fight manipulation of voters and promote fairness during the electoral process, and re-structured the administrative apparatus. Additionally, the new economic plan involved the deregulation, privatisation and internationalisation of the country's economy, along with a policy to curb the economic power of the chaebol.**

I argued that informing Kim's political strategy was: (1) the institutional legacies of former presidents Chun Doo Hwan (1980-1987) and Roh Tae Woo (1988-1992); (2) moral codes of behaviour and the ideological motivation to pursue democratic reform; and (3) a need to respond to changes in the international trade and economic arena. However, unlike Park Chung Hee, the reformist project led by Kim Young Sam met two major shortcomings: first, Kim's weak economic leadership produced inconsistent policy decisions; and second, in his attempt to implement reform from above, Kim committed the strategic failure of not building a coalition in support of the initiative. The majority of the Korean population, including certain sectors within the bureaucracy and business, strongly supported the reform drive by the presidency of Kim Young Sam as demonstrated by his popularity ratings in the first years of his term. However, the methods adopted by the government to promote the reforms failed to clearly identify who could be the major beneficiaries in order to gain their support for the policy changes. In the absence of adequate and proper information about the reforms, the potential beneficiaries failed to be convinced and persuaded about the need to support the government in their institutionalisation.

**In the Korean political system, the President is expected to lead the policy process in its various stages; from policy design to implementation. Kim Young Sam, unlike Park Chung Hee, provided weak leadership in the policy process by failing to commit himself to the several stages of the process. Kim's lack of a systematic vision on how to**

**reform the economy became evident during his term of office. He not only preferred to delegate authority to his staff in the Blue House, but also constantly reshuffled the position of Deputy Prime Minister (DPM), the country's top economic position. With an average tenure of less than eight months for each DPM, it became practically impossible for the MOFE to formulate and implement consistent policies.**

**Furthermore, by advocating a smaller and less interventionist state, whether through bureaucratic re-organisation or financial liberalisation initiatives, the administrative and economic reforms undertaken by Kim Young Sam had the effect of weakening the power of the state. The reforms, however, not only failed to produce a more effective policy coordination, but also reduced the capacity of the state to intervene in the chaebol's inefficient management through industrial policy and financial control. This explains why a supposedly strong and disciplinarian state failed to intervene to check on the chaebol's over-investments, rapid overseas expansion and heavy foreign indebtedness, as well as failing to supervise financial institutions in the period right before the financial crisis.**

**Additionally, driven by Confucian moral codes, and the Korean traditional political culture, Kim Young Sam decided to push the reform from above, i.e., by administrative fiat, without seeking to build a supporting coalition to help push for the policy agenda. The rationale behind this approach was: As long as Kim's moral integrity remained intact and popular support, measured in terms of popularity ratings maintained high levels, the implementation of reforms could succeed. Yet, it was a risky strategy because when his moral legitimacy began to erode in the aftermath of a series of scandals, Kim's leadership weakened and, without a reliable and supporting coalition, the implementation of the reforms became more difficult. Furthermore, Kim's reforms faced the constraints imposed by the system of "socialisation of private risk".**

**The executive's policies towards the *chaebol* well illustrated the constraints faced by the reformist strategy followed by Kim Young Sam. As had already happened earlier with Chun and Roh, Kim decided to abandon cooperative ties with the *chaebol* and sought to curb their economic concentration in response to the growing social demands for economic justice. However any attempt to transform the path-dependent development patterns set during the 1960s and 1970s as a policy and political outcome of the system of "socialisation of private risk" proved to be a difficult task. The *chaebol* had succeeded by strengthening their political leverage through political donations to the country's policymakers and politicians. Additionally, the *chaebol* had become a predominant economic player as the country's main vehicle for economic recovery and growth.**

**Therefore, governmental efforts to impose credit limitations to discipline the *chaebol* and induce them to comply with administrative guidance were ineffective. Not only could the *chaebol* resort to NBFIs but also to overseas financing, further facilitated with the government's financial liberalisation program. By failing to gain the cooperation of the *chaebol* to undertake the corporate reforms, as well as failing to discipline the *chaebol* for resisting them, the executive increasingly failed to supervise and monitor the behaviour of the country's major conglomerates. Resisting the reforms, the *chaebol* rapidly expanded their investment, which resulted in over-investment and high indebtedness that eventually undermined the stability of the recently liberalised financial system.**

**Chapter Six investigated in-depth a specific reform, the real name financial transaction system in 1993. This was an attempt to clearly understand why and how the presidency of Kim Young Sam designed, bargained and implemented the new financial policy and with what political and economic outcomes. The implementation of the real name financial transaction system was expected to radically change the nature**

**and the relationships within the system of “socialisation of private risk”. It would make the financial system more transparent to give the authorities increasing capacity to investigate the sources of funds hidden behind false names that had informally tied government officials, politicians and businessmen. Additionally, the new financial policy involved the introduction of a more comprehensive taxation system that would tackle the issue of tax evasion and deal with the society’s calls for a fairer distribution of wealth. Finally, it would offer the government further power to manage financial policies, as the introduction of a real name financial system was likely to curb a secretive, informal and unregulated financial market.**

**In this chapter, I first argued that Kim Young Sam’s choice to implement the new financial policy was shaped by the changing perceptions of the legacies of the false name financial system as its legitimacy began to be subjected to public inquiry and criticism following a series of scandals. Further influences were: the policy process and political lessons from the failed attempts to institutionalise the real name financial system by Chun Doo Hwan and Roh Tae Woo; and Kim’s ideological and moral motivations to seek clean politics and a just society. For the reform to succeed it would be necessary for some type of negotiation and agreement between major actors within the system in the face of their potential resistance and opposition to the end of built-in ‘spoils’ over decades. By specifically aiming at fighting tax evasion and illicit political funds, the reform was, in fact, expected to negatively affect government officials, businessmen and politicians.**

**However, Kim Young Sam preferred to go ahead with the reform without first forging a coalition. The issuance of a presidential decree was a strategic move to overcome the potential resistance that could emerge in the National Assembly as had happened during the regimes of Chun and Roh. The success of the strategy, however, depended on the maintenance of Kim’s moral legitimacy to enforce the reform. However**

**when that moral legitimacy started to wane, in the absence of a reformist-oriented alliance, Kim's capacity to institutionalise the real name financial transaction system became more difficult.**

**This examination of the policy experiences of Park Chung Hee and Kim Young Sam reveals that to understand the policy workings of the Korean developmental state, it is crucial to take into consideration the role played by leadership. This thesis does so by: advancing our insight of the variables accounting for the actions of Korean political leaders that inspired them to commence processes of institutional change; the motivations and preferences that led them to favour and consolidate some institutions but not others; the strategic actions, whether or not successful, they pursued to implement their choices; and the impact of institutional change on the country's political arrangements.**

**In concluding this last chapter, I first analyse the new insights brought by historical institutionalism to our understanding of Korean development, and secondly I examine the significance of the Korean case to advance the historical institutionalist perspective. This will serve to suggest new research directions that could help overcome the weaknesses of the developmental state and institutionalist perspectives and open the possibility for a better and more comprehensive explanation of the political economy of growth and development in Korea.**

**The developmental state paradigm has offered an important contribution for the understanding of the role of the Korean state in nurturing economic growth and development. The paradigm often constructs a model of the Korean state underlining the role of an autonomous, capable, united and coherent bureaucracy that selected and implemented policy goals that did not necessarily mirror the dominant interests in society. However, by clinging to this idea of the Korean state, the paradigm commits an important analytical oversight. Autonomy and capacity do not necessarily come together. The state might have the**

**autonomy to choose policies, but it might not have the capacity to implement them.**

**In its attempts to reify the role of the state, the statist paradigm weakens the explanatory power of the state by presenting a limited interpretation of its structure and strength. This is due to the tendency to overlook the multiple, dynamic, complex and interactive ties within the state apparatus, and between this apparatus and the society.**

**Historical institutionalism has allowed us to go beyond the idea of a reified state, at the core of the developmental state perspective, to emphasise the role of the institutional framework, ideas and historical context in structuring politics. Within this view, institutions, ideas and context affect the capacity of governments to enact laws and implement policies, to mould the perceptions, preferences, actions of individuals or groups, as well as to structure the dynamic power relations between the varied and multiple actors within the state machine and between these and other individuals or groups in society. Institutions are also path-dependent, i.e., institutions are relatively enduring features that by carrying development along a particular trajectory make future changes more difficult.**

**In this sense, the two historical moments of institutional change analysed in this thesis show clearly how an institutional arrangement shaped by a particular historical context and ideology, i.e., the system of socialisation of private risk, influenced the political arrangements and dynamics embedded in the Korean policy process. The system that emerged during the presidency of Park Chung Hee strengthened the capacity and autonomy of the Korean state to design and implement economic policies. Nonetheless, the successful implementation of the policy initiative rested on Park's carefully orchestrated balance of power between several actors: presidential office, business groups, bureaucrats and farmers. At the same time, by organising power relations, the system**

**of socialisation of private risk increasingly framed the perceptions, preferences and actions of the involved parties in the country's policy process.**

**Thus, the success of the system depended on the capacity of the state to support its maintenance through a credible commitment to an alliance where the presidential office, bureaucrats, *chaebol* and farmers exchanged political and economic favours. This credible commitment involved positive incentives as well as penalties. For example, bureaucrats were offered promotions in return for success in achieving performance targets. However they could also be sacked if they failed to attain planned targets. Meanwhile, the *chaebol* traded economic performance and political funds for financial incentives, tax savings and tariff protection. Conversely, if they attempted to escape administrative guidance, they could face tax investigations or even access to credit blocked by banks.**

**Ultimately, the system of socialisation of private risk which was institutionalised to set the country's growth and development path depended on the economic performance of the country's business conglomerates. This had the effect of curtailing institutional change as it was discovered by President Kim Young Sam. The country's administrative and economic reforms pursued during his leadership between 1993 and 1997 emerged as a threat to the equilibrium that had long sustained the system of socialisation of private risk by challenging one of its core features: cooperative ties between the bureaucracy and *chaebol*. For example, while badly managed bureaucratic re-organisation led to growing dissatisfaction among civil servants with the country's leadership, policies aiming at curbing economic concentration, by the *chaebol*, such as credit limitations, were strongly resisted by the family-owned conglomerates. Without the support of what had been a strategic alliance and fundamental to make the reforms viable, Kim's attempts to build a 'New Korea' were marred by policy inconsistencies and failures**

**that ultimately contributed to the financial crisis in 1997. What historical institutionalism shows is that for institutional reform to take place it is crucial to build a supporting coalition, and in the case of Kim Young Sam, though he acted as an agent of change, his failure to build strategic ties with other state and social actors in the implementation process contributed to stalling the reforms.**

**Historical institutionalism also provides an opportunity to go beyond the tendency of the developmental state perspective to build a static view of the state in terms of its autonomy and capacity, when these features should be regarded as transient. State domination over society is far from being a fixed condition in Korea. It varies over time and space, depending on institutional constraints and opportunities, historical legacies, context, ideas, coalition politics and how the dynamic interaction of these variables impact on the strategic behaviour of political leaders in the process of designing, negotiating and implementing public policies.**

**While historical institutionalism suggests new ways to look at the political dynamics involved in the Korean policy process, the analysis of Korea's development history also suggests three ways in which this theoretical framework can be enhanced:**

- First, by showing how Korean leaders strategically pursued institutional change, whether or not with success, I have shown a need to develop a stronger conception of the role played by agency in political and policy outcomes, i.e., actors are not only subjects but also agents of institutional change. This approach allows us then to address the ambiguous mode through which historical institutionalism interprets the recurrent ontological debate in social sciences, i.e., the nature of the relationship between institutions and individuals. The Korean case reveals how political leaders, despite the**

**constraining institutional scenario, strategically undertook reformist programs to become architects of institutional transformation;**

- **Secondly, historical institutionalism regards institutions as path-dependent and therefore decisions taken at some point in time can limit policy choices in the future. But this path-dependency has policy and political outcomes that may lead to the collapse of institutional equilibrium and produce change. In Korea, the institutionalisation of the system of socialisation of private risk had the effect of leading to economic concentration by the *chaebol* and subjecting the country's economic growth and development to their business performance. It was this situation that led to growing criticisms and protests by the country's society in the late 1970s demanding economic policy change and which strongly influenced the ideological paradigm shift from 'growth-first' to 'fairness distribution of wealth';**
- **Finally, historical institutionalism is essentially a theory set to explain policymaking in industrialised and western nations where interactions within the policy process between the different state and social actors tend to be relatively transparent. The Korean case provides, however, an opportunity to apply historical institutionalism to developing and non-western nations by incorporating one of their major features: informal politics, i.e., the interactions between a complex state and society that are not formal, visible and traceable.**

**As seen in the case of Korea, the strategic actions of political leaders to pursue their motivations and preferences are important and deserve further analysis, but just as important, and ever more pronounced**

**in the face of the country's democratisation, and therefore in need of further research, is the role played by other actors such as bureaucrats, businessmen, members of the National Assembly and civil society and how they behave during the policy bargaining and implementation process.**

**This thesis makes the case that studies of the state cannot ignore the fact that state autonomy and strength are the outcome of the dynamic and complex exchanges between the state and society. Therefore, state strength and autonomy is neither absolute nor stagnant, but will vary according to the capacity demonstrated by political leaders to negotiate conflict and settle a compromise in multiple political, economic and social arenas.**

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