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## Korea's evolving business-government relationship

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## **Korea's evolving business–government relationship**

Eun Mee Kim\*

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**Abstract:** South Korea has gained economic development despite the obstacles it faced as a war-torn country with little natural resources and capital. Poverty, lack of democracy, as well as war and conflict were challenges the country faced in the early 1960s; issues not very different from what many developing countries face in the 21<sup>st</sup> century. This paper focuses on the following topics during the most dynamic period in South Korea's economic development from 1960s to 1980s: the developmental state and industrial policies; the role of the private businesses; and state–business relationship.

**Keywords:** state–business relations, private sector, economic growth, Korea

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## 1 Introduction

South Korea's rise from one of the poorest countries in the world in the early 1960s with a GDP of USD2.36 billion to USD1,304.55 billion in 2013, is an expansion of economic magnitude rarely seen in world history (World Bank 2014). More impressive is the rise in GNP per capita from USD82 in 1961 to USD25,977 in 2013, which tells the story of dramatic poverty elimination and economic development (World Bank 2014). South Korea has gained economic development despite the obstacles it has faced as a war-torn country with little natural resources and capital. Poverty, lack of democracy, as well as war and conflict were challenges that South Korea faced in the early 1960s; issues not very different from what many developing countries face in the 21<sup>st</sup> century. In 2010, South Korea joined the OECD's Development Assistance Committee (DAC), and is currently the 15<sup>th</sup> largest economy in the world. It has become active on the world stage by sharing its own experiences of social, economic, and political development to developing countries as well as through foreign assistance.

Korea suffered from Japanese colonialism (1910-45), and the Korean War (1950-53), which left the country divided in two—to South Korea or the Republic of Korea in the south and North Korea or the Democratic Republic of Korea in the north—and nearly destroyed all the industrial and agricultural bases for development. The obstacles for development appeared insurmountable, and pundits remarked that South Korea was a 'hopeless case'.

However, South Korea made a dramatic transition from a hopeless case to a success case. Although its rapid economic development occurred in the latter half of the 20<sup>th</sup> century, its experiences are still relevant for developing countries in the 21<sup>st</sup> century since there are few contemporary cases of such successful social and economic development and poverty eradication.

Some have argued that South Korea's post-war development was due to the enormous foreign assistance it received economically and militarily as well as to the United States (US) markets that were open for foreign imports. South Korea received a total of USD12.78 billion in official development assistance (ODA) from 1945 to 1995. Although many other countries received large amounts of foreign aid, only few countries have made the transition from an aid-dependent nation to an aid-donating one. Thus, we start with the assumption that foreign assistance itself is not necessarily the answer for a nation's development, and focus on the domestic institutions that took advantage of foreign aid as well as the global market. In South Korea the developmental state and private businesses were the two main engines of development. We will examine the nature of these two institutions, and how their relationship changed over time with successful development.

This paper focuses on the following topics during the most dynamic period in South Korea's economic development from 1960s to 1980s: the developmental state and industrial policies; the role of the private businesses; and state-business relationship. We will conclude the paper with lessons for sub-Saharan African (SSA) nations, and recommend the 'democratic developmental state'.

## 2 The 1960s: overcoming insurmountable challenges with the developmental state for rapid industrialization

South Korea's rise from one of the poorest countries in the world to an industrial powerhouse began from the early 1960s. Thirty-five years of the Japanese Colonial period left the country in

economic imbalance since its growth was not in the interest of Japan. Korea was forced to provide raw material and agricultural products to Japan, and the Korean peninsula's railway and other transport systems were geared towards war efforts with China. In November 1943, with the hope to see the end of the Second World War (SWW), the heads of allied forces, President Franklin Roosevelt of the US, Prime Minister Winston Churchill of the United Kingdom, and Chiang Kai-shek of China, met at the Cairo Conference to discuss how Japan's colonies would be managed after the war. They decided that Japan should lose all territories, and that Korea should become free and independent. In early August 1945, the Soviet Union forces invaded Manchuria according to the agreement at the Yalta Conference in February 1945. The Soviet forces also arrived on the Korean peninsula immediately after Japan's defeat in the SWW. The US also arrived on the Korean peninsula concerned that the Soviet Union could make Korea a Communist country. As a result, the Soviet Union occupied the northern part of the peninsula while the US occupied the southern part. Since the two countries could not agree upon forming one government on the Korean peninsula, the two nations decided to divide the country roughly in half along the 38<sup>th</sup> parallel line. The southern part of the 38<sup>th</sup> parallel would be under the provisional government of the US, while the northern part would be under that of the Soviet Union. This decision to divide the country in half has had lasting consequences to this day.

In 1948, after the two provisional governments could not agree upon one nation, the US-supported south held a national election, and President Rhee Syngman was elected as the first President of the Republic of Korea on 15 August 1948. In the north, Kim Il-sung became the Prime Minister (and, later President and the 'Great Leader') and the Democratic People's Republic of Korea was established on 9 September 1948. On 25 June 1950, North Korea led a sudden attack on South Korea, and the entire Korean peninsula became a hot war zone. As the front line moved up and down the peninsula several times, the whole area suffered great damages and human casualties. South Korea lost nearly 80 per cent of its industrial capability with a total of over USD2.28 billion in damages when the war was over (Daggett 2010). Over 200,000 military personnel and over one million civilians were killed or were missing after the war. The US also lost over 36,000 military personnel and over 103,284 civilians (Daggett 2010). North Korean human casualties reached over 406,000 military personnel and over 600,000 civilians. China also lost over 716,000 military personnel when it helped the North Korean army during the war (Daggett 2010).

The war came to an end when the Armistice Agreement was signed in July 1953. However, the Armistice was not an official end to the war since it is not a permanent peace treaty; the two Koreas remain at war even to this day. There have been numerous military incidents along the border, at sea, and inside South Korea when North Korean infiltrators invaded the South Korean territory. The threat of another military attack had been perceived to be quite palpable during the early phase of South Korea's industrialization, especially when its level of economic development was considered to be inferior to that of North Korea. This state of military instability and threat of war represent one of many obstacles South Korea has faced.

The devastation of the Korean War has also left emotional scars to the people. Korea had boasted a history of over 5,000 years as one nation and one people. Division of the country after SWW, establishment of two different governments, and the Korean War has divided Korea into two. The Korean War brought the military forces and the people pitted against each other. Although the war ended at least temporarily in 1953, there are no channels of communication for the ordinary citizens even to this date—phone calls, letters, and visits are not permitted. The challenges of the war go beyond economic and political issues and run deeply in the psyche of the Korean people.

In the aftermath of the devastation of the Korean War, the South Korean economy was in ruins. Its GNP per capita was recorded as one of the lowest in the world, and the economic damage exceeded the entire GNP of 1949, which is the year before the war (Daggett 2010). President Rhee was unable to lift the country out of extreme poverty and his administration was mired with political scandals due to collusive ties between politicians and businesses. Foreign aid was an important source of government revenue, and there were suspicion that a substantial share of foreign aid was pocketed by the businesses with collusive ties with the politicians. The government put together economic development plans, but the inept government was not able to lead the private businesses to engage in industrialization. The economy staggered as inequality rose and inflation ran high.

The people's dissatisfaction grew with the rigged election on 15 March 1960 when President Rhee used illegal means to have his close ally to become the Vice President. The people's outcry exploded when a student's body was found in the Masan Harbor with a tear-gas shell lodged in his body from the Masan demonstration following the election. University and high school students took to the streets in several cities on 19 April 1960 and demanded that the government should investigate the death of the student as well as the election fraud. However, the military opened fire on the demonstrating students as they marched to the President's residence, which triggered a nation-wide demonstration. These series of events have been named as the April 19 Revolution or the April 19 Movement. On 26 April 1960, President Rhee announced his resignation and went into exile.

President Yoon Po Son was elected soon after, but his administration had to accept a major change in the political system into a parliamentary one with Chang Myon as the Prime Minister. Thus, the era following President Rhee is named the Chang Myon Administration (1960-61). Prime Minister Chang had two mandates from the people: democracy and economic growth. However, great political instability continued, and the economy was not in any better shape. Even with a newly revised economic development plan, the Chang regime could not turn the economy around.

On 16 May 1961, Major General Park Chung Hee led a military coup with a declaration that he felt compelled to take control of the nation to bring 'economic self-sufficiency and prosperity' in order to end poverty (Park 1966). The coup was a bloodless one, and the public accepted the coup in recognition that something had to divert the country from the course of political instability, poverty, and chaos. Although a military coup is never an answer to a chaotic situation, this is what happened in South Korea. In 1963, General Park ran for President and was elected as President.

The Park administration focused on economic development immediately following the coup. Two important strategies were announced: (1) creation of a comprehensive developmental state to lead the process of economic development; and (2) transformation of the state-business relationship from corruption and personal ties to a working partnership with formal relations (see Kim 1997).

## **2.1 The developmental state**

The Park administration decided that the government will be in control of the economic development process since private businesses or other sectors of the society were deemed to be appropriate to lead. In particular, the private businesses were considered to be mired in corruption, and were subject to a major overhaul to transform the working relationship with the government. As the first step, the government was reorganized with economic development as its top priority. The Economic Planning Board (EPB) was created on 22 July 1961 as the 'super-

ministry' to lead the other economy-related ministries of the Ministry of Finance (MOF) and the Ministry of Trade and Industry (MOTI). These three economic ministries formed the troika of the South Korean developmental state (Kim 1997). The EPB was the lead ministry among all the line ministries since it controlled the government budget. The EPB's principle functions included comprehensive development planning for the national economy; industrial policies; and government budget (EPB 1982). It was the leading ministry in the 1960s and 1970s, while the Minister was also the Deputy Prime Minister.

The developmental state in the 1960s and 1970s was characterized as comprehensive since its primary goal was economic development. Other goals of the government, including national security and social services, remained as secondary (Kim 1997). The developmental state is characterized with the following traits: (1) provision and implementation of comprehensive development planning, i.e. five-year economic development plans (FYEDPs); (2) leading the private sector with direct support (carrots) including access to domestic capital, foreign aid, and technology; and (3) disciplining of the private sector through control of licenses, taxes, and audits (see Amsden 1989; Kim 1997; Woo 1991). The domestic banks were nationalized and put under state control, which enabled the developmental state to use domestic bank credit as carrots. Foreign capital loans and ODA to South Korea were also under the state's control. The developmental state provided guarantees for repayment when South Korean private enterprises sought foreign loan capital. The developmental state was also in control of the disbursement of ODA, which was a large source of foreign capital throughout the 1960s and 1970s.

Thus, the developmental state was very effective in pursuing its national development plans since it had good ideas, but more importantly, sound instruments for intervention, i.e. carrots and sticks. The predecessor Rhee and Chang regimes also had designed national development plans; however, they were not able to implement them. It was only in the Park administration, when the development plans were implemented with great success. Both the capacity and autonomy of the South Korean state were enhanced in the Park administration compared to the past administrations (Rueschemeyer and Evans 1985). The government ministries were reorganized and the corrupt government bureaucrats were prosecuted. Government reform was an important goal of the Park administration, and was quite a successful one.

Many attribute this success to the Park administration's autonomy from the elites of the nation that controlled the government, national assembly, and private businesses. The two leaders of the Park administration, President Park Chung Hee and Prime Minister Kim Chong Pil (former Lieutenant Colonel who assisted Park in the 1961 military coup), had no ties to the elites (Koo 1987). Thus, the state's capacity and autonomy, which are the two key elements of state's effectiveness, were both enhanced in the aftermath of the military coup in the Park administration (Rueschemeyer and Evans 1985). The Illicit Wealth Accumulation Charges were a prime example of how the Park administration tamed private businesses into a working relationship with the government. The developmental state was in charge.

In addition, the developmental state of the 1960s and 1970s used the authoritarian means to control and discipline the private businesses, i.e. sticks. The Park regime effectively used the threat of tax audits, investigation of illicit accumulation of wealth and corruption, and sometimes North Korean sympathizing activities to investigate and prosecute the *Chaebols*<sup>1</sup> and the private businesses that were not in line with the developmental state's FYEDPs and industrial policies. The most widely used threat was withdrawal of preferential domestic bank loans if the target

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<sup>1</sup> South Korea's family-owned and -managed business groups.

goals including manufacturing and export volume as well as growth rates were not reached. The discipline and use of sticks were widely and effectively used by the developmental state.

Nevertheless, we have to differentiate the developmental from the authoritarian dimensions of the state; they are not two sides of the same coin. Rather, they are distinct dimensions that are sometimes paired together. This is an important point when we examine the developmental state and its effectiveness in achieving the goal of economic development (see Kim 1993). Since the South Korean developmental state was also an authoritarian state during the 1960s and 1970s, we tend to assume that the combination of the developmental and authoritarian state is the winning formula for successful development. However, numerous examples from around the world show that an authoritarian state that is developmental does not necessarily attain the goal of development, and there are many more cases in which such a state brings rent-seeking, corruption, and stagnant economy. The cases of South Korea during the Rhee Syngman and Chang Myon administration are such examples, as well as many other authoritarian regimes around the world including the Marcos regime in the Philippines and countless other authoritarian regimes that failed to bring national development. We will demonstrate later that the South Korean economy grew even more robustly under a democratic developmental state.

## **2.2 The FYEDPs and industrial policies**

The developmental state announced and successfully implemented a series of FYEDPs. As discussed above, earlier administrations also had development plans, but they were not implemented. It was only in the Park administration when the Plans could be implemented with a government reform to establish a developmental state with capacity and autonomy.

The first FYEDP was announced in late 1961 and took effect from 1962 to 1966. The main goal was to create a self-reliant economy by transforming the agrarian economy to an industrial one by securing resources, expanding basic industry and infrastructure, improving the balance of payments (including negotiations for foreign aid), and promotion of technology (FKI 1987). The target for the annual economic growth rate was set at 7.1 per cent (FKI 1987). Although the first FYEDP ran into some problems, the economy grew at an average of 8.9 per cent and the manufacturing sector grew at 29.2 per cent (EPB 1978; International Monetary Fund 1979). These were impressive growth rates that were unprecedented in South Korea. The developmental state was created to lead this process, the domestic private businesses were selected as the state's partners, and the modus operandi of state-business relationship had changed from the previous decades of corruption and economic stagnation.

The second FYEDP focused on exports. Export-oriented industrialization (EOI) had been chosen as the South Korean development strategy based on the fact that South Korea needed foreign capital for development. Given the country's lack of natural resources, capital, and technology combined with only a relatively well-educated labour force, Japan's example of EOI was adopted. South Korea decided to focus on the light manufacturing sector for its industry and exports, particularly due to its rather short history of industrialization, as well as lack of capital and technology.

The goals were again set at impressive rates: 7 per cent for annual average growth rate, USD700 million in export sales, and the industrial structure was to be modernized. Specific strategies included self-sufficiency in food production, self-sufficiency in water resources for energy, increase in employment, restraint of population growth through family planning, and promotion of science and technology (FKI 1987). The targets were set high and strategies were very broad from industrial planning to family planning.



The second FYEDP proved to be even more successful than the first. Light manufacturing sector products including textiles, clothing, footwear, ply wood, wigs, and stuffed toys were leading exports. The EOI based on light manufactured products turned out to be hugely successful. The international market, and most importantly, the US market were wide open for foreign imports. South Korea's cheap light-manufactured products successfully penetrated the US market and occupied the large discount stores in the US (see Kim 1997; Woo 1991).

The economy grew faster than what the government announced, and reached 11.1 per cent average annual growth rate and the manufacturing sector grew at an average annual growth rate of 21.1 per cent (EPB 1978; International Monetary Fund 1979). Exports grew at 28.7 per cent per annum, which was the fastest in the world at that time (EPB 1978; International Monetary Fund 1979). Exports were occupying 15.8 per cent of South Korea's GNP in 1971, compared to the mere 5.3 per cent in 1961 (EPB 1978; International Monetary Fund 1979).

### **2.3 Changing state–business relationship**

The Park administration sought to transform the state–business relationship: (1) the state would become the dominant partner; and (2) the private businesses would be tamed with carrots and sticks, i.e. with access to resources and/or with sanctions and licenses. The most dramatic measure that signaled a qualitative change in the state–business relationship was the Illicit Wealth Accumulation Charges in the immediate aftermath of the 16 May 1961 military coup. Although similar measures were also in effect during the Chang administration, they were finally executed with force when Park came to power. During the Rhee and Chang administrations, the corrupt politicians doled out favours to private businesses with whom they had personal ties, and private businesses provide political kickbacks (Jones and Sakong 1980). These corrupt businesses made profits based on rent-seeking rather than in productive manufacturing or in services (Jones and Sakong 1980).

Thus, only 12 days after the military coup on 28 May 1961, the Supreme Council for National Reconstruction, which was headed by General Park, announced that the charges of Illicit Accumulation of Wealth would be investigated and executed (Kim 1997). That same day, major business leaders were arrested and charged under the above mentioned charges, which included the following allegations: illegal acquisition of government properties, tax evasion, capital flight, unjust profiting from foreign aid, political kickbacks, etc. (Korea Yearbook 1961, 1962). All the major large businesses' heads were jailed except for Samsung's Lee Byung Chull, who happened to be on a business trip to Japan (Korea Yearbook 1962). Lee was also subject to the charges, and he returned to South Korea with a deal that was reached for him to donate a large share of his businesses to the South Korean government and his pledge to support the Park administration's development plans (Kim 1997). On 9 May 1962, MOTI announced which of the Samsung companies would be donated to the government in lieu of fines (Korea Yearbook 1962, 1963). Other businesses were also given verdicts to donate businesses in lieu of fines and prolonged jail sentences to the CEOs of businesses.

The charges also targeted corrupt politicians and government officials. They were prosecuted with a strong moralistic tone of the Park administration with an implicit message that even democratically elected politicians could be subject to corruption charges and were the culprits with private businesses for the economic failure of the previous administrations (Korea Yearbook 1962, 1963). The swift and unequivocal prosecution of the charges also sent a clear message to the public: corruption would not be tolerated; state–business relationship will change to a productive partnership based on formal working relationship rather than on personal and corrupt ties; and the developmental state was in charge.

## 2.4 Private businesses

The Park administration had choices to make in terms of whom to consider as the primary partner for economic development. Before deciding on domestic private businesses, several other groups were eliminated from potential partnership. First, the multinational corporations (MNCs) were eliminated from the running. Due to South Korea's history, foreign powers were not to be wholly trusted as primary institutions for national development. Historical relationship with China and Japanese colonialism resulted in South Korea's strong yearning for independence from foreign powers. Moreover, South Korea was of little interest to MNCs. Unlike Brazil or Mexico in Latin America, where the MNCs found natural resources, large domestic market, and lucrative investment opportunities, South Korea presented none of these attributes. South Korea's economy was in near ruins after the Korean War and years of economic stagnation; there were no natural resources; the market was relatively small; and there was great political instability. There was nothing to make South Korea an attractive investment site for MNCs. Thus, it was mutually agreed that MNCs would not be viable partners for South Korea's economic development.

State-owned enterprises (SOEs) were also eliminated from the running. Due to the corruption and collusive ties between politicians and private businesses that resulted in economic stagnation of the previous Rhee and Chang administrations, the Park administration needed a break from the past. The SOEs were seen with suspect that they could become fertile ground for corruption, and thus the SOEs were not seen as politically viable candidates. Thus, in South Korea, compared to Taiwan, for example, there were relatively fewer SOEs even in the beginning phase of its economic development.

Small and medium size enterprises (SMEs) were also not seen as the most effective partners. The Park administration had very little time on its hands since it needed to earn the public's trust and legitimacy with economic returns and SMEs were seen as not big enough to lead rapid economic development. This became even more important in the 1970s when the South Korean government led the heavy and chemical industrialization drive.

Finally, the large private domestic businesses were selected as viable business partners for the South Korean developmental state. Amsden (1989, 2010) argues that South Korea's developmental state's decision to nurture domestic enterprises was a key to its sustained economic development. Without domestic enterprises, she argues that a late industrializing nation cannot effectively catch up and bring about economic development for a long term (Amsden 1989, 2010).

South Korea's leading large businesses went through major changes when the Park regime came into power in 1961. As the developmental state took charge of the economy and controlled the private businesses with the effective use of carrots and sticks, many of the private businesses could no longer compete and went bankrupt. And a new group of Park-era private businesses was born.

## 3 The 1970s: strong state–business developmental partnership in the heavy and chemical industrialization (HCI) drive

After only a decade of rapid economic development, which was led by EOI with the light manufacturing sector, the South Korean government announced a major shift in its economic development strategy. Citing the imbalances in its economy favouring the light manufacturing sector and urban areas, the South Korean government announced that the third FYEDP would

focus on 'balance' between the light and heavy industries and between the urban and rural areas. Thus, HCI and rural development became two primary goals of the third FYEDP (EPB 1972; FKI 1987). The HCI was promoted with the 1973 announcement of the HCI drive by President Park and rural development was pursued with the *Saemaul Undong* (New Village Movement) since 1970. The target growth rates were set at GNP per capita of USD1,000 by 1981 and USD10 billion in exports (Koo and Kim 1992).

However, South Korea's ambitious plans for HCI met with great skepticism from the US and other donors. When it presented plans for an iron and steel mill, the US, West Germany, and other donors turned down the South Korean government's proposal. It was seen as premature for a nation with only a decade of industrialization based on light manufacturing sectors to begin HCI with iron and steel, automobile, and heavy machinery.

The Park government was determined to promote HCI. Since the US and other Western donors did not support its ambitious goals, South Korea negotiated with Japan, which it had severed diplomatic ties since the end of the SWW, to normalize diplomatic relations and to be given reparation funds for the colonial period. In 1965, South Korea normalized its diplomatic ties with Japan, and received the reparation funds, which were used to establish the Pohang Iron and Steel Company in 1968, which later became POSCO.

The experience of HCI demonstrates how South Korea took ownership of its own destiny and negotiated in spite of its limited leverage. South Korea's strong desire to promote HCI was driven not by economic needs, but by political and military strategies. The South Korean government was deeply concerned about its ability to defend its nation given the threats of North Korea for another invasion, and the defense industry was seen as vital for national security. North Korea military officers infiltrated South Korea on spy missions, and in 1968 a group of highly-trained North Korean military officers reached very close to the Blue House. North Korea's threat to national security was serious. A former military general, President Park was determined to have a strong defense industry controlled by domestic businesses.

President Nixon of the US announced in the Guam Islands on 25 July 1969 that the defense of the Asia Pacific must be in the hands of the people of the Asia Pacific, which later became known as the Guam Doctrine. President Nixon also announced future plans for the partial withdrawal of the US troops in the Korean peninsula. The Guam Doctrine sent shock waves throughout Asia, and President Park reaffirmed his zeal for a self-reliant military and defense industry (see Kim 1997). The domestic political situation was also precarious. President Park narrowly won another Presidential term in 1971, and he needed to secure a firm support base with the private businesses.

The HCI was selected as a strategy that would help solve many challenges faced by Park: (1) secure domestic political support by nurturing large private businesses; (2) develop the defense industry; and (3) overcome national security challenges. And, the Park administration decided to work with large business enterprises, since they were the ones with larger capital bases and access to technology necessary for heavy and chemical industries compared to SMEs. Thus, it was in the 1970s when the large private businesses were transformed into major conglomerates known as Chaebol in Korean.

The Chaebols have distinct business traits: (1) diversified businesses in several distinct sectors including light and heavy manufacturing sectors, services including non-banking financial services, and retails; (2) vertical business structure with strong ownership exercised by the founder and his family even through successions; and (3) global brands. Although the name, Chaebols dates back to the Japanese Colonial Period, and many were established during the Rhee

and Chang regimes, it was not until the 1970s when a few large enterprises reached the Chaebolism with strong state support for HCI.

### **3.1 The developmental state**

The developmental state needed partners that could deliver heavy and chemical industries, and the private businesses needed the state to take advantage of the state's provision of preferential access to capital and technology through HCI. Thus, a symbiosis between the developmental state and the private businesses was forged. The developmental state provided the preferential subsidies to the hand-picked private businesses for HCI: (1) low interest rate domestic capital; (2) access to foreign capital loans with government repayment guarantees and provision for 100 per cent foreign direct investment; and (3) protection of monopoly or oligopoly in domestic market (see Amsden 1989; Kim 1997; Woo 1991). The developmental state continued to strengthen during the 1970s with strong control of both the carrots and sticks in their relationship with the private businesses.

The developmental state sometimes used coercive measures to discipline the private businesses including tax audits, withdrawal of bank credit, and use of secret service to track down possible connections with North Korea for national security breaches (see Kim 1997 for details). Labour was also repressed with regards to labour rights including assembly, unionization, and wages.

### **3.2 HCI drive with industrial policies**

President Park made the Pronouncement for the Development of the Heavy and Chemical Industries during the State of the Nation message on 13 January 1973, which showed how strong President Park regarded HCI. Unlike other economic development plans, this was highlighted during the State of the Nation message, and President Park convened regular meetings to make sure that the HCI drive was implemented effectively and on time (see Kim 1997).

Six target industries were selected for HCI by the developmental state: (1) iron and steel; (2) non-ferrous metal; (3) machinery; (4) shipbuilding; (5) electrical appliances and electronics; and (6) petrochemicals. These six target industrial sectors were carefully chosen by the developmental state with strong potential for backward and forward linkages; multiplier effect for the national economy; and foreign capital earnings through exports (Kim 1997). Except for the iron and steel, which was chosen for a SOE, all other sectors were destined for the private sector. In fact, President Park and his close confidants were known to have hand-picked the private businesses for each of the six target industrial sectors with the exception of the iron and steel, and electrical appliances and electronics. The former was established as a SOE, and the latter was seen as already having a number of viable private businesses that would require less state support than the other five sectors (Kim 1997).

President Park's strong support for the HCI was important for the success of the HCI drive. The hand-picked Chaebols tremendous growth also contributed to the economic development and industrial deepening in the 1970s. In spite of two oil shocks in the 1970s, the South Korean economy grew at an average of 7.9 per cent and its GNP per capita increased from USD285 in 1971 to USD1,589 in 1980 (EPB 1986).

Among the largest ten Chaebols, the ones that were selected for the state's target HCI sectors and given preferential treatment outgrew their counterparts. The average annual growth rate of total assets in 1971-80 shows how dramatic the growth of the hand-picked Chaebols was: Hyundai grew on average of 38 per cent, Daewoo at 53.7 per cent, and Sunkyong (later became SK) at 36.7 per cent (Kim 1997: 153). Although the developmental state's goal was focused on

heavy and chemical industries, the continued strong export performance of the light manufacturing sector throughout the 1970s helped sustain South Korea's rapid economic development in the 1970s and did not bring lower employment rates, which are typical of HCI sectors.

However, the growth of the hand-picked Chaebols growth in the 1970s is not just a developmental state-led growth story. There are legendary stories of the Chaebols founders such as Chung Joo Young of Hyundai, who showed strong entrepreneurship beyond state-sponsorship. The growth of the Chaebol in the 1970s' HCI drive should be understood as a partnership between the developmental state and private businesses. The relationship has evolved from a clear state dominance in the 1960s to symbiosis in the 1970s: both the developmental state and the Chaebol had evolved and the latter was becoming a force on its own.

The end of the 1970s saw important changes in South Korea's political economy. President Park was assassinated on 26 October 1979 ending his long authoritarian rule. Prime Minister Choi Kyuha succeeded the Presidency according to the South Korean law for succession. The second Oil Crisis in 1979 swept through the world and also hit the South Korean economy. On 12 December 1979, another Military General, Chun Doo Hwan led a coup within the military barracks—he became the President in 1980. Factory workers and students took to the streets protesting the suspicious circumstances surrounding President Chun, which has been known as the May 1980 uprisings. The City of Kwangju suffered the greatest in the crackdown by the military forces with civilian casualties ranging from a couple hundreds to thousands. The yearning for democracy escalated throughout the 1980s in spite of the oppressive Chun administration.

#### **4 The 1980s: changing state–business power dynamics**

'The 1980s were a time of great social, economic and political upheaval in South Korea' (Kim 1997: 167). Successful economic development in the 1960s and 1970s was due to the strong developmental state, and also the large business groups known as the Chaebol. The labour, which was largely suppressed in terms of their political rights and wages in the 1960s and 1970s, also grew in number and labour unionization. Thus, the pressure toward the developmental state came from all corners of the economy and society: (1) the Chaebol requested that the developmental state relax its tight control over the private businesses—sticks— while it maintain the state's subsidies—carrots; (2) the labour requested that their political rights for assembly should be honored and their wages should be increased; and (3) students, workers, and the middle-class demanded that democracy should be installed, i.e. with free and open Presidential elections.

##### **4.1 From a comprehensive to a limited developmental state**

President Chun responded to the changing global market and domestic pressure to loosen the developmental state's tight control of businesses and labour. The Chun regime embarked on a series of economic stabilization and liberalization measures that also helped to differentiate from his predecessor President Park Chung Hee. The above mentioned measures included: (1) industrial targeting would change from selecting target sectors for heavy government subsidies to supporting sunset industries for soft landing; (2) developmental policies and industrial policies would take back stage compared to regulatory policies; and (3) important carrots of the developmental state including state-owned banks, policy loans, and industrial licensing would be abolished (Kim 1997: 174). Furthermore, the developmental focus was weakened with welfare

services taking a greater policy emphasis in the FYEDPs. In fact, the FYEDP was renamed as the Five-Year Economic and Social Development Plan in the 1982 fifth plan. Development was no longer the primary and sole goal, and regulatory offices were created and existing ones were expanded. In 1981 the Fair Trade Commission and the Office of Fair Trade were established within the EPB, and the MOF began to privatize domestic state-owned banks that were under state control for nearly two decades (EPB 1989).

The EPB was disbanded in 1994 after its establishment in 1961. The planning function was reduced to a minimum, and the national government budget was moved to a separate National Budget Administration on February 28, 1998. The EPB was merged with the Ministry of Finance and became the Ministry of Finance and Economy.

The industrial policies also took a qualitatively different character, and the MOTI, which administered industrial policies, went through great changes. For example, industrial targeting changed from picking private businesses for state's preferential treatment to one supporting sunset industries with a finite time limit of 3 years with reduction in total support (Kim 1997). Industrial licensing for private businesses was eliminated in most industries. Thus, the corridors of the MOTI were no longer swarming with representatives from private businesses looking to secure industrial licenses (Kim 1997). The troika of the developmental state went through changes from leading the private businesses in the national development plans to following the lead of private businesses. The developmental state transformed from a comprehensive to a limited developmental state in the 1980s.

Although the Chun administration did not budge for democratic political changes when it first took office, it responded to the changes for economic liberalization from the Chaebol, labour, and the middle-class. The limited developmental state had also devoid itself of using authoritarian measures as the Park administration. The developmental state was no longer dictating or leading, but supporting and regulating the private sector.

In spite of the second Oil Crisis that affected the whole world, the South Korean economy continued to outperform its counterparts. The average annual growth rate of GDP was the second fastest in the world with 9.7 per cent (National Statistical Office 1991). The annual growth rate of GNP per capita reached 13.8 per cent, with the amount increasing from USD1,734 to 5,569 (National Statistical Office 1991). These impressive growth rates were achieved in spite of the negative growth rate in 1980 following the second Oil Crisis and the assassination of President Park in 1979.

## **4.2 The democratic developmental state**

The change in the comprehensive developmental state to a limited developmental state was concomitant with the democratization movement. The developmental state also was forced to listen to the Chaebol and labour, which grew with successful economic development. The irony for the developmental state was that it was forced to relinquish its control in the market because of its success, and not because of its failure (see Kim 1993). The developmental state gave carrots to persuade private businesses to comply with the state's developmental plans. The private businesses in general and the Chaebol in particular had become too big and mature to be dependent on the state for resources. The power dynamic between the state and businesses changed from dominance, to symbiosis, and now to competition.

The Chaebols appeared to be in the driver's seat as they became less dependent on the developmental state's subsidies and the Chaebols and their products and services have become so dominant that no one could afford the collapse of the Chaebols.

The limited developmental state also relinquished some of the authoritarian apparatus to implement development plans and industrial policies. The people's voices for democratization culminated in the June 1987 democratization movement, and President Chun finally acquiesced and agreed to allow democratic Presidential elections.

The democratic developmental state can be characterized to have the following functions: (1) limited developmental state, i.e. i) the developmental state's priorities included development as well as other goals, ii) industrial policies were limited in nature with the state supporting private businesses rather than vice versa, and iii) the developmental state's focus shifted from developmental to regulatory; (2) the use of authoritarian apparatus for the implementation of developmental plans and industrial policies were limited; and (3) the developmental state's dominance over the private businesses and labour became limited.

The South Korean economy continued to grow in spite of the change in the developmental state and democratization. In fact, the economy continued to expand rapidly, and the Chaebol had become global brand names, which is different from the economic trajectory of other late comer industrial nations.

### **4.3 The chaebols become global powerhouses with global brands**

The major Chaebols continued their impressive growth even when the developmental state's support was reduced. Their dominance in the domestic market expanded with Samsung's 2013 revenue to be equivalent to 26 per cent of South Korea's GDP and the next four largest Chaebols at 39 per cent (Lee 2012). The share of the largest Chaebols in South Korea's GDP has steadily increased over time from less than 10 per cent in the 1970s.

The Chaebols are omnipresent in South Korea—you cannot live even one day without coming into direct contact with the Chaebols' products and services. From the minute you wake up, you brush your teeth with LG toothpaste, take a shower using LG soap and shampoo, watch Samsung TV while checking your Samsung smart phone for the latest phone calls and news, take the subway train built by Hyundai, shop at the Lotte Department Store, go to work in a Hyundai-built building, have lunch at a CJ-franchise restaurant, and meet your client at Samsung's hotel.

Many of the largest South Korean Chaebols are now well-known household names around the world such as Samsung, Hyundai and LG. Samsung Electronics was ranked 32 in the Fortune Global Rankings in 2010 followed by LG at 67, and Hyundai Motor at 78 followed by 4 other Chaebol companies in the top Fortune Global 500. Some Chaebol companies' products have one of the largest three global market shares including semiconductors, smart phones, TV, and monitors. Few businesses in developing countries have produced major global companies and global brands as have South Korea's Chaebols.

Although the rapid growth of South Korea's Chaebols in the 1960s 1970s owed to the developmental state's preferential treatment and support, we should not dismiss the entrepreneurship of the Chaebols. The legendary success stories of visionary risk-taking entrepreneurship of the leading Chaebols, and their impressive growth even when the state's support was largely diminished, attest to their business acumen.

### **4.4 Chaebol dominated SMEs in the South Korean economy**

South Korea's SMEs have received less direct subsidies in the earlier phase of its development due to the government's strategic national development planning that were not conducive to

SMEs. The HCI drive in the 1970s required that capital- and technology-intensive Chaebol companies became more attractive business partners to the developmental state.

However, SMEs occupy a very important place in the South Korean economy and society. SMEs produce about 45.7 per cent of South Korea's manufacturing products, there are over 3.35 million SMEs (99.9 per cent) compared 2,916 large enterprises (0.1 per cent), and most importantly SMEs hire 87.7 per cent of the labour force (Kim 2014). In terms of exports, they have surpassed the Chaebols in terms of export growth in the 2000s although their volume remains small compared to the Chaebols at about 32.9 per cent in 2013 (Kim 2014).

There have been many efforts by the South Korean developmental state to support SMEs with access to domestic bank loans, SME-designated manufacturing, service sectors that prohibit Chaebols from entering, as well as support in technology. The Korean Commission for Corporate Partnership was created in 2010 in order to help mitigate social conflict between large enterprises (many of them are Chaebol enterprises) and SMEs as the former group was seen as having an inordinately large share of the market and thus having the power of monopoly and oligopoly in the market. Thus, this commission was created to help ease the tension between the two groups, and most importantly to find creative ways for the Chaebols to assist the growth of the SMEs. This commission and other measures by the South Korean developmental state show the significance of the problems faced by SMEs working in a market dominated by large business groups. This has been considered as a social problem by the President, government officials and politicians, as well as the general public. Thus, the work by the Commission, the Chaebols, and the developmental state along with the SMEs themselves has received great attention from the public and this issue will continue to receive support from the government since the developmental state itself is part of the problem.

## **5 Conclusion and recommendations for SSA nations**

South Korea's dramatic economic development was achieved with the institutions of the developmental state, which at times was also under military authoritarian regime. The state used carrots in the form of preferential access to domestic and foreign capital, and sticks in the form of harsh punishments for corruption and inability to meet the performance standards. The latter measures helped South Korea's businesses from becoming rent-seekers in spite of a high possibility of corruption due to the generous incentives provided by the state. The mix of sound institutions, such as developmental state and strategic industrial policies, provided the formula for success for South Korea's early phase of development.

Nevertheless, an authoritarian state is hardly a recipe for successful economic development. As amply demonstrated in world history, far more countries fail to achieve economic development and reduce poverty for its people if the state is authoritarian.

Thus, we argue that South Korea's developmental state, which was at times authoritarian, should not be used as an excuse to justify an authoritarian state in the 21<sup>st</sup> century's developing countries. Instead, a democratic developmental state should be studied to provide a developmental state that could bring about poverty reduction and economic development (see Edigheji 2010). In fact, South Korea's own economic development history shows that its economic growth actually accelerated with democratization since the late 1980s.

Several lessons can be drawn from the South Korean experience that can be relevant for SSA nations in the 21<sup>st</sup> century: (1) comprehensive developmental state is useful in the early phase of economic development when other institutions including private businesses are not yet



developed; (2) the comprehensive developmental state must have some carrots under its control, which can be used to attract private enterprises to comply with national development plans; and (3) the comprehensive developmental state would need to reduce its control and direct support to private businesses when economic development is strengthened and when private businesses have matured enough to be less dependent on the developmental state for support and protection.

The democratic developmental state should be considered for 21<sup>st</sup> century developing countries. Although the South Korean history had a period in which the developmental state was also an authoritarian state, the two are not synonymous and should be considered as two distinct attributes of a state. World history has shown numerous more cases where an authoritarian developmental state failed miserably in achieving economic development and had fallen to corruption and rent-seeking. South Korea's democratization movement that culminated in the late 1980s for democratic consolidation affected the developmental state to surrender the authoritarian apparatus. The South Korean economy and private businesses continued to prosper in the era of democratic developmental state. In fact, during this period, we have witnessed the impressive growth of the Chaebols in the global market place as global brands. Thus, we should take away from the South Korean developmental story that a democratic developmental state is an important lesson to be shared with sub-Saharan African nations as well as other developing countries.

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