

Diseased *Dirigisme*

The Political Sources of Financial Policy
toward Small Business in Korea

Hun Joo Park





INSTITUTE OF EAST ASIAN STUDIES
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Abbreviations

BOK	Bank of Korea
CNB	Citizens' National Bank
DCC	Democratic Chamber of Commerce
DJP	Democratic Justice Party
EOI	export-oriented industrialization
EPB	Economic Planning Board
<i>FEER</i>	<i>Far Eastern Economic Report</i>
FKI	Federation of Korean Industries
FSC	Financial Supervisory Commission
GNP	gross national product
GTC	general trading company
HCI	heavy and chemical industrialization
IBK	Industrial Bank of Korea
<i>IHT</i>	<i>International Herald Tribune</i>
ILO	International Labour Office
IMF	International Monetary Fund
ISI	import-substitution industrialization
JCCC	Japan Council of Chambers of Commerce
JCP	Japan Communist Party
JDB	Japan Development Bank
KCIA	Korean Central Intelligence Agency
KDB	Korea Development Bank
KFSB	Korea Federation of Small Business
KIET	Korea Institute for Economics and Technology
KMT	Kuomintang
KOTRA	Korea Trade Promotion Corporation
LDP	Liberal Democratic Party
MOF	Ministry of Finance
MOFE	Ministry of Finance and Economy
MOTIE	Ministry of Trade, Industry, and Energy
MSB	Monetary Stabilization Bonds
MTI	Ministry of Trade and Industry

Abbreviations

NACF	National Agricultural Cooperative Federation
NASME	National Association of Small and Medium Enterprises
NBFI	nonbanking financial institutions
NCU	National Conference for Unification
NDP	New Democratic Party
NFFC	National Federation of Fisheries Cooperatives
NFSBA	National Federation of Small Business Associations
NGO	nongovernmental organization
NIC	newly industrializing country
NIF	National Investment Fund
NLCF	National Livestock Cooperatives Federation
NSPA	National Security Planning Agency
OBSE	Office of Bank Supervision and Examination
OECD	Organisation for Economic Co-operation and Development
PPO	Public Prosecutor's Office
SCNR	Supreme Council for National Reconstruction
SCNSM	Special Committee for National Security Measures
SERI	Samsung Economic Research Institute
SME	small and medium enterprise
SMEPC	SME Promotion Corporation
SOE	state-owned enterprise
TK group	graduates of Kyongbuk High School in Taegu
USAID	U.S. Agency for International Development
WSJ	<i>Wall Street Journal</i>

Recasting Korean *Dirigisme*

The financial and economic collapse of 1997, a juncture as pivotal as that of Park Chung Hee's seizure of power in 1961, provoked serious reflection on Korea's development experience.¹ Most Korean experts and the mainstream press saw—and still see—the nation's historical task to be to streamline the economy for more efficiency, growth, and global competitiveness. However, this viewpoint misses the real lesson in the nation's purgatory: at the heart of Korea's development experience was a failure to put the people at the center of the process. While a kind of social equality was a subsidiary goal of Korea's elites throughout the development process, it was always a secondary one, a way of justifying top-down rule, whitewashing “grand” elite collusion, and gaining popular acquiescence. Including and empowering ordinary citizens in policy making and its implementation process were never seriously considered.²

Many development scholars now believe that people and the quality of their lives are at the center of the development challenge and that political optimization and human development are necessary for developmental progress. For such rethinking about development, Korea provides a good forum. Korea represents a particularly interesting case not only because of its importance as one of the success stories that critically undermined the

¹ Korea means South Korea, unless otherwise noted.

² The process of democratization since 1987 and the Kim Dae Jung government's “NGO empowerment” policy in particular have started to engender multiplication of diverse interest groups and civil-society organizations with cross-cutting and contradictory interests. But Korean civil-society movements remain dominated by a small number of large, elitist, and top-down organizations such as the Citizens' Coalition for Economic Justice and the People's Solidarity for Participatory Democracy. See Shin Yul, “Hankuk Shiminundongeu Kaenyomjok Wisangkwa Mun-jejom” [The conceptual status and problem of Korean civil society movement], *Korean Political Science Review* 35.2 (Summer 2001).

dependency or neo-Marxist explanation for the troubled industrialization experiences of non-Western countries,³ but also because Korean *dirigisme*, or system of state-led development, carried with it a flawed authoritarian rule, which undermined the fruits of development by directing the development process without genuine and principled regard for the needs and lives of ordinary citizens.

In terms of development in a purely economic sense, before the 1997 Asian financial crisis Korea was the poster child for the International Monetary Fund (IMF): the developing country that had obeyed all its rules and prospered. Korea, a member of the Organisation for Economic Co-operation and Development since 1996, almost uniquely had made it out of the poor-country category and into the ranks of the developed economies. After the wrenching financial collapse of 1997, however, Korea was often taken to illustrate the need for open markets and to show the dangers of state-directed development. While there are elements of truth in both stories, they contradict each other. Neither provides an adequate account of Korean *dirigisme*. This book offers a critique of how these conventional analyses have interpreted Korean development by focusing on the problems of Korean *dirigisme* that led to the crisis.

The problem this book examines lies at the intersection of two areas of discussion—development and the state—often carried out separately by different professional and academic groups. Both must be understood together to get an accurate sense of Korean *dirigisme*. Development economists, though increasingly recognizing the role of the state in economic development, have not been interested in an empirical understanding of the state in terms of what it does, how, and why.⁴ This book contends that *dirigiste* development strategies and the formation of societal support

³ Immanuel Wallerstein viewed the states in the periphery as having no autonomy or capacity vis-à-vis the core, unless they withdrew from the international system and resorted to autarchy. Wallerstein, *The Modern World System* (New York: Academic Press, 1974).

⁴ See A. Hirschman, *The Strategy of Economic Development* (New Haven, Conn.: Yale University Press, 1958); W. W. Rostow, *The Stages of Economic Growth* (Cambridge: Cambridge University Press, 1960); A. Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge: Harvard University Press, 1962); S. Kuznets, *Modern Economic Growth* (New Haven, Conn.: Yale University Press, 1966); G. Myrdal, *Asian Drama* (Harmondsworth: Penguin, 1968); P. Samuelson and W. Nordhaus, *Economics*, 13th ed. (New York: McGraw-Hill, 1989); A. Sen, *Development as Freedom* (New York: Alfred A. Knopf, 2000).

TWO

The *Dirigiste* Institutions of Korean Finance

This chapter investigates the profound historical continuity in the sociopolitical and institutional foundations of Korea's financial policy making and how the central state has wielded the financial system as an industrial policy instrument. Despite dynamic economic expansion and the onset of state-led liberalization and deregulation campaigns since the early 1980s, political power holders in Korea have controlled state bureaucracies and by means of them have persistently manipulated the financial industry.¹ Both bureaucrats and financiers have lacked autonomy and have frequently worked to please the power holders. These conditions have had direct repercussions on Korean *dirigisme*, adversely affecting the decentralization and democratization of the system and pursuit of people-centered development. To demonstrate how financial and bureaucratic institutions have served the whim of state power holders in Korea, we must first identify the key players in financial policy making and then outline the financial system that they controlled.

The Financial Policy Makers

The President, His Advisers, and the Blue House

In Korea, power is highly concentrated in the capital, Seoul; in the executive branch; and in the presidency.² In terms of power

¹ Such practice contradicted convergence theory, which posits that the process of modernization necessarily creates similar institutions in any country, no matter how different the polity's politics and social contexts may have been.

² See Gregory Henderson, *Korea: The Politics of the Vortex* (Cambridge: Harvard University Press, 1968).

THREE

The Sword-Wŏn Nexus

Fully understanding Korea's *dirigiste* disease requires us to trace the origins of the nation's state-led development. Shortly after coming to power through a military coup in 1961, the Park Chung Hee regime in Korea chose an unbalanced, *chaebol*-centered modernization strategy, at the cost of high inflation and underdevelopment of small business. The politics underlying it caused the authoritarian regime to funnel scarce capital into large firms at the expense of small ones. It was the Park regime's formation of a sword-wŏn nexus and consequent unbalanced modernization that set into motion a diseased development process in Korea. The development process displayed certain pathological symptoms that subsequently metastasized into a full-blown economic, political, and societal disease. Korea's *dirigisme* assumed its essential form in the early 1960s.

By looking at the origins of Korea's *dirigisme* under Park, we can critically assess the influential developmental state model, which emphasizes the dominance of the *dirigiste* state's autonomous pilot bureaucracy.¹ In modifying or clarifying the limits of the model, Korea constitutes the hardest test case. Under President Park's leadership, Korea seemed to exemplify the classic developmental state. But even during the early stages of Korean industrialization, it was not professional bureaucrats but the key political power holders who ultimately decided policy direction.

The argument here also goes beyond Evans's static concept of embedded autonomy.² To understand the dynamics of change in modernization strategy, its critical link to elite coalition politics, and the attendant patterns of building social bases of support, one cannot look only at the state's embedded relationship with private

¹ Johnson, *MITI*; idem, "Political Institutions and Economic Performance."

² Evans, *Embedded Autonomy*.

FOUR

The Yushin Coalition

The diseased form of *dirigisme* crystallized dramatically in the 1970s. The intensification of top-down, authoritarian control through the introduction of the 1972 Yushin Constitution and the resultant implementation of the HCI drive magnified the four defining components of Korean *dirigisme*: top-downism, use of vested interests as proxies, preoccupation with growth, and battle speed. A full-scale metastasis was taking place.

The Politics of the Deepening Elite Collusion

During the Third Republic, the Park regime had been able to practice limited democracy or “soft authoritarianism.” In March 1963, after Park gave in to U.S. pressures and decided not to extend military rule for four more years, a presidential election was held in October. Thanks in part to the KCIA and the ruling DRP’s effective campaigning and vote mobilization, Park won the election by a narrow margin. Park obtained 46.6 percent of the vote, while his main rival, Yun Po-Son, received 45.1 percent. In the National Assembly election a month later, the DRP won 63 percent of the seats over a divided opposition through only 33.5 percent of the popular vote.¹ The newly introduced proportional representation system, which awarded half of the 44 national constituency seats to the DRP for winning the most direct constituency seats, made possible the ruling party’s control of the legislature.²

¹ Central Election Management Committee, *Taehanminkuk Sonkosa* [The electoral history of the Republic of Korea], various issues.

² For the specific content of the 1963 National Assembly election law, see Kim Woon Tae, *Hankuk Chongch’iron* [On Korean politics] (Seoul: Pakyongsa, 1991 [1976]), p. 351.

When the Statist Coalition Changes

The previous two chapters examined how Korea's authoritarian *dirigiste* regime under Park Chung Hee chose to grant—at the expense of small firms, consumers, and other ordinary citizens—privileged access to subsidized industrial credits to a select group of large enterprises, which subsequently became *chaebol*. The *chaebol* acted as the ruling regime's private-sector proxies for delivering quick, though unbalanced, economic growth. The regime under Chun Doo Hwan switched to a more balanced modernization and began to shore up the hitherto neglected and ailing small firms, but it remained no less authoritarian than the preceding Park regime. The flow of government-controlled credits started to shift in favor of small business. No one has yet offered a coherent and systematic explanation for the variation in financial policy of these two very similar Korean regimes.

The Background to the Shift in Financial Policy

The policy shift occurred in the face of entrenched big-business interests and in spite of the weak political muscle of the small-business sector. This empirical reality challenges Stigler's elegant theory of regulation.¹ Among other things, that pluralistic theory fails to look at the dynamics of *dirigiste* political economy and the impact of statist structure on the way interest groups play politics. Financial policies in Korea reflected the state's choice of modernization strategy. The ruling regime's political exigencies and choices dictated the elitist and top-down process of policy making.

¹ Stigler, "The Theory of Economic Regulation." According to the parsimonious predictions of Stigler's theory of economic regulation, small interest groups with higher stakes and superior organization wielding direct influence on given policy outcomes receive the lion's share of the policy, prevailing over larger groups with smaller, diffused, or unmobilized interests.

The Perspective of Small Business

The abrupt adjustment in the early 1980s of the nation's highly *chaebol*-biased modernization strategy resulted in a less discriminatory flow of industrial credits to small business. Changes in state policy, however, were not accompanied by changes in undemocratic *dirigiste* institutions: the elitist, authoritarian, and collusive system remained intact. The top-down strategic change was unilaterally imposed and did not lead to societal renewal or empowerment. The lack of organized small-business interests delimited the depth and impact of policy change. Korea's undemocratic *dirigisme* and the state's close link with its *chaebol* proxies demonstrated a persistent staying power.

The *Dirigiste* Legacy

The first half of this chapter examines how undemocratic *dirigiste* institutions inhibited fuller expression of the changes in financial policy toward small business that came in the early 1980s. It does so from the standpoint of small businesses as they lived through them. Against such an institutional backdrop, the second half of the chapter sheds light on the little-known motivations, perceptions, and performances of small-business people in Korea. In so doing, the chapter aims to offer a more nuanced account of the state of Korean small businesses. Hence, it first identifies and critically assesses three core historical-institutional aspects of top-down *dirigisme*, whose legacies have fettered SME development: unbalanced modernization, time-honored practices of financial institutions and big firms in dealing with SMEs, and the lack of viable grassroots SME organizations.

The 1992 suicide of Koo Chun Soo, a respected fifty-one-year-old owner of a small auto parts company, dramatized the problems. Koo's case made national headlines because he had won a prestigious government prize for his outstanding contribution to

Dirigiste Coalition Politics in Japan and Taiwan

This chapter is about *dirigiste* coalition politics in Japan during the period of clear LDP dominance and in Taiwan during the authoritarian period that ended in the late 1980s and early 1990s. Both Japan and Taiwan resembled Korea in their adoption of credit-based, price-administered financial systems, yet neither Japanese nor Taiwanese state power holders exploited their control of financial institutions to forge Korean-style collusion with big private capital. The different ways in which the three states wielded their similarly structured financial systems also resulted in divergent industrial structures. In Japan, for instance, both big and small businesses prospered. In Taiwan, small firms thrived, while the few large ones that developed were largely SOEs. Large private groups in Taiwan did exist and have grown much lately, but they have remained significantly smaller, less diversified, and less leveraged than those in Japan or Korea.

The chapter has two aims: to account for the differences in financial policy toward small business and the relative absence of Korean-style *dirigiste* disease in Japan and Taiwan and to illustrate the similarities in the historical and institutional processes of *dirigiste* policy change.

Japan

This section examines how and why the democratic Japanese state adopted an unbalanced modernization strategy in the 1950s and 1960s and then switched to balanced, small business-oriented modernization in the early 1970s. Before exploring Japanese-style *dirigiste* coalition politics, some words are in order on the difference between Japan and Korea in terms of small-business organization (see table 2). Compared to Korea or Taiwan, Japan

The Financial Crisis and Its Aftermath

The 1997 currency and financial crisis represented the clearest manifestation of the dysfunction of Korean *dirigisme* and its accompanying state-finance-industry collusion. The crisis, apparently due to an influx of funds and ill-prepared liberalization, more fundamentally reflected a diseased *dirigisme* squeezed between productivity concerns and labor demands. Varying analytic lenses offer different accounts of “what went wrong” in 1997, what continues to be amiss in Korean political economy and in the state’s role, and how to remedy problems in the future. The strands of positive analysis are inextricably entwined with policy directions and various lines of social critique. Post-1997 marketization reform has been characterized by the stickiness of unreconstructed statism, despite the government’s many drastic measures attempting to make Korea an “open trading nation.” Under a democratic facade, the old statist, elitist, and authoritarian style of handling things and dealing with people persists.

The Dysfunction of Korean *Dirigisme*

At the close of 1997, Korea witnessed the unfolding of its worst economic disaster since the Korean War. Beginning with a currency crisis in Thailand on July 2, 1997, the Asian crisis spread like wildfire, and at the end of November Korea verged on defaulting on its \$157 billion external debt, the short-term portion of which amounted to \$92 billion.¹ After the BOK’s futile attempt

¹ Nonperforming loans in Korea at the end of 1998 totaled 60.2 trillion wŏn (then about \$50 billion) or 10.4 percent of all loans; the figure could be over 100 trillion wŏn if more strict international criteria were used. *Chosun Ilbo*, March 5, 1999.

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