State Power and Chaebol Reform in Post-Crisis South Korea

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1. Introduction

This paper investigates the role of the South Korean state in the post-crisis era, particularly in relation to its stewardship of the neo-liberal reforms requested 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, the state apparatus appears to be one of the main beneficiaries of this reformulation.

Immediately prior to the crisis, the influence of the chaebols had increased due to the strength of the economy and the ease with which the chaebols could access capital. In contrast, the state’s influence waned due to its loss of leverage over the chaebols that the liberalisation program had produced. The post-crisis period, however, has allowed the state to regain influence because it has proven to be the only actor capable of acting as a mediator between the domestic and international economies. In fulfilling this role, the state has had to follow a different logic to that of earlier periods of industrialisation. Rather than sounding the death knell for state power, the post-crisis period has witnessed the continuing transformation of what Eun Mee Kim (1997) terms a developmentalist, ‘plan-rational’ state apparatus to a ‘market-rational’ one. While economic development continues to be its main priority, the state’s understanding of its role - and the roles of other actors - has changed considerably. Despite strong opposition from the chaebols, the state has reinvented itself as the facilitator of financial and industrial restructuring. By focusing on areas of contestation between economic and political elites, this paper provides an explanation of the impact of neo-liberal reform in South Korea by analysing the state’s crucial mediating role between internal and external forces.

The first section of this paper argues that the state has used the recent financial crisis as an opportunity to re-legitimise its role in the national political economy. Previously the state had justified its role in the process of economic development on the basis of its capacity to launch the drive to industrialisation. But with the completion of that stage of development in the 1980s, the state faced a crisis of legitimacy. It was not until the late 1990s that the state had another opportunity to take on such a significant role in the developmental process. After nurturing the chaebols as the engine of economic growth, the state was faced with the challenge of reining them in for the sake of the long-term interests of the national economy.

Next, the paper contends that in a maturing and increasingly sophisticated economy, re-asserting and re-legitimating itself has required the state to seek support from both domestic and external actors. On one side, external actors, namely the International Monetary Fund (IMF) and the American government, had long sought the reform of the chaebol-dominated, neo-mercantilist economy, which was fundamentally at odds with the neo-liberal paradigm espoused by the ‘Washington consensus.’ The paper also notes that the process of neo-liberal reform has begun prior to the crisis in response to pressure from both external parties...
such as the IMF and the US Treasury, as well as the chaebols at home, the state found itself in a crisis of legitimacy, and forsook many of the policy tools that had characterized the developmental state paradigm, such as industrial policy and control over access to capital. These reforms reduced the influence of the state, and concomitantly increased that of the chaebols. A review of the reforms required as conditions for the bailout loan, which included fiscal and monetary reform, labour market reform, financial sector reform, public sector reform, reforms to corporate governance and industrial restructuring, is presented.

Third, it is argued that the state's success in re-legitimating itself was dependent upon its ability to attract the support of the public, which was vehemently opposed to the chaebols' continued dominance of the economy. The incoming Kim Dae Jung government was able to draw on public distaste for the continued dominance of the chaebols, whose questionable business practices were considered out of step with a modernizing, educated society. Thus the state gained public support for reining in, rather than nurturing, the chaebols - in contrast to the initial stages of economic development.

This combination of international and domestic support, coupled with the personal convictions of key members of the new government that the chaebols were the source to the economic crisis (and its resolution), provided valuable ammunition to the state as it sought to create a more market-oriented, yet regulated, economy. By mediating between internal and external forces, the state has cast itself as the only actor capable of fulfilling the needs of national economy (i.e., re-establishing access to capital) by liaising with external forces (the US and IMF). This was achieved through the implementation of a neoliberal agenda, which allowed South Korea to return to international capital markets. Thus it has reclaimed a degree of legitimacy not seen since its heyday in the 1970s.

2. The State in the Pre-Crisis Period

To some, the late 1980s and early 1990s were the halcyon days of the East Asian developmental state. Not only did South Korea, Taiwan and Japan - the countries most closely associated with the developmental state model - record high growth rates and enter markets formerly dominated by American and European firms, but the statist developmental paradigm was the subject of an unprecedented degree of intellectual attention. Despite this widespread appreciation for the efficacy of the developmental state model, it faced opposition from influential quarters, most notably the US government. With the cessation of the cold war in the early 1990s, and following the attainment of relative prosperity on the part of East Asian allies such as South Korea and Japan, the US intensified efforts to open the product and financial markets of these countries (Cummings 1998). This precursor to this process was in the late 1980s, when threats were made to use Section 301 of the US Trade Act ('Super 301') to eliminate unfair trade practices (Bergsten 2002; Weiss and Hobson 2000, p. 68). This process culminated in the 'Clinton doctrine,' which demanded reciprocity from allies in the form of market opening to US goods and services.

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 developing countries (such as those that erupted in Latin America in the 1980s and again in 1994-95). Equally as important, the 'prescriptions' the IFIs made for recovery drew chiefly upon a set of policy reforms known as the Washington consensus. These reforms sought to eliminate the statist development paradigm in developing countries, and to impress upon them the benefits of shifting to a market-based economy. As such, the reforms included fiscal discipline; a redirection of public spending to areas
considered to have high economic returns (such as health, education and infrastructure); liberalisation of interest rates, exchange rates, trade and investment; privatisation; and the abolition of entry and exit barriers (Williamson 1999, p. 252).

A third source of opposition to the continuation of the statist paradigm was the chaebols - arguably the greatest beneficiaries of state leadership during South Korea’s industrialisation. While the US government and the IFIs took exception to the developmental role of the state on ideological grounds, the chaebols sought to limit the influence of the state in order to increase their own autonomy vis-à-vis the state. In particular, a key objective of the chaebols was to reduce their dependence on the state for access to finance. As such, the chaebols lobbied for the liberalisation of financial markets while opposing the lifting of entry barriers in their own spheres of interest. It was not only the financial sector where the collective pressure to liberalise was apparent: by the mid 1990s, many of the traditional elements of the developmental state had been significantly reduced in scale or eliminated. For instance, ‘industrial policy’, which was once considered the trademark of the developmental state, was all but abolished in the late 1980s and early 1990s (Chang 1998). Shorn of its traditional policy instruments, the state by the 1990s had lost a significant portion of its influence, a development that was accompanied by a concomitant rise in the influence of the chaebols.

This paper argues that not only had the partial liberalisation of the economy reduced the influence of the state and increased that of the chaebols; but also the state, and its role in the national economy, had been de-legitimated. That is, the state was no longer seen to be playing a central role in the national economy. A host of actors - external forces such as the IMF and the US, as well as the chaebols and even the largely American-educated economic bureaucracy - sought to remove the planning function from the state’s remit (Woo 1991). The state was to be relegated to a supervisory role instead, from where it would facilitate the development of the economy as a whole, rather than particular sectors of it.

As Fred Block (1986, p. 182) notes, the structures of economy, including the state apparatus itself, are ‘time-limited in their effectiveness’. Over time, institutional arrangements undergo ‘a process of growth and decay,’ and ‘some of the positive synergies that occurred during a phase of expansion can turn negative under changing historical circumstances’. In short, the structures that serve an economy at one point in time need to be reformed to retain their relevance in the future. Without self-strengthening reforms, social structures risk atrophying. As the case of South Korea in the post-crisis period demonstrates, it is possible for the state apparatus to attain a position of relevance by adopting the agenda of the dominant contemporary ideology - neo-liberalism. That is, the state was able to regain a degree of legitimacy in the late 1990s by playing a role that coincided with the ‘logic’ of a rapidly advancing economy. That would mean playing an active role in the resolution of the financial crisis that struck South Korea in late 1997, which in turn involved cooperating with external parties to facilitate access to international capital markets. So the state acted as a mediator between international and domestic capital. At the same time, it adopted a populist, anti-chaebol agenda to win popular support for its re-emergence as a prominent, legitimate actor in the national political economy. The next section of the paper outlines the reform agenda and its effects on state power.

3. The IMF Reforms

In return for a loan of sufficient scale to cover South Korea’s short-term debts, the IMF requested that the country carry out a wide-ranging package of reforms. First, the
government had to tighten fiscal and monetary policies in order to reduce inflation and reduce the budget deficit. Taxes were also raised, and funds were to be diverted from defence to welfare, in preparation for the anticipated increase in unemployment (Park 2002). Second, the government agreed to reduce the size of the public service and to reorganise the functions of the state as part of the reform process. Launched with the goal of creating a 'smaller but more efficient' government, the re-organization transferred the functions of some ministries to local governments or the private sector, reduced the public sector workforce, and granted more control over economic policymaking to the executive and prime minister (Kim 1999).

A third plank of the reform agenda was labour market reform, since the IMF considered labour market 'flexibility' (i.e., layoffs) to be vital if industrial restructuring was to proceed. It was argued that some jobs would inevitably be lost during the process of restructuring the chaebols (Kim 1998, p. 135). The Tripartite Commission on Industrial Relations was formed in January 1998 to involve trade unions in discussions about improving labour market flexibility. Despite initially opposing mass dismissals, the unions eventually agreed to layoffs in 'unavoidable' circumstances. In return, unions were granted permission to engage in political activities, and to extend their coverage to the public service and the teaching profession for the first time (Park and Park 2000, p. 86). The government also established a $US4.4 billion fund to compensate for job losses resulting from the restructuring process. 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, p. 279).

Fourthly, financial sector reform was pursued. The main thrust of the reforms in this area 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 standards of the sector and to encourage the closure of troubled institutions. At the same time, the financial condition of many financial institutions was impaired by non-performing loans, so the overall performance of institutions 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, p. 461; Haggard 2000, p.149; Kim 1998, p.132; Park 2002, p. 65). The reforms also sought to ensure that independent and competent supervisory agencies were established. Specifically, the IMF advised the government to grant the Bank of Korea full independence, which it had not hitherto enjoyed (Kim 1998, p. 131). A new institution responsible for overseeing the entire financial sector, the Financial Securities Commission (FSC), would complement the newly independent central bank (Park 2002, p. 65). Capital account liberalisation was also pursued, though this process had begun well before the outbreak of the crisis.

Finally, the reforms targeted the managerial style of the chaebols (governance) and their production processes (restructuring). Improvements to corporate governance would involve the 'five plus three principles': greater transparency, better accounting and reporting practices, greater accountability by owner-managers, abolition of mutual guarantees among chaebol affiliates, and a streamlining of the operations of chaebol enterprises (Mo and Moon 2003, p. 128). 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 the chaebols' 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, p.131-32). 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. 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 recapitalise the chaebols in return for an end to the practice of mutual debt guarantees between chaebol affiliates (Cumings 1998, p. 63-64; Choi 2002, p. 268; Lim 2003; Shin 2000, p. 191-94).

4. The Re-Emergence of the State in the Post-Crisis Era

While it is possible to argue that the raison d'être of the South Korean state has changed markedly in the wake of the financial crisis and the subsequent neo-liberal reforms, this paper contends that the crisis and reforms expedited a change in the role of the state that was already underway. As mentioned above, neo-liberals both inside and outside of the state increasingly scrutinised the efficacy of the statist development paradigm from the 1980s. Gradually, the ideological and institutional bases of strategic intervention in the political economy were eroded, resulting in a form of liberalisation that sought to weaken the role of the state, rather than strengthen it (Clifford 1998; Weiss and Hobson 2000, p.62). As part of the shift to a more market-oriented economy, the state’s role was minimised, and it was urged to act as a regulator rather than facilitator of development, and to devote itself to resolving structural problems such as monopolies, economic disparities between regions, cost structures and barriers to higher efficiency (Kim 2003; Kong 2000, p. 15).

Eun Mee Kim (1997) has described this type of transformation as the shift from a ‘comprehensive’ to a ‘limited’ developmental state (LDS). According to Kim, a comprehensive developmental state (CDS) is ‘plan-rational’ rather than ‘market-rational’: the state focuses on development rather than regulation. The CDS, she claims, caters to the long-terms interests of the economy by supporting the private sector during its infancy. For example, it ensures that firms have access to adequate levels of capital and technology, while also providing indirect assistance by mediating between domestic firms and multinational corporations, and by promoting international trade. As the sophistication of the economy increases however, it is more difficult for the state to perform these tasks, as firms seek autonomy from the state. Instead, the state is called upon to play a more supervisory and regulatory role, which is the hallmark of an LDS. Commensurate with the higher degree of economic development that is present under an LDS, some sectors of the economy may remain plan-rational, while others become increasingly market-rational (Kim 1997; Kim 1999).

Given the ongoing transformation of the state since the 1980s, its actions in the post-crisis period hardly represent a radical break from the past. Claims that the Asian financial crisis would “change thought about economic development and economic policy in fundamental ways,” and that the tools of developmental states have been totally discredited (Carnaut 1998, p. 10) should thus be viewed with some caution. To reiterate: it was neither the crisis nor the reform agenda that changed thoughts about policymaking and the role of the state. The crisis, and especially the IMF’s intervention, merely expedited changes that were already underway (Kristof 1998). In addition, the crisis gave the state the chance to reassert a degree of legitimacy by regulating the activities of the chaebols more effectively.

The state’s re-assertion of its legitimacy is best illustrated with respect to its role in the restructuring of the financial sector. After abdicating its role of investment coordinator
in the 1980s and early 1990s, the state’s capacity to discipline the chaebols diminished markedly, as witnessed by their excessive borrowing (Kim 2000, Kong 2000:19, Weiss and Hobson 2000:66). The financial crisis, however, returned to the state a degree of leverage over the chaebols, insofar as it became not only a direct shareholder of several banks following their nationalisation but also the ultimate guarantor of the survival of the entire financial system due to its control of the recapitalisation process (Haggard, Lim and Kim 2003:318). In turn, creditor banks put pressure on the chaebols to comply with the conditions of the workout and big deal programs. Chaebol owners and shareholders, meanwhile, have been expected to bear the costs of corporate failures: the socialization of risk, a founding principle of the developmental state, has all but disappeared (Haggard, Lim and Kim 2003, p. 311; Sanger 1997).

Of overriding importance though has been the role of the state in re-establishing access to international capital markets for the national economy. The debt-laden chaebols had relied on continual replenishments of short-term capital to operate in the lead-up to the financial crisis, and indeed it was precisely this reliance on foreign lending that precipitated the crisis in the second half of 1997. Only the state was able to re-establish the link to international capital: it achieved this by agreeing to implement the IMF’s neoliberal reforms.

Liaising with international creditors and IFIs was only one half of the state’s return to legitimacy in the national political economy: the other half of its role involved reining in the power of the chaebols, which it had nurtured in an earlier period of development. Perhaps the clearest indication that the developmental alliance between the state and the chaebols has changed was the handling of the Daewoo Group’s bankruptcy in the second half of 1999. Hitherto, the state had been reluctant to allow chaebol groups of Daewoo’s scale to collapse due to the potential social and economic fallout of such an incident. In contrast the Kim Dae Jung government, which believed that the chaebols and their proclivity for excessive borrowing and expansion were the cause of the financial crisis, refused to rescue Daewoo when it failed to comply with the conditions of its workout program in either substance or spirit. The group’s owners resorted to ‘creative’ accounting practices such as revaluing assets, accessing funds through NBFIs and issuing more equity (Park 2002, p. 76). The state’s willingness to tolerate the collapse of Daewoo and the resultant financial turmoil convinced other chaebol owners that the principle of restructuring would be enforced. By the end of 2000, 17 out of the top 30 chaebols had entered receivership or had undergone restructuring processes such as workouts (Crotty and Lee 2002, p. 674; Mo and Moon 2003, p. 131-36).

In spite of the resolve that the state displayed in the case of the Daewoo collapse, the process of restructuring has been far from smooth. Nor has the state proven capable of bringing the chaebols as a class to heel. Indeed, Daewoo represented a particularly egregious case of corporate profligacy, even by the standards of the chaebols (Lee 2003), and it seems probable that the state fully understood the salutary effect that Daewoo’s bankruptcy would have on similarly recalcitrant chaebol owners. That is, while the state would be both unlikely and unwilling to bear the consequences of a string 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 improve their finances and restructure their business operations. As such, the state has at least partially ameliorated the problem of what has been called ‘chaebol non-reform’: the propensity of the state to avoid structural reforms in the face of social opposition. As Kong (2000, p. 84) explains:

An economic setback traced to Chaebol malpractice provokes widespread calls for
structural reform; then the realisation sinks in that effective structural reform would have
to deepen economic pain in the short-term; favourable cyclical factors plus some limited
adjustments by the Chaebol themselves promote recovery; once the recovery is under way,
the momentum for structural reform evaporates.

The financial crisis appears to have broken this cycle to some extent, as substantial
reforms have been implemented. Indeed, the success of the reforms - and the state’s bid to
regain legitimacy in the political economy - stems from the state’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 stemmed from
two sources: the external support of the US government and the IMF, and also domestic
societal groups other than the chaebols. Without popular support, disciplining the chaebols
and implementing the conditions of the IMF loan would have been far more arduous for
the state. Public opinion opposed the all-pervading social, political and economic influence
of the chaebols since Liberation in 1945, and the chaebols were widely considered to be
responsible for bringing the economic crisis to the country due to their reckless lending and
expansion. An an unreconstructed and outdated remnant of the authoritarian era in the eyes
of the increasingly modernised and educated populace, the chaebols found themselves the
Thus the state gained public support for reining in, rather than nurturing, the chaebols - in
contrast to the initial stages of economic development.

It was against this background of overt hostility to the chaebols that the state
harnessed the support of both domestic and external actors to regain an influential position
for itself in the national political economy. Now less dependent on the chaebols for its
political survival, the state adopted a more populist platform that incorporated the interests
of a wider group of societal actors into the formulation of development strategies (Haggard,
Lim and Kim 2003, p. 311). The government’s platform included efforts to gain the
support of both the official and independent trade union federations through the formation
of a tripartite commission. The commission’s main task was to minimise the social impact
of the restructuring process. The unions were initially opposed to the principle of layoffs
but the state convinced the federations to cooperate in the restructuring in return for
measures to establish a rudimentary social safety net and also full recognition of the rights
of the unions to participate in the political process and to organise in a wider range of
sectors (Park and Park 2000, p. 86; Strom 1998a).

The cooperation of the union federations, while not strictly necessary, was certainly
desirable for the resolution of the crisis. The incoming government was determined to
restructure the chaebols regardless of the stance of the unions. Election promises to hold a
six-month moratorium on layoffs were greeted with scepticism (Crotty and Lee 2002, pp.
668-69; Pollack 1997). Indeed, in one of his first public statements after winning the
presidential election in December 1997, Kim Dae Jung stated that job losses would be
inevitable, and that it might be necessary for up to 30% of the workforce to be laid off in
order to save the remainder and revive the national economy. Analysts initially predicted
that at least half a million jobs would need to be shed in 1998 alone to meet the goals of the
restructuring project (Strom 1998b). The unions’ support was desirable insofar as it would
improve the prospects for social stability in the wake of the crisis. Kim’s stance attracted
the support of the middle classes, who were less likely to be directly affected by layoffs
and who had traditionally been mistrustful of trade unions. It was felt that militancy was
inappropriate during a national economic crisis. Moreover, the public was wary of any
party that appeared to share the chaebols’ stated goal of opposing restructuring. 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
5. Conclusions

This paper has focused on the way in which the state has reacted to the IMF reforms, and it has argued that the reforms represented an opportunity to strengthen the state’s standing vis-à-vis other actors, especially the chaebols. The state proved itself to be the only actor capable of facilitating the process of industrial and financial restructuring that was requested as a condition for the emergency loans in 1997 and 1998. As such, the state had to assume a new guise, and to operate in accordance to a markedly different template to that of the early stages of economic development. Despite the transformation from a ‘plan-rational’ state (which was primarily dictated to by the logic of launching the drive to industrialisation) to a ‘market-rational’ one, the goal of the state has not changed: its overriding objective is still to further the national interest through economic development. On this basis, the state regained a degree of legitimacy in the national political economy.

In the post-crisis period, the state has been forced to rein in the influence of the chaebols, rather than to nurture them. Yet the latent influence of the chaebols should not be underestimated, especially given their ongoing importance to national economic prosperity. Moreover, the longevity of the state’s renewed influence has yet to be proven. If the chaebols were to simply ‘hunker down’ for several years until the hostility towards them inside and outside of government dissipates, they could well regain their previous level of influence. Likewise, concerns that the reforms implemented in the wake of the crisis may merely replace the chaebols’ unregulated (and sometimes illegal) dominance of the economy with a more regulated (and legalised) form of dominance (Kim 1998, p.135). What likelihood is there, after all, of competitors emerging who are capable of challenging the preponderance of the chaebols? Could such challengers replicate, or indeed emulate, the contribution of the chaebols to national economic development?

More pointedly, with the easing of the sense of desperation that accompanied the crisis, as well as the anti-chaebol sentiment, a revival in the influence of the chaebols seems inevitable. Indeed, the chaebols have received help from an unlikely source in the quest to frustrate the process of restructuring: the trade union federations, erstwhile class enemies of the chaebol owners, began to actively oppose the restructuring process after pressure from the rank-and-file membership, and entered into an unlikely alliance with the chaebols to slow or halt the break up of the industrial groups. These efforts have not been wholly unsuccessful: the social costs of restructuring (most notably, rising unemployment), as well as bankruptcies, have put pressure on the state to ease some of the conditions associated with the restructuring process and to take into account the interests of its social partners in the formulation of development strategies (Haggard, Lim and Kim 2003, p. 312, Park 2003, p. 202). In sum, the view of the South Korean state that emerges in the post-crisis period accords with what Zaki Laïdi (2002) has labelled a ‘fractal state’: one which is no longer able to dominate society but which is the ultimate protector of the national interest. The state has responded with resilience and flexibility to the challenges of the past five years but its ability to do so in the future is far from assured.
References


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