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A legitimate paradox: neo-liberal reform and the return of the state in Korea

David Hundt

School of Political Science and International Studies
University of Queensland
Brisbane
Australia

Telephone: 61 7 3365 3217
E-mail: s4014111@student.uq.edu.au

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A legitimate paradox: neo-liberal reform and the return of the state in Korea

David Hundt
University of Queensland

This paper examines the neo-liberal reforms that the Kim government implemented in post-crisis Korea. It argues that by embracing the reforms, the state, paradoxically, re-legitimised itself in the national political economy. The process of enacting the reforms completed the power shift from a collusive state-chaebol alliance towards a new alliance based on a more populist social contract - but one that nonetheless generally conformed to the tenets of neo-liberalism. Kim and his closest associates identified the malpractices of the chaebols as the main cause of the crisis, so reforming the chaebols would be the key to economic recovery. Combining populism and neo-liberalism, they drew on support from both domestic and international sources to rein in, rather than nurture, the chaebols.

I. INTRODUCTION

This paper investigates the role of the Korean state in the post-crisis era, particularly in relation to its stewardship of the neo-liberal reforms required as a condition of the IMF loan package. It argues that the process of neo-liberal reform has contributed to a reformulation of power relativities in the national political economy, but contrary to the expectations of some, state elites - particularly the president and bureaucrats who were not products of the now-defunct Economic Planning Board (EPB) - appear to be the main beneficiaries. The paradox that emerges is that neo-liberal reforms do not necessarily weaken the influence of state elites; the case of Korea indicates that some elites grasped an opportunity to
regain leadership of the economic policymaking agenda.

The pro-reform state elites have followed a different logic to that of earlier periods of industrialization, enthusiastically pursuing the liberalisation of financial markets and industrial restructuring while also implementing the framework for a rudimentary welfare state, instead of focusing on incentives for corporate investment. Rather than sounding the death knell for the state, the post-crisis period has witnessed the ongoing transformation of what E.M. Kim [1997] and Henderson [1993] term a developmentalist, ‘plan-rational’ state to a ‘market-rational’ one. While economic development continues to be its main priority, the state’s *modus operandi* has changed considerably. Despite strong opposition from the chaebols, the state reinvented itself as the facilitator of financial and industrial restructuring.

This paper advances the propositions outlined above through a range of interrelated arguments. First, it is argued that in a maturing and increasingly sophisticated economy, the state needed support from both domestic and international actors to regain control of the economic policymaking agenda. This entailed both appeals to populism and the adoption of neo-liberal reform. The was a new social contract whose primary focus would be on the welfare of the national economy, even if that necessitated anti-chaebol measures or the involvement of foreign capital - notions anathema to the traditional Korean developmental paradigm. Next the paper notes that the process of neo-liberal reform began well before the outbreak of the crisis, and that a significant portion of the impetus for reform came from Korean political and economic elites rather than external actors such as the IMF. The crisis was an opportunity to intensify earlier reform
measures. Further, the state’s success in re-legitimating itself was in at least in part due to the support of the public, who were vehemently opposed to the chaebols’ continued dominance of the economy. The strong anti-chaebol sentiment shared by the Kim government and the public resulted in attempts to rein in, rather than nurture, the chaebols. Thus the breakdown of the traditional alliance between the state and business, and the transition to the new social contract, are features of the post-crisis period. The paper concludes by briefly exploring the implications of these developments.

II. THE STATE IN THE PRE-CRISIS PERIOD

This section provides a brief sketch of the Korean ‘developmental’ state prior to the 1990s - a period in which neo-liberal reform was pursued more extensively than is often acknowledged. The paper argues that the Korean state lost its sense of developmental purpose - and legitimacy - during the 1980s; thus the attainment of a new sense of purpose was all the more significant in the post-crisis period.

In the literature devoted to Korea’s modernisation, a common theme had been that the developmental state had the unique ability to master market forces and harness them for industrialisation. Wade [1990] for instance claims that in a ‘governed market,’ the state steered investment into priority sectors; this would not have occurred under purely free market conditions, where investment decisions are almost entirely the remit of the private sector. According to Amsden [1990: 16], a judicious combination of incentives and disincentives (‘support and discipline’) produced the optimal level of competition amongst the chaebols while also
ensuring that the needs of the wider economy were met by stimulating trade and investment. In a similar manner Kim Yong Hwan, a policymaker during the early phases of industrialisation, writes of the state’s stewardship of the heavy and chemical industry drive in the 1970s that “the policy would deliver the optimal results in all perspectives - that is, the mutually disciplining and supporting relationship between economic rationalisation and technological rationalisation” [Y.H. Kim 2003]. That is, state “got the prices wrong” in order to make particular industries, such as automobiles, steel and shipbuilding, profitable [Amsden, 1989].

Nonetheless, the developmental state model depicted above faced opposition from several quarters, starting in the 1980s. First, the US intensified efforts to open the product and financial markets of Korea and Japan once these countries attained relative prosperity and with the waning of the cold war in Asia [see Cumings, 1998]. Also opposed to state-led development were the international financial institutions (IFIs), especially the IMF. The IFIs were the main instruments available for resolving economic crises in Latin America in the 1980s and again in 1994-95. Equally important, the IFIs’ ‘prescriptions’ for recovery drew chiefly upon the ‘Washington consensus,’ which sought to eliminate the statist development paradigm in developing countries, and to impress upon them the benefits of shifting to a market-based economy [Williamson, 1999: 252].

The anti-statist rhetoric emanating from the IFIs and Western governments began to manifest itself within Korea in the form of pro-reform policymakers who called for the reduction or abolition of many of the traditional elements of the developmental state. Industrial policy, which illustrated most clearly the tendency of the developmental state to involve itself in micro-level decisions, was anathema
to advocates of neo-liberal reform. Crucially, the 1980s also witnessed the
democratisation of the Korean body-politic, and some features of the military-
authoritarian state were in the process of reform. Most notably, from the
viewpoint of this paper, the locus of policymaking changed from the Economic
Planning Board (EPB) - traditionally a stronghold of bureaucrats who advocated a
greater role for the Park Chung Hee-era developmental state - to the Ministry of
Finance and Economy (MOFE), whose predominantly Western-educated
bureaucrats pursued more pro-market policies [J.-H. Kim 2000]. This symbolic
change resulted in the policy instruments favoured by the EPB being largely
abandoned (and the EPB itself dismantled) by the early 1990s, significantly
reducing the state’s capacity to intervene in the economy. This development was
accompanied by a concomitant rise in the influence of the chaebols [Chang,
1998b].

This reduction in the influence of the state - and increase in that of the chaebols -
amounted to the *de-legitimation* of the state’s role in the national economy.
Legitimacy, according to Seabrooke [2002: 23], “involves the contestation of
power between state and society.” This contestation does not merely involve the
attainment, use and retention of resources: it also entails the shaping of the policy
agenda and the ascription of an ‘appropriate’ role to the state. The norms and
material interests of society influence the contestation of power, and thus
determine the degree of legitimacy of the state at a given point in time [Seabrooke,
2002: 2-3]. Likewise, this paper contends that the dominance of the neo-liberal
paradigm, both domestically and within the IFIs and Western governments,
assisted proponents of reform in the battle for ideas about the role of the Korean
state. In particular, the proponents of reform - who included the IMF, the US government, the chaebols and, increasingly, the chiefly US-educated MOFE bureaucrats, arguing that the state should be relegated to a supervisory role, through which it would facilitate the development of the economy as a whole, rather than be involved in sectoral industrial policies [Weiss, 2003].

State institutions, it has been claimed, are often “time-limited in their effectiveness.” Institutional arrangements undergo “a process of growth and decay... some of the positive synergies that occurred during a phase of expansion can turn negative under changing historical circumstances” [Block, 1986: 182]. In short, the institutions that serve society at one point in time may need to be reformed to retain their effectiveness. As the case of Korea in the post-crisis period demonstrates, it was possible for the state to regain legitimacy by adopting the dominant contemporary ideology (neo-liberalism), and altering its institutional form accordingly. Specifically, state leaders played an active role in the resolution of the financial crisis of late 1997. Kim Dae-jung and his chief ministers facilitated neo-liberal reform in order to re-legitimise their position in the national political economy, from which they would be able to continue exercising a significant degree of influence on the policymaking agenda.

III. THE REFORM PACKAGE

This section of the paper outlines the reform agenda that the Kim government negotiated with the IMF in return for a loan of sufficient scale to cover Korea’s short-term debts. What should be noted, however, is that the government did not
wholly oppose these reforms: indeed, the measures that were pursued largely coincided with the policies that incoming President Kim Dae-jung had long championed. As will be discussed further, Kim and senior officials became more than just willing accomplices to the IMF during the crisis; they oversaw a comprehensive attempt to wrest control of the national economy back from the chaebols, which were widely blamed for causing the crisis in the first place.

First, the government tightened fiscal and monetary policies in order to reduce inflation and the budget deficit. Taxes were raised, and funds diverted from defence to welfare, in preparation for the anticipated increase in unemployment [Park, 2002]. Second, the government reorganised the functions of the state. Launched with the goal of creating a ‘smaller but more efficient’ government, the re-organisation transferred the functions of some ministries to local governments and lower-level civil servants, furthering the efforts of the previous government to democratise the state apparatus [No, Lee et al., 2002: 380-381]. Other aims of public sector reform were a reduction in the size of the public sector workforce, the privatisation of state-owned enterprises, the introduction of ‘performance-based’ pay and employment systems for public servants, and the delegation of more control over economic policymaking to the executive and prime minister [E.M. Kim, 1999: 43-46; Na, 2003: 298].

A third plank of the agenda was labour market reform, since the IMF considered ‘flexibility’ to be vital if industrial restructuring was to proceed. It was argued that some jobs would inevitably be lost during the restructuring of the chaebols. The ‘Tripartite Commission on Industrial Relations,’ formed in January 1998 with the goal of improving flexibility, resulted in the major trade union federations
agreeing to layoffs in ‘unavoidable’ circumstances [S.-J. Kim, 1998: 135]. In return, unions were granted permission to engage in political activities and to extend their coverage to the public service and education [Park and Park, 2000: 86]. While the revision of the Labour Relations Law in March 1997 had resulted in trade unions acceding to the notion of limited job security in return for greater freedoms for union activity [No, Lee et al, 2002: 376-377], the IMF reforms removed almost entirely the expectation of job security. The government also established a $4.4 billion fund to compensate for job losses resulting from restructuring. Another outcome of the tripartite talks was the legalisation of ‘dispatch centres,’ which were responsible for employing workers on short-term contracts for less than regular wages [Kwon and O’Donnell, 1999: 279].

Fourthly, financial sector reform was pursued, the main goal of which was to increase the level of competition among financial institutions. Introducing foreign competition to the financial sector would, the IMF claimed, raise the overall performance of the sector and encourage the closure of insolvent institutions. At the same time, the financial condition of many institutions was impaired by non-performing loans, so their overall performance was poor. After initiating a process of rationalisation, the government re-capitalised the surviving institutions. The net effect of these changes, it was claimed, would be a more competitive, better-capitalised and market-oriented financial sector [Choong, 2001: 461; Haggard, 2000: 149]. The independence of financial supervisory agencies was also enhanced, with the IMF advising the government to grant full independence to the Bank of Korea, which it had not hitherto enjoyed. A new supervisory agency, the

Finally, the reforms targeted the management of the chaebols (governance) and their production processes (restructuring). Improvements to corporate governance would involve the ‘five-plus-three’ principles. The initial five principles were: greater transparency, better accounting and reporting, greater accountability by owner-managers, abolition of mutual guarantees among chaebol affiliates, and a streamlining of the chaebols’ operations. The government later announced additional measures to improve corporate governance. Financial market supervisory agencies were to more rigorously oversee the chaebols’ control of non-bank financial institutions (NBFIs), a source of much of their credit, as well as inter-subsidiary investments. In addition, illicit collaboration was to be dissuaded by preventing ‘irregular inheritances’ and gift giving among chaebol owners [Mo and Moon, 2003: 128-132].

To emphasise the need for industrial restructuring, the IMF argued that one of the main causes of the crisis was low profitability, which in turn was the result of over-capacity and excessive investment in industries such as shipbuilding, automobiles, electronics and semiconductors. In the words of Kim’s first Minister for Finance and Economy Lee Kyu-seong, “Companies, in the past, had a finger in every pie and concentrated on expanding their power quantitatively but now that kind of indiscriminate expansion is instead acting as a burden” [Song, 1999: 97]. The proposed remedy to this problem was the elimination of surplus production capacity, in the form of the outright shutdown of plant and equipment, asset swaps between chaebols in similar industries (‘big deals’), as well as ‘workout
programs,’ which involved an injection of public funds to re-capitalise the chaebols in return for the elimination to the practice of mutual debt guarantees between chaebol affiliates [Cumings, 1998: 63-64; Choi, 2002: 268; Shin, 2000: 191-194].

IV. LEARNING TO LOVE THE IMF?

The reforms had an all-pervading effect on the Korean economy. Some commentators have referred to the IMF reforms as a ‘mistake’ imposed on an unwilling country under crisis conditions. Feldstein [1998], for instance, chides the IMF for overstepping the mark during the crisis by insisting that crisis countries undergo major structural and institutional change. Radelet and Sachs [1998: 18-20], meanwhile, claim that macro policies were generally sound and that the crisis was attributable mainly to the destabilisation of international financial markets due to investor panic. The response to the crisis should have been more moderate, it is argued; instead of over-reacting and requesting wide-ranging institutional reform [Wade, 1998], the IMF should have calmed markets and allowed the crisis countries to resume growth while implementing regulatory reforms that would have helped their financial systems resist sudden shifts in capital flows.

The purpose of this paper, however, is not to assess the severity of the reform package. Bustelo [2000] performs that task adequately. Instead, it is argued here that to castigate the IMF for the reforms is to ignore the point that Korean officials were not only highly complicit in the implementation of the reforms; they were
more than willing to accept the chance to refashion the national political economy in line with the reforms. Even prominent defenders of the statist paradigm such as Chang [1998a, 1998b] and Chang, Park and Yoo [1998] note that the IMF reforms were only an extension of the Kim Yong-Sam (1993-98) government’s efforts to roll back the developmental state’s most characteristic elements such as restrictions on duplicate investment - which, as will be seem later in this paper, were not enforced when Samsung entered the car industry. According to these scholars, the crisis could be attributed more to policy failure by the Kim Yong-Sam government than structural factors such as external pressure from the US.

Accordingly, it is pertinent to note that Kim Dae-jung and his senior economic ministers consistently articulated a tough policy on chaebol reform, calling for a complete overhaul of the extant model of state-business relations. In the view of Kim’s appointee as head of the Bank of Korea, “we should have transformed quickly in the early 1980s... we basically failed in the transition to a new market economy system” [Bu and Jang, 1998: 221]. Kim’s then finance minister Kang Bong-gyun summarised the government’s approach to economic policy as “getting rid of the factors that have prevented the market mechanism from working over the past few decades” [Kwon, 2000: 76]. Even before taking office, Kim indicated that the privileges offered by previous regimes would be withdrawn. At a press conference on the day after his election, Kim [1997] enunciated his preference for a market economy, claiming that his government would “totally rescue all firms from the chains of power and from the protection of power... only firms that adapt to the market economy and are victorious in global competition will survive.” According to one insider, Kim would have
pursued the sort of reforms that the IMF had demanded even if the financial crisis had not occurred: “When President Kim was running for office, he once said in private ‘it’s worked out for the best’ after the IMF demanded that the chaebols be reformed” [Yun, 1999: 272]. That is, the president-elect believed that reckless investment on the part of the chaebol had imperilled not only the conglomerates but also the entire national economy. Ending this outdated system, with its high associated social and political costs, would be a high priority.

Lee Kyu-seong, claimed that previous governments and the chaebols were jointly responsible for the crisis - a claim that would be repeatedly heard as the post-crisis period wore on. In his view, the crisis was attributable to the accumulated ills of an ‘authoritarian political-bureaucratic economy (gwanchi gyeongje)’, which Lee claimed delayed the development of democracy and a functioning market economy; a faulty ‘globalisation’ policy, which had opened financial markets but not introduced the market principles of responsibility and punishment; and the failure of the chaebols to restructure in response to the changing conditions of the global economy [K.-H. Kim, 1998: 169-170]. For Kim Dae-jung’s economic team, then, reform was inevitable. As Lee commented elsewhere, “there isn’t really any response apart from the policies prescribed by the IMF” [Song, 1999: 93].

If the political economy were altered in this ways that the incoming government was proposing, it would have represented a significant change from the uniquely Korean situation of the past, when firms with a weak capital base grew on the basis of government favours and close ties with political leaders [Yoon, Kim and Lee, 2003: 358-359]. This system, referred to as jeonggyeong yuchak in Korean, is
precisely the set of arrangements that Kim Dae-jung’s government sought to bring to end through the reform drive after the crisis.

While it is possible to argue that the *raison d’être* of the Korean state has changed markedly in the wake of the neo-liberal reforms, this paper contends that the crisis and reforms expedited changes that were already underway. Crucial support for a change to the statist paradigm came from both the US-trained technocrats and the Kim Yong-Sam government which came to power in 1993. This trend became even more apparent with the inauguration of Kim Dae-jung as president. Gradually, the ideological and institutional bases of strategic intervention in the political economy eroded, resulting in a form of liberalisation that sought to weaken the developmental role of the state [Weiss and Hobson, 2000: 62].

To illustrate this change in the role of the state, this paper refers to what E.M. Kim [1997] describes as the shift from a ‘comprehensive’ to a ‘limited’ developmental state. According to Kim, a comprehensive developmental state (CDS) is ‘plan-rational’ rather than ‘market-rational’, meaning that the state focuses on development rather than regulation. The CDS, Kim claims, caters to the economy’s long-term interests by supporting the private sector during its infancy. As the sophistication of the economy increases however, it is more difficult for the state to perform these tasks, because firms seek greater autonomy from the state. Instead, the state plays a supervisory and regulatory role, transforming in the process from being ‘pro-business’ to ‘pro-market’. In other words, the structural transformation of the economy determines the role of the state. Further, the state’s ‘structural power’, or the power that the state (and other actors) possesses on the basis of its position in the political economy, allows the state to act against
business for the good of the national economy [Block, 1992: 284]. This implies that the state will be less concerned about promoting the interests of specific firms (as was the case in the past); instead, the interests of the economy as a whole become paramount. By acting to further these broader interests the state is able to regain legitimacy as a participant in the political economy: that is, because it is seen to pursue national rather than sectoral interests.

In the Korean context, the changing role of the state can first be illustrated by the manner in which the state was able to regenerate the confidence of international lenders on behalf of the chaebols by linking domestic and international capital markets. For instance, it brought liquidity back into the financial system by agreeing to the IMF reforms in return for a resumption in lending from international financial institutions [Haggard, Lim and Kim (HLK), 2003: 318]. In a narrower sense, the state’s regaining of legitimacy, and its exploitation of its enhanced structural power (along with the diminution of that of the chaebols) can be detected in the way in which the government oversaw the process of chaebol restructuring, which symbolised a break from the past - the passing, or at least radical reorganisation, of the chaebol system.

The next section of this paper will provide more specific examples of how the Kim government implemented its agenda for a market economy in the post-crisis period. In particular, it will concentrate on two cases where the state exploited its structural power to rein in the power of the chaebols. In the first, the government sought to restructure a chaebol that was widely perceived to be poorly run (Daewoo) in order to demonstrate that Korea was committed to reform. The second case highlights the government’s efforts to reduce excess capacity in
particular industries by encouraging mergers and asset swaps (the proposed big
deals involving Samsung Motor). This latter case also illustrates the visceral
reaction of the chaebols to the reform agenda.

V. CHAEBOL REFORM: DAEWOO AND SAMSUNG

A clear indication that the developmental alliance between the state and the
chaebols had changed was the handling of the Daewoo Group’s bankruptcy in
August 1999. Hitherto, the state had been reluctant to allow chaebols of Daewoo’s
scale to collapse due to the potential social and economic fallout. The Daewoo
Group represented a particularly egregious case of corporate profligacy, even by
the standards of the chaebols, with the group’s owners resorting to ‘creative’
accounting practices such as revaluing assets, accessing funds through NBFIs and
issuing more equity [D.G. Lee, 2003; Park, 2002: 76]. Daewoo was the ‘Korean
model’ writ small: it relied particularly heavily on overseas borrowing to fund its
expansion, and its financial structure was weaker than most groups. A Seoul-based
foreign banker was quoted as saying: “The Daewoo Group did not have a project
within the group that was earning money... Naturally, it was forced to rely on
foreign loans... Daewoo’s troubles with foreign financial institutions have
worsened its financial woes” [Yun, 1999: 267].

The government’s willingness to publicly criticise the group’s slow progress in
restructuring heightened Daewoo’s predicament. Foreign investors on the lookout
for joint venture partners in Korea took the government’s negative prognosis of
Daewoo’s restructuring proposals as a suggestion that the group was unlikely to
receive new capital injections on favourable terms, and that it might even be broken up [C.-H. Lee, 1999: 262]. According to one government official, Daewoo was the least active chaebol in putting forward a proposal to improve its own financial position, and it seemed to misread the government’s determination to proceed with restructuring. Soon after the crisis, a number of groups published schedules to reduce their debt-to-equity ratios below the government’s target of 200%. Daewoo, in contrast, increased its debt in this period, with the total reaching 59.9 trillion won (about $51 billion) at the end of 1998 - 17.1 trillion won more than the previous year [Yun, 1999: 268-272]. It took Daewoo until early 1999 to realise that its survival was at stake. The government’s warnings were far from subtle on occasions: the chairman of the FSC (and later finance minister), Lee Hun-jai, pointedly stated that Daewoo’s leadership would be removed if restructuring did not proceed in a timely manner. On 19 April of that year, Daewoo’s announced a proposal to restructure itself that appeared to reflect all the government’s demands - unlike its earlier attempts [Lim, 1999: 219-220].

It is likely that the government fully understood the salutary effect that Daewoo’s bankruptcy would have on similarly recalcitrant chaebol owners. Thus, while the government would be both unlikely and unwilling to bear the consequences of a series of collapses on the same scale as Daewoo, it might have allowed a small number of other chaebols to go bankrupt. Other chaebols owners, not wanting to imperil the survival of their groups, heeded the lessons of Daewoo and made more substantive efforts to restructure their operations: by the end of 2000, 17 out of the top 30 chaebols had entered receivership or had undergone restructuring processes such as workouts [Mo and Moon, 2003: 131-136].
The Daewoo case illustrates the Kim government’s pursuit of an initial goal of reform: the lowering of debt levels, which had great symbolic value given the notoriously high levels of borrowing of the chaebols. Samsung Motor, meanwhile, shows how the chaebols responded to attempts to change other aspects of the chaebol system: the governance structures of Korean business groups, especially cross-subsidisation [Lim, 1999: 224]. The peak business lobby, the Federation of Korean Industry (FKI) defended this system by arguing that the chaebols - and the economy - grew rapidly by using profitable business units to subsidise the development of new, less profitable ones. The chaebols claimed that without this ‘convoy system of business (seondansik gyeong-yeong)’, which necessarily tied the fortunes of an entire business group together, it would not have been possible to invest resources in new industries [C.-H. Lee, 1999: 257].

In the case of Samsung, the electronics division had acted as the group’s capital stream in the 1980s and 1990s, and provided the funds to enter the car industry. However a collapse in the price of semiconductors and electrical goods in 1995 and 1996 was to have an adverse effect on the financial structure of the entire group, especially in the wake of the cut-off of international lending during the financial crisis. The Kim Dae-jung government’s prognosis of the ‘chaebol problem’ was that the practice of cross-subsidisation under the convoy system resulted in unprofitable business units dragging down entire chaebols and ultimately the national economy [H.-K. Kim, 1998: 174]. To the government, the Samsung case was a typical example of a profitable activity (electronics) subsidising an unprofitable one (cars) in an industry that suffered from overcapacity. Even worse, in the eyes of the Kim government, Samsung indicated
an interest in taking over Kia, the fourth-biggest carmaker, which had collapsed in 1997 with debts totaling 12.8 trillion won. The government sought to dispose of Kia by selling it to foreign interests, because allowing one of the other established carmakers (Hyundai, Daewoo and Ssangyeong) to take over Kia would only perpetuate the overcapacity problem. Samsung Motor, which only began production in 1998 after spending billions of dollars building a car plant, applied to take over Kia; its rationale was that assuming Kia’s production capacity would ensure Samsung’s survival in the post-crisis period. The perpetuation of this type of logic - the ‘too big to fail’ mentality - was precisely what the government sought to avoid. It instead courted foreign interests without success during 1998 and the first half of 1999, while at the same time proposing that Samsung, as the newest entrant and most unprofitable producer, merge with Daewoo (whose group, as mentioned earlier, in this section faced problems of its own. This proposal came to naught, as Samsung and Daewoo failed to agree on the terms of a merger. Samsung instead declared its motor division bankrupt on June 30 of that year, having produced only a small number of vehicles [Yu, 1999: 256-257].

Following the collapse of Daewoo, the group’s car unit was sold to General Motors. Thus the Samsung case exemplifies the intent of the Kim government to rationalise industrial sectors that it perceived to be uncompetitive, despite its public pronouncements that the chaebols should entirely determine asset swaps and mergers [Song, 1999: 96]. Kang Bong-gyun hinted that reforming, not abolishing, the chaebol system was the goal of the reform agenda: “The government doesn’t want the chaebols to be broken up; it wants ‘changed chaebols’” [Kwon, 2000: 67]. Even if that involved the sale of key industrial
assets to foreign interests, or their outright disposal, the government was intent on reform. Not only did ministers claim that foreign capital would accelerate the reforms launched in 1997, some in the government thought that FDI was essential if Korean financial institutions and conglomerates were to regain international competitiveness in the medium-to-long term [The Economist, 2002: 79; H.-K. Kim, 1998: 176]. Nonetheless, the Samsung Group, unlike Daewoo, was strong enough in its entirety to avoid a forced collapse. It is also worth noting that Samsung, despite its costly and ill-advised venture into the car industry, was generally better managed than Daewoo, so the loss of an industrial conglomerate such as Samsung would patently not be in the interests of the national economy. This may explain the differences between the government's handling of each case.

VI. THE END OF THE AFFAIR?

The Samsung case also showed that the chaebols were not powerless in their response to the reforms in the post-crisis era. Despite ceding a prized asset - its car-making unit, for which group chairman and chief shareholder Lee Keun-Hee had a personal, longstanding passion - Samsung avoided being dismembered like Daewoo. Indeed, it received a handsome reward in return for leaving the car industry: the group was given permission to publicly list Samsung Life Insurance at a price that delivered massive windfall profits to Lee and other key shareholders [Yu, 1999: 258-259]. Nonetheless, the government regained an influential position in the national political economy in the post-crisis period by harnessing the support of both domestic and external actors, and this entailed an overtly hostile
approach to the chaebols, as illustrated in the Daewoo and Samsung cases. Now less dependent on the chaebols for its political survival, the state altered its policy mix to reflect the interests of a wider group of societal actors [HLK, 2003: 311], while faithfully implementing the neo-liberal reform agenda.

In order to muster support from the Korean public, the state reverted to a populist stance, that involved not just casting the chaebols as the villain in the piece, but also casting itself as a neutral, responsible, necessary - and thus legitimate - actor in the national economy. Despite expectations in some quarters that Kim Dae-jung would find common cause with trade unions, his natural constituency was the Korean middle classes; the Tripartite Commission notwithstanding, the government’s political strategy was to reach over the heads of the unions and directly to the public for support. In one of his first public statements after winning the December 1997 election, the president stated that job losses would be inevitable. As Lee Kyu-seong would later comment, “I think that the public must understand that reducing employment by 10-20% through restructuring is a way to prevent a situation where all 100% of jobs are lost to unemployment in the future” [Song, 1999: 91]. The middle classes, who were less likely to be directly affected by layoffs, had traditionally distrusted trade unions, and felt that militancy was inappropriate during a national crisis. Moreover, this section of the public was wary of any party that appeared to share the chaebols’ opposition to reform. The state capitalised on the anti-chaebol sentiment to paint striking workers as anti-reform, and by implication, as working in the interests of the chaebols and against those of the country as a whole.
The chaebols responded to the charge that they, and by implication the chaebol system, were responsible for the crisis with a propaganda offensive of their own. For example Daewoo chairman Kim Woo Choong claimed in a speech soon after the crisis broke out that there was nothing wrong with the chaebol system: “If the big business system is not preserved, in the 21st century our country’s capitalist system will be in danger” [Yun, 1999: 274]. In a separate presentation, he blamed the West for the crisis, arguing that advanced countries intend to take over our domestic market and eliminate Korean big business, who are their competitors... Despite the creation of large firms through M&As being a recent trend amongst the world’s companies, only in our country is big business the subject of criticism... it is wrong to unconditionally condemn big business as the culprit of the economic crisis” [Yun, 1999: 274].

Former FKI president Sohn Byung-doo reinforced the message that the chaebols were not solely responsible for the crisis, saying “wasn’t the main cause [of the crisis] sheeted home to just the excessive investments of the chaebols?... There is a clear responsibility on the chaebols but they were not the [sole] culprits.” He claimed that the chaebols have contributed significantly to the advanced industrial society that is modern Korea: “Aren’t firms the driving force behind the creation of national wealth?... Our society has accepted the free market economy system and enjoyed its benefits but we don’t seem to really understand its strengths and blessings” [N. Lee, 2003: 223]. Likewise, an FKI advisor warned the government not to adopt a populist stance, arguing that “The government is trying to pursue chaebol reform by exposing the immorality of the chaebols and [presenting] a negative image of their leaders. If the government... denounces the chaebols as the object for reform, it might be popular in the beginning but it will ultimately be a meaningless policy” [C.-H. Lee, 1999: 256-257]. The FKI would later warn that
the strength of anti-business sentiment, which has long permeated Korean society due to the Confucian disdain for entrepreneurship, is detrimental to the normal operations of business [Seo, 2004].

The mutual antagonism between the government and business in the Daewoo and Samsung cases has resulted in less cooperation in the post-crisis period - a development of historical significance given that close collaboration between these parties has been a hallmark of the Korea model of development. The chaebols have been particularly disturbed by the government’s taking unilateral action - that is, its exercise of structural power and its reassertion of leadership in respect to the policy agenda. Whereas in previous decades the chaebols had substantial input into the policymaking process, their leaders now complain that they are unable to respond to the government’s reform agenda because they are unsure of its aim and extent, and that they have no clear line of communication with the government. To the chaebols, ‘talks’ are merely meant to make official the government’s policy, so there is no sense of mutual trust [Y.-G. Kim, 1999].

Further, the chaebols feel that the government is interfering in matters that should be left to the private sector to decide, most notably decisions about mergers and asset swaps. Indeed, the Kim government’s three senior economic officials have claimed the right to intervene selectively. It is the duty of the government to provide leadership in cases where, in the words of Kang Bong-gyun, “autonomously managed systems and traditions are not in place” [Kwon, 2000: 77], such as the selection of a new FKI chairman to replace Kim Woo Choong, who resigned following the collapse of Daewoo. Similarly, Lee Hun-jai believes in principle that market forces should operate, but only on the pre-condition that
the market operates smoothly [H.-K. Kim, 1998: 176]. The Kim government appropriated the right to decide when this was the case. And Lee Kyu-seong claims that it is inappropriate for the state to interfere illegally in the restructuring process or in forcing banks to raise interest rates, but “we are in a crisis situation where the autonomous market mechanism is broken, so it is impossible to fly with instruments and we have no choice but to rely on sight” [K.-H. Kim, 1998: 172]. The interventionist streak evident in these comments indicates that some elements of the Korean developmental state remain alongside the neo-liberal reform agenda - a combination unsettling for the chaebols.

The message that the chaebols emitted in the post-crisis era was that the government could not be trusted: not only were the policies it announced detrimental to the national economy, the chaebols claimed; the government was also determined to destroy the chaebol system, which had served Korea so well. An advisor to the FKI said that despite the myriad rationales provided for chaebol reform, they amounted to a project that would end the chaebol system as we know it: “The government claims to be in favour of chaebol reform, not the break up of the chaebols. However if all the policies that the government has suggested are implemented, the chaebols will be broken up... the government is just using the expression of reform” [C.-H. Lee, 1999: 254]. Trust was also eroded due to un-kept promises. Sohn Byung-doo complained that the government’s approach to the big deal process was seriously flawed, with little or none of the promises initially made being kept. For instance, the government, Sohn claimed, promised a wide range of taxation and financial assistance to the chaebols, as well as support for the chaebols’ efforts to downsize their workforces. “But once things started,
the government abrogated responsibility for [this] model of assistance, and they said that credit would be decided through a conference with the financial delegation, and they kept on dragging their feet” [N. Lee, 2003: 226].

Further, the chaebols resented the Kim government’s use of coercion in chaebol reform, such as the setting of timetables for compliance with restructuring; the government threatened to investigate non-compliers on the grounds of crimes such as selling shares illegally and fixing the price of shares [Lim, 1999: 225]. Officials such as Kang Bong-gyun came in for strong criticism from the FKI for underhand tactics: “although the government talks about negotiations, it interferes through telephone messages and directives. Since there is potential for problems to develop in the future, they don’t want to document anything [now].” The government also stood accused of intimidating business leaders: “is it negotiating to haul business leaders in front of the president and tell them to sign an agreement?... The leaders of the top-five chaebols are not saying anything and trembling in front of the president; would they even dream of resisting? This is close to a reign of terror” [C.-H. Lee, 1999: 255-256].

VII. CONCLUSIONS

This paper has focused on the way in which the IMF reforms represented an opportunity for political and economic elites within the Kim government to strengthen their standing vis-à-vis other actors, especially the chaebols. The state proved itself to be capable of facilitating the process of industrial and financial restructuring that was required as a condition for the emergency loans. As such,
the state operated in accordance to a markedly different template - part populism, part neo-liberalism - to that of the early stages of economic development.

Since the crisis, the success of the reforms - and the state’s bid to regain legitimacy in the political economy - has stemmed from the Kim government’s ability to capitalise on the public’s sense of outrage at the excesses of the chaebols and their culpability in the outbreak of the crisis. That is, the legitimacy that was restored to the state has stemmed from two sources: the external support of the US and the IFIs for implementing the neo-liberal agenda, and also domestic groups other than the chaebols. The government was more than willing to capitalise on the perception that the chaebols were responsible for bringing the economic crisis to the country due to their reckless lending and expansion. Thus the state gained public support for reining in, rather than nurturing, the chaebols - in contrast to the initial stages of economic development.

Yet the latent capacity of the chaebols to influence policymaking due to their structural position in the economy - their structural power - should not be underestimated. The observation has been made that the ‘too big to fail’ mentality has largely - perhaps even totally - disappeared in the wake of the collapse of Daewoo and several smaller chaebols [Na, 2003: 297-298; Song, 1999: 97; Yun, 1999: 274]. The danger remains that investment will not return to previous levels, with deleterious effects on production and employment. Demand is weak, and the rate of credit delinquency is hitting new highs, accentuating the need for new investment [C.-S. Lee, 2004]. Business leaders have warned that the measures proffered by the government in the post-crisis period would not deliver a recovery in investment; the chaebols would have preferred new injections of capital rather
than coercive restructuring [N. Lee, 2003: 226]. It remains to be seen whether
Korean firms’ recent surge in foreign investment - especially in China - continues,
or whether the state is capable of inducing renewed investment in the domestic
economy.

There are also concerns that the relaxation of barriers to foreign investment has
weakened the long-term growth potential of the economy. The penetration of
foreign capital has been far from insignificant: as at early 2002, foreigners owned
36.2% of listed stock in Korea, and a majority of shares in leading firms such as
Samsung Electronics, POSCO and Hyundai Motors [Crotty, 2002: 673-676].

Others [such as Yun, 2003: 237-239] agree with the government’s rationale for
inducing investment - that it has benefited Korea by introducing new technology
and managerial practices, and has thus facilitated the process of restructuring the
chaebols. Foreign capital has even challenged the chaebols’ practice of cross-
subsidisation in the courts, as the case of Sovereign Asset Management and SK
Corp has illustrated [The Economist, 2004: 60-61].

The state sought a renewed mandate in the post-crisis period, and it played a vital
role in Korea’s economic recovery, as this paper has noted. Yet in doing so, it may
have dealt a fatal blow to business confidence, with grave implications for the
long-term prospects of the national economy. The Kim government’s successor -
which includes some of Kim Dae-jung’s senior ministers, such as Lee Hun-jai -
faces the challenge of simultaneously satisfying the disparate interests of the
chaebols, labour and foreign investors. The revival of a cooperative relationship
with chaebol leaders will be crucial to the economy’s well being.
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In this paper ‘Korea’ refers to the Republic of Korea (the ROK or South Korea).

This paper adopts the Korean government’s official system of Romanisation (Ministry of Culture and Tourism proclamation 2000-8, http://www.mct.go.kr:8080/english/K_about/Language04.html). The new system permits the use of terms such as ‘chaebol’ (rather than ‘jaebeol’) - the family-owned conglomerates that have dominated the Korean economy - since such terms have become widely used in Korean Studies, and to alter their Romanisation would only create unnecessary confusion.

Refer to the paper by Mark Beeson and Iyanatul Islam in this volume for a more complete explanation of the Washington consensus.


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