The State Activism toward the Big Business in Korea, 1998-2000:
Path dependence and Institutional Embeddedness

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1. Introduction

The Asian financial crisis overtook the Korean economy in late 1997. It resulted in more than 1.5 million people out of work and an International Monetary Fund (IMF) bailout. Under the dramatic changed economic situation, the new Kim Dae Jung government, upon its inauguration in 1998, disclosed an extensive economic reform program highlighted by bold restructuring of Korea’s conglomerates, known as chaebol.\footnote{A chaebol is characterized as a group of large corporate groups operating in diverse and mostly unrelated industries, usually under the ownership and control of a single family. Many scholars agree that the success of chaebol has highly depended upon the strong support of the state in challenging cheap credit to favored chaebol, coordinating investment and export strategies and constraining the labor force (Cheng 1990, Fields 1997, Haggard and Moon 1993, Kim 1997, Wade 1990, and Woo 1991). Under the high growth era of the 1970s and the 1980s, the chaebol were able to borrow more and more capital from financial institutions, which assumed that the companies would be able to earn enough over time to repay their debts. Yet, when the growth slowed in 1997, some chaebols with huge debts have collapsed one after another, leaving many of the leading financial institutions burdened with unrecoverable loans.}

The state undertook a series of measure to force chaebol to focus their business operations on a small number of core industries, to rely less on debt financing, to improve transparency in decision making, and to enhance the accountability of controlling shareholders and mangers.

In this process, the Director of General Economic Policy Bureau in the Ministry of Finance and Economy (MOFE) declared that “unlike financial sector reform…the bulk of corporate sector restructuring, under the principle of a market economy, must be initiated by the corporate themselves” (Hyun 1999, p.4). Also, according to the report of Ministry of Finance and Economy (1998, pp.5-6), the Kim Dae Jung government highlighted the necessity of making “a decisive break with the previous state-led development model.” President Kim Dae Jung himself often commits to let market force work, saying that “the lagging development of a democratic, free market economy gave rise to collusive links between politicians and businessmen as well as a strong tendency on the part of the government to interfere in the market” (Laurence 1999, pp.366-67). The rhetoric of bureaucrats and political actors have made them sound like free-market liberalizers. However, the Kim Dae Jung government has kept up the state’s intrusive role in shaping the market and business. Despite the regime’s proclamation that it would not intervene in the corporate restructuring process except to offer ‘basic guidelines,’ there has been mounting evidence of familiar state activism of Korea at various levels.
This study examines the extent of state activism in the chaebol reform process of the Kim Dae Jung government. As an analytic framework to explain state activism in Korea, I suggest the institutional web, composed of four variables: 1) deep-rooted ideological orientation of state-led industrial coordination; 2) centralized bureaucratic system as a function of policy implementation; 3) state’s financial control of the chaebol; and 4) personalized power of the president’s leadership. These variables are incorporated into what North calls, “the interdependent web of an institutional matrix” in Korean political economy (North 1990, p.95). Whereas the Korean state’s chaebol policies have been not static but dynamic and evolutionary for the last four decades, the pattern of state activism has been constrained by the institutional web, in which each institution is interdependent each other and follows its historical path.

While crises may shock countries out of traditional policy choices that are deemed to have failed and generate demand for radical reform (Williams and Haggard 1994, pp.562-65), preexisting ideas and institutions powerfully structure the basic direction of the state’s reform changes. Over the last 40 years, the Korean state’s political actors and bureaucrats, state policies and regulations, and politics generally have played a crucial role in how firms and markets developed. Countries with long traditions of governmental oversight toward industry and intervention view their reform tasks quite differently from those with an arms-length approach and a legacy of laissez faire. The influences of the legacy of the past and the institutional constraints on policy makers that are stressed in the notion of path dependence and embeddedness are particularly in evidence when we come to discuss dynamic Korea’s chaebol policies. Additionally, although this study focuses only on the Kim Dae Jung government, future studies are needed at the broad historical level more focusing on the ‘path dependence’ issues of the state activism.

2. Theoretical Review

This study characterizes institutions as organizations such as bureaucratic structures, sets of formal rules such as those pertaining to the financial system, time-sanctioned standard operating procedures, and accepted ways of doing things that are product of custom and precedent. This definition is similar with Hall’s oft-cited definition, “formal rules, compliance procedures, and standard operating practices that
structure the relationship between individuals in various units of the polity and economy” (Hall 1986, p.19). Furthermore, the institutional model in this study is based on the concept of ‘embeddedness’ and ‘path dependence,’ which emerge from historical institutionalism (Hall and Taylor 1996, Immergut 1998, Pierson and Skocpol 2000, and Thelen and Steinmo 1992).

For historical institutionalists, since institutional contexts vary from one country to another, being embedded in their broader societies and rooted in their histories, there is the divergence among response to common challenges. As Orru argues, “the institutional factors result from a combination of sociocultural, financial, political, and economic traits that are often linked with each other at multiple levels, and are, therefore, hard to isolate in clear fashion” (Orru 1997, p.349). Thus, “small changes or changes in one area that leave the other components of these national systems untouched do not bring about convergence” (Woolcock 1998, p.195).

Moreover, historical institutionalists regard institutions as the legacy of concrete historical process. According to them, once an institution is formed, it is difficult to change even when the specific circumstances that brought the organization into existence have changed. Historical institutionalists emphasize that previous choice has a determining power over the next behavior in that later decision cannot reverse the previous one-the path dependent character of social and political transformation within individual national societies. For them, institutions are “relatively persistent features of the historical landscape and one of the central factors pushing historical development along a set of paths” (Hall and Taylor 1996, p.941). Thus, institutional arrangements at a point in time are “both a dependent variable at time t and an independent variable at time t+1,” in order words, prior institutional choices condition future options and institutional

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2 For example, Ikenberry (1989) conceptualizes the institutional continuity with two ways: at the macro level, institutional reform is carried out within the existing array of organizations and structures that shape and constrain any effects to change; at the micro level, individuals within the organization seek to preserve and protect their missions and responsibilities even when underlying social forces continue to evolve.

3 Path dependence suggests the dynamics of self-reinforcing or positive feedback in a political system-what economists call “increasing returns” processes (Pierson 2000). Once established, patterns of politics, the institutional ‘rules of the game,’ and the public’s ways of thinking about the political world would often produce self-reinforcing dynamics. Here, time and sequence of particular events or processes matter since self-reinforcing processes affecting a particular aspect of political and social life can generate the consequences of later developments in a sequence (Pierson and Skocpol 2000, p.11).
capacities are “a product of choices made during some earlier period” (Krasner 1988, pp.71-72).

While path dependence does not mean that continued stability is inevitable, the direction of the change is limited by the norms and rules, and other institutional arrangements which are intricately linked at any moment in time. As Chang, Park and Yoo (1998) remind us, the distinctive German and Japanese economic systems emerged from a period of the American Occupation Authority and Occupation-led institutional and legal reforms. Even concerted attempts at institutional transfer can lead to different outcomes.

Indeed, the profound influence of institutional embeddedness and historical contingency or path dependence tempers the enthusiasm of the Kim Dae Jung government facing economic crisis. Thus, through an analysis of the Korean state’s activism vis-à-vis the chaebol, this study examines the web of “preexisting institutions (which) play a key role in shaping response to exogenous factors by acting as a filter or intervening variable between external pressures and the responses to them” (Regini 2000, p.8). Before analyzing the institutional web model, the next section shows major chaebol policies under the Kim Dae Jung government.

3. Current Chaebol Policy Issues- Five and Three Tasks of Restructuring

When the Kim Dae Jung government concluded that one of the causes of the economic crisis was the excessive expansion and diversification of the chaebol, it launched a highly ambitious reform program in 1998. On January 13, 1998, President Kim Dae Jung reached on agreement with four chaebol leaders on ‘Five Tasks of Business Restructuring’ (Chosun Ilbo, January 13, 1998). The five tasks are to enhance transparency in corporate management, to strengthen the accountability of major shareholders, to eliminate cross-debt guarantees among a chaebol’s subsidiaries, to improve capital structure of corporations, and to specialize in a smaller number of core business lines. Afterwards, the state led the way in chaebol restructuring through the revision of related legislation to facilitate the five tasks and the periodic check of the progress in those agreed tasks. Several laws related to chaebol restructuring such as the

On August 15, 1999, after the celebration of Korea’s Liberation Day, President Kim Dae Jung added three supplementary tasks, without the agreement of the chaebol leaders this time, to the initial five tasks to correct ‘undesirable’ aspects of the chaebol’s management practices. The three tasks are to restrict the chaebol from controlling the financial industry, to suppress obscure internal transactions and circular shareholding among their subsidiaries within a chaebol, and to prevent ad hoc inheritance of the top shareholder’s shares to his or her siblings (Chosun Ilbo August 15, 1999).

Based on these eight principles, we can divide two different aspects to the chaebol restructuring. The first is about internal corporate governance, separating management control from ownership to promote professional management. The second is about external organization, dismantling the group structure to make subsidiaries independent. The state officially denies that it is pursuing the first objective and insists that its position be on organizational reform. President Kim Dae Jung has indicated more than once that he has no plans to change the size or purpose of the chaebol (Korea Herald, June 2, 1998 and July 11, 1998). Ministry of Finance and Economy, Lee Kyu Sung, said that Kim’s reforms were not aimed at diminishing the power and size of the chaebol, but rather at using various incentives and tax reductions to encourage restructuring (Korea Herald, April 10, 1998). However, many of policy measures suggest that the state is seeking out both goals (Yoo 2000).

Legal standards related to internal corporate governance are strengthened to ensure transparency and accountability of management in five areas: outside director system, responsibility of controlling shareholders, rights of minority shareholders, rights of institutional shareholders, and accounting standards. First, clauses related to securities listing are revised to require all listed companies on the Korean Stock Exchange (KSE) to appoint independent directors, which should exclude people who share the same interests with the controlling shareholder. Its revision aims to rectify the practice of illicit control of the firm through proxy equity participation (Black et al. 2000, p.13).

Second, the revised Korean Commercial Law (KCL) includes a clause stipulating the ‘duty of loyalty’ of directors and removes the Chairman’s Secretary Office (CSO) of
the chaebol. The CSO was the core body to sustain the owner-chairman’s centralized control of the member companies with arrangement and coordination of internal trading and cross-subsidization among member companies. Also, the state encourages the registration of the chaebol’s owner-chairman as the representative director of at least one of the member companies. Although owner-chairmen of the chaebol exercised absolute control over their subsidiaries, they were not formally members of the boards of directors of any of these companies and were thus not legally liable for the damage that their actions may have caused. Thanks to the revised KCL, owner-chairmen are required to assume formal CEO status with full legal responsibilities and thus can be held legally accountable for all their managerial decisions.

Third, to strengthen voting rights of minority shareholders who had been largely ignored, the state revised Securities Exchange Law to lowering the minimum shareholdings required in demanding financial review, removal of directors, and taking legal action against managerial abuse. Additionally, KCL introduces a cumulative voting system when directors are appointed. As a result, it becomes easier for minority stockholders to monitor corporate decision making by demanding accountability from controlling owners.\(^4\)

Fourth, the role of institutional investors as monitors of corporate management is strengthened as Securities Investment Trust Law is revised with endowment of voting rights for shares in funds managed by investment trust companies and bank trust accounts (Black et al. 2000, p.66).

Finally, Corporate External Audit Law (CEAL) is revised to improve the accounting system. The reliability of Korean firms’ accounting data had become an issue since murky accounting practices, allowing firms to bypass investment and transfer-

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\(^4\) Each requirement of shareholdings is loosened from 1 percent to 0.005 percent for class action suits, from 3 percent to 0.5 percent for inspecting the accounting books, and from 1 to .25 percent for the request of dismissal of directors and auditors. These changes initiates new shareholder activism in Korea that is led by citizen groups representing minority shareholders, and sometimes even foreign investors. The chaebol also steps up their efforts to establish shareholder-oriented management practices. For example, the annual shareholders meeting of Samsung Electronics took more than 13 hours due to active discussion on corporate governance issue (Chosun Ilbo, March 28, 1998). In February 1999, Samsung Electronics executives agreed to most of the requests of minority shareholder activists at the general meeting and decided to institute an interim divided system and a regulatory mechanism for internal trading (Chosun Ilbo, February 28, 1999).
pricing restrictions, had discouraged foreign investors from investing in them. Thus, accounting standards for the 30 largest chaebols are revised to bring them into compliance with combined financial statements, based on International Accounting Standards or United States Generally Accepted Principles. These combined financial statements would provide more accurate information about the chaebol finances by showing internal transactions among their subsidiaries, including their cross-shareholdings and mutual-payment guarantees. Furthermore, the CEAL adds the obligation of establishing an election committee for the assignment of outside auditors for the top thirty chaebols and all listed companies on the KSE. Similarly it increases the penalty of outside auditors for the wrongdoings and permits shareholders’ class action suits against them.

Regarding the chaebol’s external business structure, the state’s reform measures focused on two areas: M&A market and the chaebol’s capital structure. First, to revitalize the domestic M&A market, the state completely abolished the obligation public purchase of shares during the takeover, and restrictions on the total amount of shareholdings a company can have in other companies, through the amendment of Securities Exchange Law and Fair Trade Law. Moreover, M&A activity, which involves foreign firms, is promoted by the revised Foreign Investment Law. The procedure of authorization by the Ministry of Finance and Economy for large-scale foreign direct investment is lifted, except for defense industry companies. Foreign investors are also able to buy up to 33% of the total share of a company without approval of current board of directors (Kim 1999, pp.76-7).

The second category aims to improve financial conditions of the chaebol since the high level of corporate debt and the common practice of cross-debt guarantees among subsidiaries belonging to a chaebol were considered to main factors in the financial weakness of the banking system.\(^5\) Due to amendments of the Fair Trade Law, cross-debt...

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\(^5\) Ilbo, February 20, 1999). Similarly, SK Telecom accepted minority shareholders’ request for managerial transparency (Chosun Ilbo, March 27, 1998).

\(^5\) The practice of cross-debt guarantees allowed subsidiaries of the chaebol to provide loan guarantees for them, often without collateral. Since the guarantees did not appear on the balance sheet of the guarantor, this practice enabled the chaebol to accumulate a higher level of debt than was recorded in their financial statements.
guarantees were to be abolished by March 2000 and any new issue of cross-debt guarantees is prohibited. Also, the Capital Structure Improvement Agreement is signed between creditor banks and their partner chaebols under the state guidance. It covers a reduction in the debt-to-equity ratios to 200% by the year 1999, a clause for the banks’ overseeing of companies’ new investment, and encouragement of the choice of core industry by the chaebol.

As the result of the state’s push, there have been huge changes in many areas of the chaebol’s structure. Management transparency has been enhanced through extensive revision of the legislation relating to the corporate governance structure, while their financial stability and capital structure have been improved through the abolition of debt-guarantees and the reduction of debt-to-equity ratios. The four largest chaebols cut their total number of subsidiaries from 232 in 1997 to 137 in 1999 (Korea Times April 11, 2000). Hyundai and LG cut their debt-to-equity ratios to 181 percent and 184.2 percent, respectively and Samsung and SK registered debt-to-equity ratio of 161 percent and 166.3 percent as of 2000 (Chosun Ilbo April 13, 2000).

It is the first time that a reform of the chaebol’s internal governance structure has been undertaken so seriously by the state. A series of revisions of corporate law is a good example of formal institutionalized reform. In the past, chaebol policies centered mainly on financial and business restructuring, that is, industrial adjustment or company ownership change by force.

Although it is undeniable that the Kim Dae Jung government has made many changes in the chaebol structure, it has adopted familiar activist approaches during the reform process. The next three sections show its activist measures, depending on four different institutions, such as the ideology of state-led industrialization, financial institutions and bureaucratic system, and personalized president’s leadership style.

4. State-led Industrial Coordination

Kim Dae Jung regime’s chaebol restructuring policy is resembles with deep-rooted practice of state-led industrial coordination. In addition above various sets of

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6 Among top five chaebols, in July 1999, Daewoo went into virtual bankruptcy.
measure of chaebol reform, another element of the restructuring process involves massive mergers and swaps of companies and business lines among the five largest chaebols including Hyundai, Samsung, Daewoo, LG and SK.\footnote{Different restructuring approaches were applied according to the scale of the chaebol. The top five chaebols were to follow a program named the ‘Big Deals,’ whereas for the 6th to 64th largest chaebols, restructuring was to be carried through the program named the ‘Workout.’ The top five chaebols have separate status from other smaller chaebols since their financial resilience affects their position vis-à-vis the state. Moreover, since their business activities involved key sectors and they are linked to hundreds of subcontractors, their economic influence is even greater than their size would suggest. Thus, these five chaebols have been a target of more extensive reforms than other corporations and the Kim Dae Jung government has made reform of the top five chaebols a top priority.} This is called as a Big Deals program. Considering over-diversified business areas and excess productivity capacities as the major problem in the low profitability of the chaebol and in the less competitiveness of the nation’s economy, the state forced the chaebol to focus on a few specialized businesses through mergers of their subsidiaries.

On July 1998, there was an agreement on the Big Deals among the top five chaebols at a meeting between the state and the chaebol (Y.R. Lee 1999, pp.91-97). Immediately after the meeting, the Federation of Korean Industries, an association of the chaebol, announced a sweeping business swap plan among 17 companies belonging to the 5 largest chaebols in the seven industrial sectors of aerospace, oil refining, petrochemicals, power plant equipment, railway vehicles, semiconductors, and ship engines. However, the Big Deals did not go forward due to disputes among those chaebols that were reluctant to give up their business or were not satisfied about the selling price of their business.

On December 1998, again, an agreement between the state and the top five chaebols was made for a speedier implementation plan for the Big Deals (Y.R. Lee 1999, pp.219-234). The business swap of Daewoo Electronics and Samsung Motors between Daewoo and Samsung was additionally added to the program. The final decision was composed of 13 companies belonging to the top five chaebols, excluding SK, and three non-top five chaebol companies, Korea Heavy Industries, Hanwha Energy, and Hanjin Heavy Industries. The revenue size of those targeted companies under the Big Deals was 7.4 percent of the national GDP in 1998 (Joongang Ilbo February 20, 1999). Table 1 lists the major Big Deals proposed and the results to date.
The main impetus for such mergers is to alleviate over-investment problem and the resulting over-competition among the chaebol through business swaps by which a surviving company created through a merger can concentrate on its core business but with a much bigger size and a fewer number of companies. The state officially announced that the Big Deals in the private sector should be implemented based on market rules and mutual agreements between involved companies. For example, when he met the U.S. Trade Representative, the chairman of the FSC, Chun Yun Chul, said that “Big Deals in Korea have been done under market principles and the Korea state had not intervened in the process” (Korea Economic Daily, October 15, 1998). However, the state exerted a strong influence toward the Big Deal since its early stage. For example, the Minister of Industry and Resources, Park Tae Young, determined that the semiconductor industry was an over-invested sector, which needed to be restructured (Chosun Ilbo, November 12, 1998). Rather than leaving the discipline of market mechanism, the state identified a number of target industries.

The state’s demand for a large-scale swap program is deeply rooted in its ideological orientation, which is basically the same as the economic logic of the 1970s and 1980s. Table 2 shows that, over the last 30 years, diverse types of industrial rationalization have been carried out under the coordination of the state: company rationalization and industrial rationalization under the Park government of the 1970s; heavy industry adjustment program under the Chun government of the early 1980s; and core business specialization under the Roh and Kim Young Sam government of the 1990s (J.W. Lee 1999, p.253). The state’s industrial coordination programs are regular, resurfacing repeatedly as subject for state activism toward the chaebol. In the process of forcefully implementing industrial adjustment, cooperative companies have been compensated with preferential treatment such as privileged loans and tax exemptions. This time, as an incentive for taking part in the swap deals, debt-to-equity swaps are provided to the chaebol.

These state-led industrial coordination programs are based on the general public attitude supporting state intervention in economy and control-oriented economic principles outlined in the Constitution. First, the chaebol have only limited popular support. The average Korean citizen believes that the chaebol are too big and a source of
corruption (Cho 1997, pp.217-224). Additionally, they believe that the chaebol are responsible for bringing on the current crisis. Under the situation in which the public response to economic collapse was a sense of national humiliation, many ordinary Koreans donated their own personal wealth in an effort to bail out the economy and wanted to return a degree of national autonomy. A 1999 Gallup survey commissioned by Monthly Joongang (February 1999) revealed that 45.3 percent of the public approved the direct use of state intervention in the restructuring the chaebol while only 28.8 percent agreed with market-based reform and 22.4 percent with indirect control via financial institutions. Furthermore, the chaebol’s owners and their family members tend to be ostracized by society, which takes it for granted that the state would intervene in the personal affairs of chaebol families, admonishing them for their extravagant life-style and mediating in conflicts between family members over the issue of inheritance. This kind of public attitude highly pressures the state directly intervening not only in the business but also corporate structure.

Furthermore, in the Korean Constitution there is a separate chapter on economic matters, Article 119 through 127 in Chapter 9. The economic provisions of the Constitution grant the state virtually unlimited authority and control, to such an extent that all economic policies pursued by the state can be legally justified (Weekly Donga December 9, 1999). With the exception of Section 1 of Article 119, these articles provide the state with the power to guide and control the economy for specific national purposes. Particularly, Section 2 of Article 119 indicates “the State may regulate and coordinate economic affairs for the balanced growth and stabilization of national economy, maintenance of fair distribution of income, prevention of market domination and abuse of economic power, and the democratization of economy through the coordination between economic bodies” (Yang 1994, p.962). Despite nine constitutional amendments, the underlying nature of the Korean Constitution in terms of advocating control of the economy has changed little since 1945. The basic promise of the Constitution is that the economic order is a means to achieve national goals and the public laws should prevail over private interests as long as they are enacted by majority of the National Assembly (Min 1999). The nationalization of banks, preferential treatment through financial support and taxation, licensing and granting approval for market entry are all authorized and
justified under the Constitution. The example of the Big Deals policy shows Kin Dae Jung government is also trapped with ideology of state-led industrial coordination, resulting from general public attitude and the Constitution. In the Big Deals, the state guided and forced swaps among the chaebol, determining the acquiring and acquired companies in advance and giving them the guidelines and deadlines to be met.

5. Financial Control through the Centralized Bureaucratic System- Business as Usual

As with previous regimes, the Kim Dae Jung government centralizes powerful role of executive branch to facilitate its reform drive. First of all, outside of the central bank, the Financial Supervisory Commission (FSC) was established in April 1998 to function as a neutral and independent supervisory and policy-making body (E.M. Kim 2000). The FSC was expanded into the Financial Supervisory Service (FSS) in January 1999 by merging four existing supervisory bodies, including the Banking Supervisory Authority, Securities Supervisory Board, Insurance Supervisory Board and Non-Bank Supervisory Authority. The FSC is established as an independent supervisory organization with broad powers over the full range of business. It is given the power to monitor, discipline and control financial institutions except for the authority to make and revise financial laws, which is still held by the MOEF. For example, the FSC has the authority to issue business licenses for financial institutions, the authority to review the appointment of bank chairs, and the authority to look into corporate bank accounts without obtaining search warrants from the courts.\(^8\)

Armed with these exclusive powers, the FSC plays a key role in steering financial reform programs and chaebol reforms. Indeed, it is the state’s main organizational weapon to enforce the highly problematic deals between the chaebol. Since most of the banks to which the chaebol owe a large amount of outstanding debt are heavily dependent on state’s subsidies for their restructuring, they are willing to exert pressure on the chaebol at the FSC’s request. Thus, the FSC represents the resurrection of the state-controlled financial sector of the developmental era.

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\(^8\) The state monitors the FSC with appointing officials and allocating the budget. At the same time, it owns many of the financial institutions, which are constituents of the FSC. Thus, a regulatory agency of the state regulates a state-owned banking sector.
In addition, the state empowers the Fair Trade Commission (FTC) with new institutional provisions such as the right to look into bank accounts of the chaebol and the right to look into the internal financial transactions among chaebol’s member firms to take heavy punitive measures in the case of infringement. Then, the FTC launched investigation three times into illegal internal transactions among the five largest chaebols and imposed a total 100 billion won in surcharges (Joongang Ilbo August 12, 1999). The FTC is also charged with monitoring the swaps to prevent delays in restructuring. The chaebol consider as the serious pressure, statements made by high ranking officials of FTC or FSC in which they said that government would take a knife to the chaebol, and administrative sudden decisions to investigate subsidiaries’ internal dealings (Chosun Ilbo, 1998, May 8).  

For example, in the process of the merger between Hyundai Electronics and LG Semiconductors, the consolidated bureaucratic system used its formal and informal activism for the goal of Big Deals. The forced merger between LG Semiconductors and Hyundai semiconductors was initially resisted by the LG, which was required to sell its equities to Hyundai. LG protested that the value of its company was actually greater than that of Hyundai (Chosun Ilbo December 26, 1998). It also pointed out that the takeover of LG Semiconductor by Hyundai was inconsistent with the state’s big deal guidelines, which clearly prescribed that relatedness among business areas was a core criterion. However, LG reluctantly agreed to hand over its semiconductor business only after the state threatened to take strong punitive measures such as the early recall of its bank loans and the prohibition of future loans (Chosun Ilbo December 19, 1998). Later in the

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9 However, the Kim Dae Jung government has adopted different rules each time that important decisions are needed, using circumstantial necessity as an excuse. For instance, the FSC put off a comprehensive audit into subsidiaries of Hyundai on November 2000 when Hyundai experienced a liquidity problem. It announced that “given unfavorable situations facing Hyundai, the FSC decided to indefinitely postpone the inspection originally scheduled to begin in this month, but it would conduct an audit into financial units of Samsung next month as planned” (Korea herald November 8, 2000). Another, when Hyundai Engineering and Construction (HEC)’s liquidity problem dragged on, the state stepped into persuade the head of Hyundai Motors to help HEC. The chairman of FSC, Lee Keun Young, met with owner-manager of Hyundai Motors, Chung Mong Koo, to ask him to help his brother’s company on November 14, 2000 (Chosun Ilbo, November 24, 2000). But, in the wake of the sibling battle over management control of Hyundai, Hyundai Motors and its affiliates were already separated from the Hyundai Group on August 2000, virtually becoming an independent chaebol. While pressing the chaebol to spin off their subsidiaries, the state asked the independent corporate to support it’s past mother company.
negotiations between the LG and Hyundai agreement could not reached about the proper price for LG Semiconductors. Since Hyundai and LG first announced their plans for a merger of semiconductor industries on September 3, 1998, the bureaucracies, such as MOFE, the FSC, and the FTC, were very critical of the slow pace and partial nature of the merger compared to other sectors. On October 12, 1998, the Ministry of the MOFE, Lee Gyu Seong, announced that the semiconductor industry would be included in the workout programs and warned strong restriction on this sector, using suspension and withdrawal of credit or limitation of corporate bills (Chosun Ilbo, September 14, 1998). Then, the major trading banks for Hyundai and LG, the Commercial Bank of Korea and the Korea Exchange Bank, began to limit credit to these two firms (Chosun Ilbo, December 28, 1998). In order to put pressure on the deadlocked negotiations, President Kim also declared that the state might apply ‘workout,’ forced restructuring preceded by the removal of management control from the owners, to the chaebol that failed to keep their promises about these deals (Chosun Ilbo April 15, 1999). This resulted in the LG and Hyundai agreeing on the price of LG Semiconductors on April 23, 1999 (Chosun Ilbo April 23, 1999).

As we see the example of the merger process between Hyundai and LG, in addition to bureaucratic system, the state has used its control over the banks to force the chaebol to improve their financial structure and streamline their business activities. Since the direct cause of the economic crisis was the crippled financial sector, the Kim Dae Jung government first targeted to reform the financial sector. During this financial reform process, the state not only strengthened its regulatory power over financial institutions but gained additional influence by becoming a shareholder in the financial institutions that is bailed out with public funds. The state took control of commercial banks, insurance companies, and investment trust companies through an equity-debt swap in 1998. By purchasing non-performing loans and through the injection of public funds, the state has become the largest shareholder for most commercial banks. For example, its percent of holding stock are 95.7 percent of Cho Hung Bank, 95.3 percent of Han Il Bank, 94.2 percent of Commercial Bank, 93.8 percent of Korea First Bank, 93.8 percent
of Seoul Bank, 33.6 percent of Foreign Exchange Bank, 16.1 percent of Housing Bank, and 10.4 percent of Kukmin Bank as of June 1998 (Chosun Ilbo June 19, 1998). 10

Many of the state’s initiatives toward the chaebol are based on its ability to control credit of financial institutions over the chaebol. The state has not been reluctant to exercise its ownership right of financial institutions in forcing chaebol restructuring. From February to April 1998, many agreements were made between their main creditor banks and 57 subsidiaries of the chaebol owing more than 250 billion won on the matter of capital structure restructuring. The main context of the agreement between the banks and those companies was the reduction of the chaebol’s debt-to-equity ratio to 200 percent by the end of 1999, their business restructuring, and a clause for the banks’ overseeing of the chaebol’s new investment. Officially, these agreements between the banks and the chaebol were voluntary, but there was no doubt that the state was deeply involved. To induce corporations to reduce outstanding debt, the creditor banks directed the chaebol to sell some of their member companies and assets or attracting foreign investment. However, as Mo and Moon (1999) criticize, while the banks have a role to play in the management of the firms to which they lend, it is not appropriate for the banks to force their debtors to give up business lines and reduce debt ratios when the debtors are not formally in default.

A policy measure halting the injection of new capital to the financially distressed corporations would be sufficient for the state to bring them into the state-drawn reform programs, since the most debt-ridden corporations would be pushed to the brink of collapse during economic recession (Haggard, Maxfield, and Schneider 1997). According to the report of the Korean Development Institute (Laurence 1999, p.367), six of the 30 largest chaebols kept afloat by bank loans given under state guidance. Moreover, threatening a corporation with the cutoff of capital is credible when the chaebol, upon receiving various demands from their main creditor banks, cannot turn to another bank since no bank is in a position to help them against the wishes of the state (Mo and Moon, 1999, pp.161-163). As their main creditors, the banks now have enormous power over the chaebol; they can virtually bankrupt firms by cutting off their creditors. Thus, as of

10 Among them, Korea First Bank was sold off to New Bridge Capital, a U.S.-based vulture fund, on
December 1999, Daewoo, which once had 37 subsidiaries in diverse industries and ranked as the second largest asset holder in Korea, was virtually dissolved its 12 major firms under workout programs.

At the same time, although there were innumerable points of conflict between the state and the chaebol, the state never allowed a complete breakdown of the chaebol. The state follows a pragmatic approach toward a particular chaebol, considering it as backbone of the nation’s economy. The current preferential loans for Hyundai are a good example. Although state officials have repeatedly stressed their willingness to allow creditor banks to determine the fate of terminally ailing companies by market principles, the state-influenced banks have continually extended preferential loans to keep Hyundai’s subsidiaries afloat. On March 12, 2001, creditor banks announced to extend financial aids, totaling about $2.47 billion, to Hyundai Electronics Industries (HEI), Hyundai Engineering and Construction (HEC), and Hyundai Petrochemicals (HP) through debt rollovers, new credit and extension of new trade financing (Chosun Ilbo March 21, 2001).

For example, the 17 credit banks, led by Korea Exchange Bank (KEB) allowed HEI with free access to trade-related loans of up to $1.98 billion by the end of 2001 and extended the maturity of 300 billion won of HEI loans, most in overdrafts, for 2002. With regard to HEC suffering from chronic liquidity shortage, state-run Korea Development Bank (KDB) extended $400 million in payment guarantees for the ailing contractors’ overseas borrowing and projects, with the KEB and six other lenders guaranteeing the payment of $200 million of them to KDB. The creditor banks also decided to give a six-month extension on the repayment of HP’s debts maturing by the end of June, 2001 and infused 115 billion won in loans to the ailing petrochemical unit for period of six months, taking the firm’s plants and real estate assets as security.

Since there has been liquidity problems of Hyundai on May 2000, this newest bailout is the fifth assistance of the state (Joongang Ilbo March 22, 2001). Each time the state repeatedly emphasized that it would be the last time for Hyundai. The state tends

December 27, 1999 (Chosun Ilbo December 27, 1999).

11 For example, the state and creditor banks said that they would provide no more funds to Hyundai when they announced a support plan for the company, which included 800 billion won, in January 2001 (Chosun Ilbo, January 21, 2001). The chairman of the FSC also confirmed at the time that there would be no
to fear that Hyundai is simply too big to fail and its collapse could touch off a chain-reaction of economic havoc: Domestic projects like nuclear power plants and other infrastructure projects involving Hyundai would stall; as overseas projects fell of schedule, the contractors would be subject to massive lawsuits and claims; and banks that provided performance guarantees worth billions of dollars on behalf of Hyundai overseas could be pushed closer to insolvency. For instance, an official of the Blue House, the presidential office, announced that “we are doing what is deemed necessary to save companies leading the country’s strategic industries. I do not think that there is anybody in the country who wants to see Hyundai fail” (Korea Times February 7, 2001). The Minister of Finance and Economy directly highlighted that “there would be no more bankruptcies of the chaebol like Daewoo’s fall in 1999” and “the liquidity crunch of Hyundai was not serious” (Chosun Ilbo July 23, 2000). Another official of the Blue House said that “Hyundai is different from Daewoo. Its semiconductors and constructions are Korea’s backbone industries. These firms hold large market shares of their industries and these businesses are deeply linked with other domestic companies. Thus, these firms should not be sold off just to follow market principles” (Joongang Ilbo January 16, 2001). However, many newspapers’ editorials compared the state’s repeated support to Hyundai to ‘pouring water into a bottomless water’ (Chosun Ilbo March 11, 2001, Hankuk Ilbo March 12, 2001, and Joongang Ilbo March 12, 2001).^{12}

additional help, since “without the provision of the remaining 200 billion won, Hyundai would have no liquidity problems” (Chosun Ilbo, January 22, 2001).

^{12} There are various political behind-the-scene stories and rumors regarding the Kim Dae Jung government’s support to Hyundai. Among them, there is strong relationship between Kim Dae Jung government’s engagement policy of North Korea and Hyundai. The biggest achievement of Kim’s engagement policy is North Korea’s October 1998 agreement to permit Hyundai to bring South Korean tourists abroad cruise ships to Mount Kumkang in North Korea. To arrange these visits, Hyundai agreed to pay North Korea $150 million over the first six months. But, the Hyundai’s tourism business of Mt. Kumkang is widely seen as one of the causes of its liquidity problems. As of January 2001, Hyundai Asan, the Hyundai’s North Korea business unit, has spent an estimated $624 million, including $342 million in monthly tourism fees, $156 million in operations of the cruise ships and $126 million in facility investment, but earned only $233 million from the business (Korea Herald January 21, 2001). It is said that the President decided to allow preferential loans to Hyundai to keep his engagement policy and the state is likely to indirectly help Hyundai’s North Korea project unit over its unprofitable tourism business. For example, an official of the Ministry of Unification said, “we will ask North Korea to help Hyundai Asan, at the inter-Korean ministerial-level talks” (Joongang Ilbo March 12, 2001). Indeed, the Kim Dae Jung government intends to ‘reviving Hyundai first, no question asked.’
There has been active state participation in commercial bank credit allocation, which is used to bring the chaebol into the state-drawn reform programs and/or to prevent a particular chaebol from going bankrupt. Before the economic crisis, state control of the banking sector has persisted despite financial deregulation of the 1990s. The asset portfolios of banks were still consisted by limits on lending and, although the banking sector had been largely privately owned since the mid-1980s, the state did not allow it to have full managerial autonomy.

Although the state-owned banks are considered as being temporary and necessary part of the transition period, it is unlikely that the state stake in the financial sector will diminish in the near future. Directors of commercial banks are not accustomed to autonomous decision making on important issues and tend to continue relying on state officials. These tendencies show that changing patterns of behavior and institutional traditions will take a much longer time than is thought.

6. The President’s Personalized Leadership Style

As seen above, state activism vis-à-vis the chaebol can be simplified three steps: meeting of President and chaebol leaders, the Minister’s open denouncements and real pressure through financial institutions and other state agencies. During this process, the President extensively intervened in the economic policy-making process with well-defined and concentrated power. Moreover, the economy-related power of the president is highly strengthened under Kim Dae Jung government since President Kim consolidates power around the Blue House, creating the Planning and Budget Commission (PBC), which he makes directly subordinate to the Blue House, and the FSC, which he places outside MOFE. The president uses these agencies, rather than the MOFE as his key agents of reform.

The presidential office has been the predominant center of policy decision-making procedures since the Park era (Hahm and Plein 1997). Almost every single significant power has been concentrated in the hands of the President, who is virtually unchecked by any other institution. The President has been able to mobilize power apparatus, such as the National Intelligence Service (NIS, previously the Agency for National Security Planning), the Attorney General (AG), the Chief of Police Bureau (CPB), and the Office
of National Tax Administration (ONTA) at his discretion, to deal with his political opponents and to force through his economic agenda. Although the economic transformation and democratic transition since the late 1980s largely undermined presidential power by setting institutional constraints on the president and bringing the presidential office under democratic rules, the President himself has remained the single most important institution. Particularly, major policies around the chaebol still remain in the hands of the president. An important pattern that has been repeated in the case of policy vis-à-vis the chaebol is the dominance of the President, over the economic bureaucracy and other governing institutions in the decision making and implementation process.

For examples, after the series of aircraft accidents of the Korean Air Line (KAL), the President Kim stated that the KAL, the subsidiary of Hanjin, should be managed by professional staff, not as a family run business and concentrate on providing an efficient and safe service for its customers (Chosun Ilbo, April 21, 1999). Some critics argue that the President’s calling for a management reshuffling at KAL was inappropriate intervention in private business, overstepping the bounds of his authority, and there is no relationship between ownership structure and ‘an efficient and safe service.’ However, President’s order was faithfully executed after the ONTA announced the imposition of 541.6 billion won penalty against subsidiaries of Hanjin, including KAL, and their management for evading taxes and amassing a number of secret slush funds (Chosun Ilbo, October 4, 1999). The owner-chairman of Hanjin, Cho Jung Hoon, was resigned and the family management was out of KAL’s daily operations.

President Kim has continued the established tradition of informal arrangements, rather than formal procedures, in deciding major policy issues. Blue House talks between the President and the chaebol’s owner-chairmen are often used to lay out reform programs with businesses at each phase and to verify progress on these programs. The President often used his supreme power at these meetings to dissolve deadlocks among the chaebol, banks and the government. The first meeting, in January 1998, laid out the five reform targets concerning the chaebol. The meeting in August 1998 put pressure on the foot-dragging chaebol. The meeting in December 1998 was used to settle the big deals among the five largest chaebols. The meeting in April 1999 was used to determine
whether or not the reform agreements of state-business were proceeding as planned. The meeting in August 1999 was used to reach the contractual agreement of three new reform targets. The sequence of the Blue House meeting clearly shows that informal administrative guidance and the personalized presidential system in Korea.

The nature of negotiation with the chaebol leaders were also informal and closed when they agreed with five principles of reform on the first meeting, leading some observers to wonder whether the chaebol leaders had any choice but to agree. President Kim called the chairmen of five largest chaebols to the Blue House to get the word straight from the president’s lips: Divest yourselves of poor-performing subsidiaries; reduce your debt-to-equity ratios toward the end of this year; and eliminate debt guarantees between subsidiaries. Repeatedly, President Kim warned the chaebol to put their reform programs into action at press conferences and face-to-face meetings with chairmen of the chaebol in the Blue House. One of chaebol tycoons told that he was not expecting President Kim to be so personally involved (Asiaweek, February 23, 1999).

Although there is no question that the Kim Dae Jung government is democratic, President Kim has maintained a commanding position in the process of chaebol policy implementation. Accordingly, some scholars criticize the policy style of President Kim Dae Jung as “command and control” (Haggard et al. 1999), “imperial power” (S.H. Kim 2000b), and “unlimited and top-down” (Mo and Moon 1999). In spite of democratization since the late 1980s, politics in Korea is still characterized by the personality-dominated system that articulates the interest of its top leaders. Weak party system and region-based politics contribute to the personalized presidential leadership.

First, political parties in Korea are organized around their leaders, and the party operations tend to be personality-driven, much as an individual leader would treat his own property (Yang, 1996). There have rarely been either policy-oriented or grass-root parties. Instead, most all parties have been ephemeral: whenever a party leader changed, the party disappeared. It is thus not surprising that the parties of the three dominant presidents of the authoritarian era, Rhee Syngman’s Liberal Party, Park Chung Hee’s

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13 For instance, participants in the meeting which was held on August 25, 1999, included the owner-chairmen of the five largest chaebols, heads of the MOFE, FSC, FTC, MPB (Ministry of Planning and
Democratic Republican Party, and Chun Doo Whan’s Democratic Justice Party have risen and fallen with their leaders. Moreover, the raison d’être of political parties has been the need of leaders for an instrument to gain or perpetuate power. For example, Kim Dae Jung has merged and spilt his party such as Party for Peace and Democracy (1987-1990), New Democratic Coalition Party (1990-1991), Democratic Party (1991-1995), National Congress for New Politics (1995-2000) and New Millennium Democratic Party (2000-) whenever he needs escaping stalemated political situation (Y.H. Lee, 2000). Political parties have been weak, divided from each other and often within themselves on regional lines and organized around personal cliques.

Next, the regional antagonism contributes to the continuation of centralized personal leadership. President Kim has maintained a commanding position within his own parties and tended to magnify the rivalries and animosities between the regions. The level of voting support for him has closely coincided with his regional background of Honam providence in west. In 1992 and 1997 presidential elections, for example, Kim Dae Jung received more than 95 percent of the votes in the southwestern city of Kwangju, 88 percent and 93 percent in the respective election from the two Honam provinces, and less than 10 percent in 1992 and about 12 percent in 1997 from the two Youngnam provinces in east (Sohn 1999, p.146). The previous ruling elite based on Youngnam region has been placed by those on Honam region (S.H. Kim 2000, p.177). To consolidate his power Kim Dae Jung ensures that his ministries are drawn largely from his home province. The key positions in major ministries or agencies are filled by officials either form his home region or sympathetic to his reform program. For example, President Kim assigned the nucleus positions of power agencies, such as the NIC (Shin Gun), Ministry of Justice (Kim Jung Nam), CPB (Lee Moo Young), ONTA (Ahn Jung Nam), FTC (Lee Nam Ki), high ranking officials of AG (Kim Dae Woong), and Ministry of National Defense (Kim Dong Shin) to Honam elites (Chosun Ilbo March 27, 2001).

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Budget), the chief presidential economic adviser, and the heads of major banks, such as Hanvit, Korea First, Korea Exchange and Korea Development Bank (Joongang Ilbo August 25, 1999).

There are two main vehicles for leaders of governing parties as well as opposition parties to control their party members, money and nomination. Leaders not only have the control over the use of political funds, but also to monopolize the power of nomination of candidates for national and local elections.
Given the authoritarian legacies, political structure of executive dominance and personalized party politics, the presidency remain the primary actor in major policymaking. In fact, democratization remains largely confined to formal procedures at the political level, failing short of economic and social democratization with broad participation by the public. Policy formation is still monopolized by the president and his close associates behind the scenes. This trend is intensified when decisions of the chaebol policy are made. It will not be an easy task to break the legacy of personalized power and the authoritarian style of top-down policymaking.

7. Path Dependence and Institutional Embeddedness

It is argued that an activist role of the state is inevitable to initiate market-oriented reforms at least in the short term (Haggard and Kaufman 1995, and Mainwaring and Shugart 1998). For example, distinguishing between the initiation and consolidation of economic reforms, Haggard and Kaufman (1995) emphasize the benefits of a centralized executive authority that can overcome political stalemate through selecting a cohesive policy-making team, and override bureaucratic and political opposition to policy initiation. According to them, the state has to play an active role to help the market function well in a transition economy, during which the foundation of a market economy is established. But, in the case of Korea, the activist state is not necessary for overcoming economic crisis, but is continued its features from the past. From the early days of Korean economic development firms have been largely financed by bank loans under the state influence, and a relationship-based system has developed among firms, their banks and the state, through ownership, family ties and political deal making.

During the restructuring process, the Kim Dae Jung government may want to select only what is desirable from past practices and institutions. Nevertheless, the parts of old system, which is composed of the institutional web, are so integrated that they cannot be easily divided into separate parts for the new government to choose an efficient solution. This is the core of my argument of institutional web model in which ideological orientation of the state-coordinated industrial sector, bureaucratic controlled banking sector, and president-led informal politics have continued in the chaebol restructuring
process during the Kim Dae Jung era. Figure 1 shows the interdependent institutional web model.

First, originating from the general public attitude and the Constitution, the Korean state has kept its ideological orientation of state-led industrialization. Various forms of state intervention have been tried over time, from import-substitution in the early days via state-directed export promotion and the push for the heavy-chemical industry to the more recent implementation of a number of the policies that go under the name of structural adjustment. The ideology of the past developmental strategy has been persistent despite political changes such as from an authoritarian to democratic government, and economic changes from high economic growth to severe economic crisis. For example, in the early 1980s, when recession led to massive over-capacity in the automobile industry, the Chun government forced some producers to exit and others to reduce the number of models and engine sizes. Similarly, since the recent financial crisis the government has exerted great pressure on the chaebol to exchange many of their major assets to boost economies of scale. Recent Kim Dae Jung government’s Big Deals program follows the traditional pattern of state-coordinated business specialization policy. Roughly speaking, the current Kim Dae Jung government’s intervening way to the chaebol is only a shadow of its predecessors, based on the same ideological orientation.

Second, the state has centralized financial control via formal or informal channels. In Korea, “government control of the banks is …the single most important economic factor explaining the distinctly subordinate position of the private sector” (Jones and Sakong 1980, p.122). Whereas, since the main commercial banks were privatized in the 1980s, the directive intervention of the state as a financier seems to be no longer possible, a comparatively moderate and less stifling incentive-centered intervention is still feasible. While formal institutions may collapse or be dismantled, as was the case of the liberalizing non-banking sector in Kim Young Sam era, informal institutions, such as social networks and repeated operating procedures, tend to persist and continue to shape the behavior of different actors. For example, while presidents in private banks are apparently elected by a general meeting of the stockholders, the appointment of them is decided by the ‘invisible hand’ of the state. They have been customarily recruited from among ex-government officials of the MOFE (Woo-Cumings 1997). This practice puts
these financial organizations in the hands of persons sympathetic to state persuasion. Long-existing networks of political and economic elites, despite undergoing some shifts, remained in place as did many of their traditional informal patterns of interaction. The state chooses winners and losers among the chaebol due to its direct dealings with the chaebol, and banks tend to grant loans based on which companies have political connections rather than on which companies are able to repay. The state directs banks to make loans to those companies that are strategically placed in the political structure. Moreover, after the financial crisis, the state restored its control of the financial institutions during financial restructuring process, and thus uses them as a guide to the chaebol policy.

Third, whereas this study does not deny the increasing leverage of corporations and civil society against the state, especially after democratization in the late 1980s, it focuses on the powerful place of the bureaucracy in the Korean political economy as a role of policy implementation and concentration. The bureaucratic system remains intact both in terms of size and function (E.M. Kim 1999). Rather the only change is that the power balance among the various ministries and officers has shifted somewhat depending on different governments. We can trace such various organizational capacities of bureaucratic structure, including Economic and Planning Board (EPB) in the 1970s and 1980s, FTC in the 1990s, and FSC after 1998, and other various ministries.

Finally, in Korea, power is highly concentrated in the executive branch, and ultimately in the presidency, as Henderson (1968) points out. Policy arrangements in Korea are often considered as a personality-driven way. The presidency has set the direction, priorities, and objectives of economic or social policy by relying on an inner circle of advisors around the Blue House to help lay out and execute policy strategies (Hahm and Plein 1995). Even the bureaucracy, identified as a strong institutional presence, has been structurally dependent on and vulnerable to presidential prerogative (Chung 1989). All the strategic decisions and major policies are decided practically by the president himself with the assistance of a small number of top advisors. In the past, the president used autocratic force to enforce its decisions. For instance, after the coup of the 1960s the new Park regime immediately pressured big businesses to confess improper activities and ‘voluntarily’ donate part of their wealth to the state. Even after the
democratization, presidents have not hesitated to use informal way to obtain their goal of industrial restructuring.

Under the state’s intertwined and path dependent institutional web, the chaebol have no way of protecting themselves. Even though the big 5 chaebols are not as dependent on the state as they might have been, they ultimately found themselves in a position of dependence. If the chaebol do not do what the state tells them to do, they would be subject to credit sanctions, or other discretionary means used to bring them into line. However, outcomes from the institutional web are not planned or intended but rather are the consequences of unanticipated effects and constrained choice. The institutional web follows its historical path, which is not usually a “efficient” process of moving “rapidly to a unique solution” (March and Olsen 1984, p.734), but is much more indeterminate and context-dependent. Although political actors build these state institutions, there is no assurance that they will produce what they intend.

For instance, although chaebol’s chairmen’s secretary offices were officially dismantled by the state’s pressure, virtual functions of secretary office have been maintained for the coordination of member companies by delegating this function to one of their core companies (Chosun Ilbo February 8, 1998). Big Deals program also has a number of perverse consequences such as leading to greater concentration in the various sectors, a move from oligopoly to monopoly. Moreover, after the Big Deals are over, it is uncertain whether the state allow new entries into the industries where Big Deals have happened: If the state allows them, it raises the question of why it ordered the Big Deals in the first place; if not, it has to find out a logical explanation for why it cannot (Yi 1999, pp.305-6).

8. Conclusion

To abide by its principle of ‘parallel development of democracy and market economy,’ the Kim Dae Jung government should have implemented the chaebol reform in a more market-based form. However, restructuring processes have highly depended upon the state’s hand. With the ideology based on state-led industrialization, President Kim Dae Jung has negotiated directly with the chaebol over the restructuring plans, and the bureaucratic system such as FSC, FTC, and MOFE has pushed corporate governance
reforms or debt restructuring through the control of financial institutions. When implementing chaebol reforms, the Kim government has often used informal administrative guidance with an implicit threat of sanctions.

The institutional web model in this study argues that institutional interdependent structures are the key to understanding how and why the state activism persists. Historical path and institutional embeddedness have intertwined to shape profoundly the state’s active behaviors. The legacy of the developmental state has created regulatory administrative systems that do not bode well for the creation of market economies. The legacy has also created an arena of political jockeying through concentrated presidential system within the marketplace. Since each institutional feature is interdependently embedded and structured within the web, its change is not easy task.

This study provides an analytic lens, which can be applied to other developing countries, which have been experiencing similar economic restructuring. Like many other countries of Asia and Latin America, Korea has experienced political and economic changes. What role do domestic factors play in this process? If the determining factor in industrial reforms is domestic in nature even in such a small country as Korea, then domestic factors will most likely be the deciding consideration when countries attempt to transform their economies. Moreover, a case study of Korea can help in understanding similar interventionist tendencies in other countries. These states, like Korea, profess a commitment to the free market, yet state involvement in the economy has continued in the 2000s. This study can shed light on why that intervention persists.
<table>
<thead>
<tr>
<th>Type of industry</th>
<th>Targeted firms</th>
<th>Details</th>
<th>Status</th>
</tr>
</thead>
</table>
| Aerospace        | • Samsung Aerospace Industries  
• Daewoo Heavy Industries  
• Hyundai Space & Aircraft | Establishment of Korea Aerospace Industries through the merger among three companies | Completed- Delay of foreign capital attraction and difficulty in raising working capital |
| Automobiles      | • Samsung Motors  
• Daewoo Motor | Daewoo Motor takes over Samsung Motors | Aborted- After the Daewoo bankrupt, Samsung Motors sold to a foreign auto-maker |
| Oil-refining     | • Hyundai Oilbank  
• Hanwha Energy | Hyundai Oilbank takes over Hanwha Energy’s oil-refining business | Completed- Foreign capital attraction in the form of equity participation in progress |
| Petrochemicals   | • Samsung General Chemical  
• Hyundai Petrochemical | Foreign investment in progress for the company by the merger between Samsung and Hyundai | Aborted- Failure of the merger deal due to the hesitation of the Mitsui concerning equity participation in the merged company |
| Power plant      | • Korea Heavy Industries  
• Samsung Heavy Industries  
• Hyundai Heavy Industries | Assets of Samsung Heavy Industries and Hyundai Heavy Industries transferred to Korea Heavy Industries | Completed |
| Railway vehicles | • Hyundai Precision  
• Daewoo Heavy Industries  
• Hanjin Heavy Industries | Hyundai, Daewoo, and Hanjin invested on a 4:4:2 basis establishing the Korea Railway Vehicle Co. | Completed- Failure of additional investment by partners and delay of a debt reduction plan |
| Semiconductors | Hyundai Electronics  
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Merger between Hyundai Electronics and LG Semiconductors | Completed- 
| Hyundai takes over LG Semiconductors, but suffers from the low profitability | | |
| Ship engines | Korea Heavy Industries  
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Korea Heavy Industries  
| Samsung Heavy Industries | Korea Heavy Industries takes over Samsung Heavy Industries’ ship engines business | Completed- 
| Privatization of Korea Heavy Industries | earmarked | |


Table 2 Major Cases of the State-led Industrial Coordination

<table>
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<th>Contents</th>
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<td>Company Rationalization (1969-1971)</td>
<td>112 insolvent firms in the PVC, automobile, steel, chemical and textile industries were liquidated or acquired by other chaebols</td>
</tr>
<tr>
<td>Industrial Rationalization (1972)</td>
<td>61 firms, including 30 in heavy industries, 8 in chemical industries, and 10 in light industries, undertook capacity adjustment, business specialization, subcontract system improvement, and M&amp;As through state financial and tax support</td>
</tr>
<tr>
<td>Investment Readjustment of Heavy Industries (late 1970s-early 1980s)</td>
<td>The electricity generating, heavy construction equipment, automobile, and diesel engine industries were restructured by state-led M&amp;As with bail-out financing and interest rate subsidies</td>
</tr>
<tr>
<td>Business Specialization (1990s)</td>
<td>Indirect inducement policy aimed at specializing two or three main core industries of the big 30 chaebols through easing bank credit limits and other preferential treatments</td>
</tr>
</tbody>
</table>

Source: J.W. Lee (1999, P.254) and Jwa and Seo (2000, p.330)
Figure 1.1 The Interdependent Institutional Web

- President’s Personalized Leadership Style
- Financial Control through Formal and/or Informal Way
- Ideological Orientation of the State-led Industrial Cooperation
- Centralized Bureaucratic System

Chaebol Policy
References


