

## The *Chaebol*

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FACED WITH SOUTH KOREA'S unique transformation into a modern industrial economy in a mere generation's time, many observers fall back on simple images to explain the state-business relationship that enabled the nation's hypergrowth. Some analysts project an image of "Korea, Inc.," where the state and the *chaebol* deeply penetrated each other's organizations by personnel exchanges at the top of their hierarchies, seeking to influence decisions and to learn from the other's organizational features and functions.<sup>1</sup> The *chaebol* is portrayed as an organization created and managed by the state for national interests, with Park sitting on top as the CEO. There are others who agree with the proponents of Korea, Inc., that the state-*chaebol* relationship was extremely close during Park's political rule, but give it the opposite characterization of "crony capitalism." In this view, the *chaebol* captured the state to pillage banks and sabotage market forces in pursuit of rents. Rather than the *chaebol* serving national interests as defined by the state, it was the state that came to the aid of rent-seeking *chaebol* conglomerates in the literature of crony capitalism.

The two views both have the historical facts wrong. Indeed, the state-*chaebol* relationship was extremely close, but the nature of that closeness cannot be adequately captured by static, unidimensional concepts like those of Korea, Inc., or crony capitalism. The *chaebol* were neither captives of the state nor its masters. They were organizations based not only on traditional family ties but also on modern rational business enterprises

that made their own decisions, albeit within the confines of state policies.<sup>2</sup> As Stephan Haggard argues, it is more useful to view the state-*chaebol* relationship as an ongoing negotiation, continually reinterpreted and remade under the pressures of socioeconomic and political change.<sup>3</sup> Even during Park's rule, when the *chaebol* were reborn into industrial conglomerates under massive political patronage, their relationship with the state was more complex than those images of unidirectional power flow that the proponents of Korea, Inc., and crony capitalism portray.

The transfer of elite bureaucrats to the *chaebol* did not occur with great frequency during Park's rule.<sup>4</sup> In fact, because the locus of decision making and coalition building resided at the top of the state organization, Park's Blue House, there was less need for the *chaebol* to invite retired career bureaucrats to act as go-betweens in the way the Japanese *keiretsu* did through *amakudari*.<sup>5</sup> Big deals were made directly between Park and the owner-managers of his choice, so that the *chaebol* were less interested in securing *amakudari*-like channels of coordination with state ministries. Moreover, deal making in the Blue House took place in ways that made the concept of leader-follower less relevant. To be sure, Park had the power to make or break any one *chaebol* group, but Park could not weaken the *chaebol* as a class if he was to transform South Korea into an industrial economy in his lifetime. On the contrary, after committing a series of economic policy blunders in 1961–1962 that almost cost him his military junta (see Chapters 2 and 3), Park came to recognize that the *chaebol* were more experienced in running a business entity, just as he was more knowledgeable about running the state. As long as the *chaebol* accepted the broad direction of economic policy and refrained from getting entangled in partisan politics, Park let the *chaebol* be the CEOs of South Korean economic development, implementing politically formulated and bureaucratically elaborated goals with great autonomy and discretion. In fact, the *chaebol* came to be the source of major innovative policy ideas, from the construction of special export zones and industrial complexes to the launching of Japanese-style general trading companies, to the entry into the Middle East construction boom in the mid-1970s.

Just as it is wrong to view Park and the *chaebol* in terms of leader and follower, it is not constructive to ask who was more indispensable and who was less powerful. Rather, Chapter 9 proposes to look at the state-*chaebol* relationship as a partnership, asking how each party complemented the other. And this was a partnership between visionaries. Park strove to become the Meiji of South Korea, whereas the leading *chaebol* groups hoped to grow into conglomerates on a par with the Japanese *keiretsu*. Sharing the *han*, or anguish, of being born into one of the world's

poorest countries, only recently liberated from Japanese colonial rule and scarred by three years of a violent cold war conflict-turned-civil war, Park and the *chaebol* were united by the vision of pulling South Korea and its people out of their absolute poverty, and drawn together by their fearless “can do” spirit and ethic of hard work. For Park the *chaebol* were indispensable for his political project of “rich nation, strong army” (*puguk kangbyōng*), and for the *chaebol* Park was indispensable for their growth into a corporate empire. As Yi Chun-lim once recollected, “it was not really that one led the other into something that he did not want to do. Park and [big business] formed a full-fledged partnership on the basis of broad trust, common vision, and hard work.”<sup>6</sup> In the eyes of David Kang, this partnership was one of “mutual hostages,” with the state and the *chaebol* each preventing the other from taking measures that threatened vital interests. By contrast, Chapter 9 presents the partnership to be that of “mutual guarantors,” each enabling the other to achieve its vital interests.

Because the partnership was based on asymmetric political exchange, where Park defended *chaebol* allies from the threats of business failure in return for their plunging into his risky industrial projects, it imbued both the state and the *chaebol* with contradictory traits. The state was both predatory and developmental (see Chapter 7), generating rents to lure the *chaebol* into the risky frontiers of growth, but at the same time bureaucratically regulating and politically disciplining rent-seekers to keep rent-seeking below a systemically dangerous level. Likewise, the *chaebol* were both cronies and entrepreneurs, cultivating Park's support to secure licenses, subsidies, and loans, but also harnessing the rents for investment in his industrial programs as part of their original pledge to line up behind his vision of nation building. Consequently, during the Park era, the state-*chaebol* relationship was characterized by a constant effort to balance between the predatory and the developmental tendencies of the state, the cronyism and the entrepreneurial energy of the *chaebol*, and the generation of rents and the regulation of the ensuing moral hazards.

Park knew that the balancing act required for the state-*chaebol* partnership he envisioned would be an extremely challenging political task. To generate rents for the *chaebol* willing to invest in risky projects, but without worsening the moral hazards to the level of triggering a systemic crisis, Park developed a set of rules and norms for the state-*chaebol* partnership. First, in order to ensure that his business “cronies” were also individuals with a conquering entrepreneurial spirit, Park chose partners from the *chaebol* with a proven track record of risk taking, managerial capability, and high performance. To be sure, Park preferred allying with the *chaebol*

from his Kyöngsang region in order to insure against the danger of non-Kyöngsang business groups coalescing around one or another alternative regional center of political power, but he did not shy away from partnering with non-Kyöngsang entrepreneurs like Chöng Chu-yöng of Hyundai (Kangwön Province), Kim U-jung of Daewoo (Kyönggi), and Cho Chung-hun of Hanjin (Seoul) when they shared his visionary mind, “can do” spirit, and entrepreneurial capabilities. Even then, however, Park was aware of the need to keep his *chaebol* partners in line and check their abuse of his trust. The best way to do so was to take advantage of their rivalry. Consequently, as a second rule of thumb, he built a structure of oligopolistic competition in the strategic industries over time, searching for challengers among second- or third-tier medium-sized *chaebol* groups to compete with the front-runners.

Third, as the proponents of Korea, Inc., and crony capitalism argue, Park backed his *chaebol* allies with massive subsidized resources, but contrary to the portrayal of guaranteed business success, he was prepared to let failing *chaebol* groups go under, once he thought he had exhausted relief measures. This was an extremely costly way to balance between the requirements of socializing business risks and disciplining the moral hazards, but it was nonetheless effective in moving state-*chaebol* relations toward hypergrowth. On the one hand, by supporting hard-pressed business partners until he exhausted all possible policy options during a period of macroeconomic adjustment, Park crafted the image of a reliable patron who backed words of support with concrete actions when his business partners were in trouble. This image made his words of commitment credible, thus making his task of mobilizing the *chaebol* behind risky industrial projects that much easier. When Park had to pull the plug from the weakest of the *chaebol* to save the stronger of the South Korean big businesses and to stabilize the economy during a period of adjustment, on the other hand, most of the *chaebol* looked at his action not as a breach of his earlier promise of unswerving support but as an unavoidable adjustment forced upon him by the financially fragile South Korean economy, because he resorted to restructuring the weakest of the *chaebol* only after he had exhausted all options of keeping those *chaebol* groups afloat through state support.

That the weakest of the *chaebol* would be allowed to fall—albeit after the failure of a concerted rescue operation by the state—was a rule that prevented the moral hazards from rising to the level of a systemically destabilizing scale. The rule was economically inefficient, wasting too many resources in keeping alive too weak business ventures for too long, but it was a politically effective strategy to retain the trust and loyalty of big business while at the same time preventing the worst forms of moral

hazards. As a result of this economically costly but politically effective balancing act, the Park era came to be characterized by both spectacular business successes and spectacular business failures. The likes of Chöng Chu-yöng, Kim U-jung, and Cho Chung-hun grew into industrial tycoons during Park’s eighteen years of rule, but there were also many more would-be *chaebol* leaders who fell while attempting to seize what they thought was the opportunity of their lifetime to build a corporate empire. In sharp contrast to the arguments of Korea, Inc., and crony capitalism that the *chaebol* had an easy way to the top, the Park era was Janus-faced, where an opportunity for hyper corporate growth could turn into a dangerous moment of adjustment and maybe even business failure. The opportunity and the risk that came with it resulted in a continuous reordering of the Big Ten. It was only in the late 1970s that the structure of the South Korean business community stabilized.

Fourth, aware of the danger that the *chaebol* could use their rents to become alternative centers of political power either on their own or as a junior ally of party politicians, Park made it very clear to big business that his support for their industrial ventures came on the condition that they did not seek political power themselves. To be sure, there were *chaebol*-turned-politicians like Kim Söng-gon of Ssangyong, who raised political funds for the ruling Democratic Republican Party (DRP) by leveraging his business background, but they were more the exception than the rule. Park preferred the *chaebol* to remain entrepreneurs. When he relied on the likes of Kim Söng-gon to raise political funds, Park made it clear that they worked solely for him under his trust. When they strayed from their role of caretakers to seek their own power, as Park thought Kim Söng-gon did in 1972, Park swiftly cracked down on the real or imagined challengers in order to send a clear message to all that DRP fundraisers were only caretakers, that the ultimate power rested solely in the hands of Park, and that the *chaebol* should not seek political power for themselves. The rule that the *chaebol* should not themselves become political powers was essential for Park’s ability to choose his partners largely on the basis of performance, to keep the *chaebol* in line through oligopolistic rivalry, and to discipline the worst forms of moral hazards by letting the weakest of the *chaebol* go under during a period of adjustment. The transformation of the *chaebol* into an alternative center of political power either on their own or as a junior ally of party politicians would have obstructed the already very challenging task of balancing between predatory and developmental tendencies of the state, between cronyism and entrepreneurial energy of the *chaebol*, and between the generation of rents and regulation of the ensuing moral hazards.

This is not to argue that Park had in place these four rules and norms

governing state-*chaebol* relations from the very start of his rule. On the contrary, these rules and norms emerged out of political conflicts, policy mistakes, and learning throughout the eighteen years he was in power. They were continually made and remade as Park zigzagged to find an appropriate formula for the state-*chaebol* partnership that would enable him to use the rents for economically productive purposes. Chapter 9 analyzes this making of rules and norms governing state-*chaebol* partnership during the Park era.

### Partnering with the *Chaebol*, 1961–1963

When Park seized power in 1961, his first priority was winning public support for his military coup. Having overthrown the democratically elected government of Chang Myŏn by brute force under the pretext of cleaning up corruption, establishing political order, and building state competence, Park necessarily came to justify his coup by stressing his ability to generate economic growth. The technocratic rationale made Park search for ways to win over the business community, because only with its support could he make economic growth happen. Consequently the first months of military rule saw Park busy with the task of selecting entrepreneurs that he could trust and work with to devise a new set of rules and norms governing the state-*chaebol* relationship in the direction of launching an economic takeoff. The objective was to get the *chaebol* to collaborate in state-formulated industrial projects through an asymmetric exchange of political support and risk taking between the state and the *chaebol*.

Despite his statist ideology, Park knew that he would be able to achieve his economic goals only with the private sector's cooperation. Consequently, he sought to strengthen state leverage, but he did so not to expand the state's direct productive capacities at the expense of the *chaebol*, but to secure the private sector's compliance with state-formulated policy objectives. And to induce the *chaebol* to venture into more risky kinds of production and marketing activities, Park was ready to assist his strategically chosen *chaebol* partners in strengthening their corporate capabilities. To strengthen state leverage with which to persuade the *chaebol* into collaborating with the military junta, Park centralized power in the Economic Planning Board (EPB) and used it to encourage the *chaebol* into taking risks in return for his political support. He also nationalized all commercial banks with an eye to controlling the sources of capital. At the command of the Ministry of Finance (MoF), banks no longer acted as the agents of commercial financial transactions. Rather, they became an in-

strument through which the state could secure business compliance with the goals of industrial policy and macroeconomic planning. By implicitly threatening to revoke preferential bank loans if the borrower failed to meet state-set targets, the MoF used commercial banks as both carrot and stick in its efforts to reshape the preferences, interests, and strategies of business companies in the direction of the first Five-Year Economic Development Plan (FYEDP).

Once Park lined up his powerful arsenal of centralized economic bureaucracy and state-owned commercial banks by July 1961, he began looking for his business partners. His choice was the *chaebol*, whose owner-managers he had initially put under house arrest on the charge of illicit wealth accumulation immediately after the military coup. Although the public remained critical of these large companies' activities of rent-seeking during Syngman Rhee's rule (1948–1960), Park soon came to value their leaders' proven record of business success. And in any case, the economies of scale necessary to fulfill Park's vision of building a modern industrial economy in his lifetime could not be achieved by relying on small- and medium-sized enterprises (SMEs). The large enterprises with access to capital and technology were the only actors capable of participating in large-scale infrastructure projects and mass-producing manufactured goods for export.

On the other hand, Park excluded multinational corporations (MNCs) from his potential business partners out of both choice and necessity. Still fresh in the minds of South Koreans were memories of Japanese colonial exploitation, which made the option of generating economic growth through foreign direct investment (FDI) unpopular. An admirer of the Japanese Meiji Restoration that modernized through the nurturing of "national champions," Park also personally preferred to maintain national ownership of productive assets and chose foreign commercial loans over FDI to build infant industries. To keep Park on the nationalist path to modernization, moreover, South Korea was not a hospitable investment site for MNCs, suffering as it did from chronic political instability, limited domestic markets, and poor resource endowment. The economy was then still struggling with post-Korean War reconstruction as well.

By contrast, the option of replacing private producers with state-owned enterprises (SOEs) as an engine of growth was briefly experimented with in mid-1962, when Park came to be frustrated by the lack of progress in the *chaebol* groups' pledged investment in the first FYEDP projects. Endorsing the radical ideas of forced savings drawn up by the Kim Chong-p'il-led Korea Central Intelligence Agency (KCIA), Park identified a newly strengthened state-controlled Korea Industry Development Com-

pany (KIDC) as a conduit to channel the money in frozen bank accounts to FYEDP projects during the currency reform of June 1962. This brief play with radical statism ended as a political fiasco, with the United States lashing back with an interruption of aid because it charged that the military junta was trying to move toward a socialist economy.<sup>7</sup> Securing over 90 percent of the national budget from U.S. aid-generated counterpart funds as late as 1961, Park could not but backtrack from both the currency reform and the KIDC-channeled project financing. The junta found itself returning to the original task of negotiating a state-*chaebol* relationship that would transform the *chaebol* into a willing partner of the state in economic development.

For South Korea, the exclusion of statist options in the early stage of economic development was to clear the way to hypergrowth. The SOEs of South Korea did not have the capital, technology, or managerial expertise required for developing the modern manufacturing sector. They had also been the hotbed of corruption and inefficiency during Syngman Rhee's political rule, supporting his Liberal Party as a source of electoral funds. The military junta's rhetoric of anticorruption notwithstanding, it was unlikely that the politically fragile coup makers—externally lacking ideological legitimacy and internally trapped in intense factional power struggles—could remain disciplined in their exercise of power and resist the temptation of corruption. The expansion of SOEs would only have provided the rival factions of the junta an added incentive to use the state apparatus for rent-seeking.

Certainly by mid-1962, if not from the very day of the military coup in May 1961, then, teaming up with large domestic enterprises constituted the less politically risky and more economically viable option for Park. Consequently, he personally chose some of his life-long business partners from among the *chaebol* on the basis of two potentially contradictory criteria. On the one hand, Park searched for *chaebol* owners with a solid business track record to tap the best of South Korea's entrepreneurial resources. In particular, he looked for businessmen with a zeal for growth and an appetite for risk taking. Park was looking for business leaders who resembled himself: visionaries. Chŏng Chu-yŏng of Hyundai captured this spirit more than any other among the *chaebol*. At the same time, however, Park patronized Kyŏngsang-born *chaebol* owner-managers when possible, in order to give his regionalist ruling coalition a solid financial base. The strategy of choosing *chaebol* partners on the basis of entrepreneurial performance and regional background with an eye to balance the requirements of economic growth and political coalition building originated during the junta years when Park was challenged by coup makers from the

P'yŏngan and Hamgyŏng region (see Chapters 1 and 2), but it came to be continually strengthened even after his presidential election in October 1963. However, it is important to emphasize that the partnership required two willing partners. Park's choice also had to be the choice of the entrepreneurs if it was to result in actual investment. From their perspective, the junta's vision of a big push into industrialization presented not only new opportunities but also new challenges. Depending on the outcome of their risk taking, the old-timer entrepreneurs might either construct an empire of affiliate firms across unrelated industries, or see their companies shaken from their foundations under financial pressures. To stay out of the race to grow entailed costs as well, because the second-tier firms were likely to take the risk to push aside the front-runners with the goal of winning Park's political support. Once overtaken by the rising stars, the front-runners would find themselves without the privileged access to bank loans that they had earlier enjoyed.

Ironically, the business leaders' efforts to establish channels of communication and cooperation with the new rulers of South Korea began in the worst possible situation for them, when the coup makers, with an eye to winning popular support, initiated an investigation into their wealth gained in the 1950s. The day after the coup, Park arrested twenty-one business leaders on charges of illicit wealth accumulation. Some younger officers in the junta even called for the execution of some of the *chaebol* leaders in order to clean up corruption once and for all. By the end of May 1961, the Supreme Council for National Reconstruction (SCNR) had formally established an investigatory committee and put the issue at the top of its agenda. The swiftness with which the military junta went after the large entrepreneurs and the seriousness of the charges indicate that its mainstream faction, led by Park and Kim Chong-p'il, had formulated a fairly detailed plan to prosecute these individuals prior to launching the coup. The entrepreneurs were accused of illegally acquiring state-invested properties, unjustly purchasing state-owned foreign exchange at preferential rates, profiting from unfair bidding, illicitly benefiting from state-distributed foreign loans, evading taxes, and illegally transferring property to foreign countries in return for providing Liberal Party politicians with political funds.<sup>8</sup>

Since the *modus operandi* of business firms during the Liberal Party regime had been rent-seeking, which made corruption part of everyday business practices, most *chaebol* owner-managers of the day were vulnerable to the military junta's charges. Those running businesses in the lucrative "three white industries" (sugar refineries, flour mills, and textile mills), in particular, became a target of investigation because their prosperity owed

much to the state's preferential distribution of U.S. aid goods, import licenses, production permits, and preferential bank loans. The oligopolistic market that ensured high profits for the three white industries was a state-sanctioned and -maintained structure. Under investigation were two of the most successful business tycoons: Yi Pyŏng-ch'ŏl, of Samsung, whose illicit wealth was officially estimated at 800 million won (19 percent of the total illicit wealth), and Hong Chae-sŏn, of Kŭmsŏng Textiles, which later became Ssangyong.<sup>9</sup>

As dramatically as the junta demonstrated its power to shake up and challenge big business in May 1961 with its investigation into Liberal Party-brokered business deals, its gesture to put the past behind it and move forward to construct a growth machine with the same *chaebol* owner-managers as its junior partners came abruptly. On June 27, Yi Pyŏng-ch'ol returned from Japan to face charges. What awaited him, however, was not imprisonment but a historic meeting with Park Chung Hee. There Yi Pyŏng-ch'ol convinced Park that the prosecution would inadvertently prevent Park from pursuing economic growth by irreparably damaging business confidence. The Samsung *chaebol* leader added that Park would benefit more by having the business leaders work for South Korea's rapid industrialization than by putting them in jail, which only wasted their talents. Park knew better than anyone that he had to work with big business if he were to put the country on the track to growth. Much of the managerial expertise, organizational capabilities, capital, and technology required for modernization were in the hands of the *chaebol*, not the armed forces. Moreover, even compared to the state bureaucracy, the *chaebol*, with their entrepreneurial spirit, looked like the ideal vehicle for penetrating export markets.

Equally critical for Park, relying on the *chaebol* as an instrument of modernization did not threaten his political interests, because the *chaebol* were not the "conquering bourgeoisie," sure of their historical mission and ideological legitimacy. Rather, the leading business groups were seen as rent-seekers, living off state licenses and loans and accused of illicit wealth accumulation. They were not in a position to claim political legitimacy, which made Park less hesitant in making a U-turn to partner with them and support their diversification and conglomeration. Thus began in June a series of arm-twisting and behind-the-scenes negotiations between the state and the *chaebol*, out of which new terms of political exchange were drawn up to clear the way for business investment in FYEDP projects.

In August, with Park's blessing, the business leaders launched a National Association of Company Presidents, which was to become the Federation

of Korean Industries (FKI) in 1968. Established as a summit organization of large industrial conglomerates, the FKI not only served as a channel to voice and defend the collective interests of big business but also enabled the state to control, shape, and influence those interests. The sense of camaraderie developed by the FKI was to help the state and the *chaebol* jointly tackle the challenging task of negotiating the market shares required for the establishment of "industrial rationalization cartels" aimed at preventing "excessive competition" among rival conglomerates.<sup>10</sup> At the same time, Park organized the FKI to monopolize the political loyalty of its members and preempt not only the opposition but also his potential rivals within the ruling coalition from securing an independent source of political funds. Once he had herded all of big business into the FKI, Park preferred to make business deals with the *chaebol* on an individual basis, often behind closed doors and in one-on-one conversations directly with their owner-managers, rather than in the open through the official channels of the FKI.

Ironically, it was the issue of illicit wealth accumulation that Park leveraged to construct a system of state-*chaebol* coordination on his terms. He could destroy any uncooperative *chaebol* owner-manager by levying exorbitant fines, or protect cooperative ones by acquitting them of shady business deals. It was through the adjustment of fines that Park thought he could set the *chaebol* groups' terms of participation in FYEDP projects and their place in partisan politics. The negotiation for the acquittal of the business owners from the charges against them was a well-orchestrated play, with Park as its producer interested in getting maximum compliance from his future partners. The *chaebol* owner-managers, including Yi Pyŏng-ch'ol, who were under house arrest, well understood Park's intentions. They knew that the politics of rapid industrialization—not elections—was the only game in town and that they had to help Park achieve his economic vision and ambitions if they were to survive. They also understood that the most critical issue was not the threat of imprisonment, which was not going to happen, once Park met with Yi Pyŏng-ch'ol on June 27 to start talks on state-*chaebol* cooperation, but Park's decision on the two closely coordinated issues of how much to levy in fines and how to distribute FYEDP projects among the *chaebol*. Depending on the nature of the projects allotted and the level of fines imposed, the owner-managers had an opportunity to grow into an industrial conglomerate in both name and reality, or could go insolvent under the pressure of market forces and legal fines.

For the two parties to come to a final deal, however, several attempts at negotiation were necessary. In August 1961, the junta enacted a Special

Law on the Disposition of Illegally Accumulated Capital, which allowed the business leaders convicted of illegal wealth accumulation to “donate” to the state the factories they were to construct under state guidance in lieu of a fine. This was the *chaebol* owner-managers’ idea. By persuading Park to enact the special law rather than to expropriate the illicitly accumulated wealth immediately, the business leaders bought time to gain Park’s trust through their participation in various FYEDP projects and to use that trust to renegotiate the fines later.<sup>11</sup> With the strategy of renegotiating the terms of the fines and maybe even winning their revocation from a position of political strength, eighteen of the original twenty-one illicit wealth accumulators began building the factories Park had designated for them.

As the owner-managers hoped, Park soon discarded his plan to nationalize the factories to be built by the illicit wealth accumulators. Rather than nationalization, Park went back to the option of levying fines. But by January 1962, he had reduced the fines twice, by 90 percent in the first round and again by a half in the second round. In the end, the *chaebol* owner-managers got away with a mere slap on the wrist. Apparently Park never intended to punish the *chaebol* for their past shady business deals. On the contrary, from the beginning the top priority was getting the *chaebol* to acquiesce in his vision of modernization and accommodate the state’s administrative guidance on investment. The issue of illicit wealth accumulation was a mere instrument in this game of arm-twisting to “persuade” the *chaebol* to collaborate with Park.

Once Park ventured into negotiating new terms of state-*chaebol* cooperation, moreover, big business inevitably came to increase its leverage on Park. First, once resources were concentrated in the *chaebol* groups’ investment projects, Park was bound to look at the business failure of *chaebol* conglomerates as the political failure of the developmental state he was building up as the partner to the *chaebol*. Consequently, the balance of power shifted toward the *chaebol*, because the state thought their bankruptcy threatened the financial viability of the state itself. Second, the political weakness of the *chaebol* became a source of influence on economic policy, because it allowed Park to support big business without fear of inadvertently fostering an alternative center of political power. Confident of the business groups’ political weakness, but also fearing the negative political fallout of economic recession, Park made subsidies available for the *chaebol* to enter new frontiers of growth.

Third, the dynamics of political exchange itself strengthened the hands of the *chaebol*. Because the owner-managers made their entry decision on the basis of Park’s pledge of support, the withholding of state subsidies during business difficulty would be perceived as a breach of the political

understanding between Park and the *chaebol*, which could irreparably damage Park’s credibility and, hence, his ability to persuade future investors to take risks. In a sense, the moment that Park and the *chaebol* agreed to pursue FYEDP projects jointly as part of their efforts to put the issue of illicit wealth accumulation behind them, they both lost much of their political maneuverability. The state could not withdraw support as it liked. Nor were the *chaebol* free to exit from their lines of business simply because of financial losses. The alliance between Park and the *chaebol* meant that they were each other’s guarantor and that they had to weather corporate and financial distress together.

Even during the formative era of military rule, it was not unusual to see the *chaebol* helping Park formulate goals and the state bureaucracy implementing *chaebol* ideas. It was Yi Pyŏng-ch’ol who persuaded Park to make concessions on the issue of illicit wealth accumulation in return for *chaebol* participation in FYEDP projects in June 1961. Thereafter, Park periodically consulted Yi Pyŏng-ch’ol for advice, and even backed Yi’s effort to organize big business as the first president of the newly established FKI. In that role, Yi Pyŏng-ch’ol led a delegation of business leaders to the United States and Western Europe as part of efforts to attract foreign capital. At stake was nothing less than the survival of their businesses, as the owner-managers worked to construct the factories they were required to build in return for Park’s agreement to defer and reduce their fines. Shortly after the trip, on January 11, 1962, the FKI submitted a proposal for the construction of the Ulsan Industrial Complex. Three weeks later, Park held a groundbreaking ceremony. The Ulsan project was to popularize the idea of building a cluster of backwardly- and forwardly-linked industries in a geographically compact area with an eye to facilitating well-coordinated collective actions between the state and the business community, suppliers and assemblers, and industrial and service sectors. A myriad of industrial complexes and export zones eventually emerged throughout South Korea during the 1963–1979 period.

Kim Ip-sam, the FKI executive vice chairman during the entire Park era, once recollected that “Park himself confessed on several occasions that he knew nothing about the economy in meetings with business leaders immediately after the 1961 military coup.”<sup>12</sup> Many of the innovative ideas that later became his trademark were of *chaebol* origin. “The strategy of export promotion was first suggested by Chŏn T’aek-bo of Ch’ŏnusa, a producer of leather goods and toys. The idea of attracting foreign capital and commercial loans through the construction of industrial complexes was likewise put forth to Park by business leaders during the early days of military rule.” To be sure, Kim Ip-sam acknowledged that these ideas bore fruit

only because “Park was an extraordinary person, open to new ideas and capable of transforming them into a detailed workable action program,” and “a quick learner . . . intensely interested in the economy. He studied hard to learn about economic issues and to discover ways to bring about economic development. Nevertheless, the point is that it was the *chaebol* who had the ideas and the means to attain economic development.” Even during the “easy” stage of developing light industry in the 1960s, Park needed the *chaebol* as much as the *chaebol* needed him for the generation of industrial growth. The mutual dependence of the two was to become even more apparent in the 1970s, when Park embarked on the riskier program of heavy and chemical industrialization (HCI).

#### Rebirth of the *Chaebol*, 1964–1967

In the initial years of the first FYEDP, the economy performed dismally despite a comprehensive reorganization of the state and a visible shift of political priorities toward economic growth. Unfavorable external economic conditions were initially blamed, but Park soon realized that the problem had deeper roots. After the radical measures of forced saving, including the currency reform and the KIDC debacle of June 1962, paralyzed the economy, Park ordered the EPB to revise the first FYEDP in December of the same year. The revised plan, announced in February 1964, called for concentrating resources in a few strategic industries and promoting exports in order to withstand the whims of the world market. The principles of resource concentration and export promotion signaled that Park was now emulating Meiji Japan in his strategy of modernization, in which the state worked exclusively with the economic powerhouses of the *zaibatsu* to grow through export markets. But unlike the pre-World War II Japanese *zaibatsu*, which possessed both industrial firms and financial institutions within their group organization, the *chaebol* of the mid-1960s were strictly manufacturing entities. The nationalization of commercial banks by the junta in 1961 helped the Ministry of Finance to control the *chaebol*.

Once Park secured *chaebol* participation in FYEDP projects, a handful of top-ranking *chaebol* groups came to enjoy privileged access to the state bureaucracy, including the Blue House. Some of the *chaebol* were showered with preferential bank loans, state-guaranteed foreign loans, and oligopolistic entry licenses in return for not only taking the risk to develop state-designated industries, but also supplying political funds to Park’s ruling Democratic Republican Party. Although Park discouraged big business from itself becoming a player in party politics, he did let a handful of the

*chaebol* owner-managers’ extended family members become second-tier leaders in the ruling coalition by taking on crucial DRP posts. Kim Söng-gon of Ssangyong rose to the position of DRP finance chair, serving Park’s interests in holding Kim Chong-p’il’s DRP mainstream faction in check. Both as an old-time civilian politician with a Liberal Party background and as a former entrepreneur with an extensive personal network throughout the South Korean business community, Kim Söng-gon was made for the task of building an anti-mainstream faction in the interest of maintaining a balance of power within the DRP.

The state-*chaebol* partnership Park constructed was Janus-faced. The partnership was fed by the rents generated through subsidized bank loans, state-guaranteed foreign loans, and selectively distributed licenses, but the politics of rent-seeking did not degenerate into the classic predatory type of plundering, because, in the last analysis, the *chaebol* as exporters lived in a competitive world of global market forces, and because they remained accountable to Park as the state-designated vehicles for building a “rich nation, a strong army.” Park tied the state provision of rents to the *chaebol* partners’ ability to achieve FYEDP target goals, withdrawing the sources of rents when he thought the recipients had failed to deliver their part of the bargain without justifiable cause.

Park’s strategy worked because the state’s capacity for generating rents was dramatically strengthened through a series of policy decisions during the mid-1960s. The signing of a normalization treaty with Japan in 1965 not only resulted in a lump-sum transfer of Japanese money in the form of reparation funds, but also cleared the way for the entry of Japanese capital on a commercial basis. To facilitate foreign loans and FDI institutionally, the National Assembly enacted the Foreign Capital Inducement Law, drafted by the Ministry of Finance, in 1966. Park’s 1964 decision to dispatch combat troops to South Vietnam in support of U.S. war efforts also provided the *chaebol* with the opportunity to earn foreign exchange. The war produced two Cinderellas, Hanjin as a transportation magnate in control of a shipping company, an airline, and a bus and truck company, and Hyundai as a construction conglomerate.

It soon became clear that the key to business growth was access to state-guaranteed foreign loans. The manufacturing sector took 52.1 percent of South Korea’s total foreign loans in 1966 and 69.1 percent in 1968, a huge jump from 10.3 percent in 1962.<sup>13</sup> Moreover, in order to encourage the *chaebol* to take risks and foreign commercial banks to lend money to the risk-taking *chaebol*, the state guaranteed repayment of 90 percent of the foreign commercial loans, either directly (40 percent) or indirectly through state-owned banks (50 percent). Such a socialization of the finan-

cial risk and costs by the state ended up in driving the *chaebol* to finance their business expansion and diversification aggressively through the available loans.

The benefits accruing to a *chaebol* from being designated as a recipient of state-guaranteed foreign loans exceeded the simple sum of foreign loans and included a wide range of privileges from low interest rates on domestic loans, to easy access to scarce foreign exchange, and even to legal prohibition of labor organizations. The benefit of low interest domestic loans became particularly great when Park introduced a “reverse interest rate system” in 1965, which put the domestic bankers’ deposit rates above lending rates.<sup>14</sup> To make loan-financed business growth even more irresistible, the average rate of inflation was then roughly 21 percent per year—3 to 5 percentage points below the state-owned banks’ lending rates. Equally critical, whereas the South Korean domestic banks’ interest rates ranged between 24 and 26 percent during the 1965–1970 period, the rates on export-policy loans, many of which were provided to the foreign loan-financed *chaebol*, stood in the range of 6.0–6.5 percent. The press even charged that some *chaebol* were re-lending their bank loans in the private curb market, where interest rates hit 50–60 percent, rather than investing in risky manufacturing projects.<sup>15</sup> It was in a certain sense profitable for companies to acquire as many domestic bank loans as possible.

At the same time, Park allowed the *chaebol* to organize their corporate governance structures, inter-firm relations, and internal hierarchy in the direction that would enable them to raise capital with a minimum threat to their corporate control. The *chaebol* established multiple businesses with a minimum amount of equity capital through a system of cross-shareholding and cross-loan guarantees, while legally protected from threats of hostile takeovers. The *chaebol* also had their subsidiaries support each other through insider trading and subsidies, while centralizing internal decision-making processes through the establishment of a planning and management office with an eye to orchestrate a concerted action of mutual assistance among their affiliate firms. What we know as the *chaebol* of today emerged from these organizational experiments of the mid-1960s: a group of business firms that seem to be independent but are actually run by one owner-manager family through an opaque corporate governance structure, including cross-shareholding, cross-loan guarantees, inter-firm insider trading and subsidies, and centralized planning and management offices. This structure enabled a *chaebol* to participate as a monolithic actor in diversified unrelated markets, with systematic control over affiliated firms with regard to financial, personnel, and management issues. As such, the *chaebol* constituted the South Korean business firms’ way of mobilizing

scarce resources and managing business risks that included market uncertainty and international disadvantage.

Consequently, despite inter-firm and inter-sectoral variations in organization, the *chaebol* exhibited several common characteristics. First, all firms in the group were controlled by a central company, which was typically operated by an owner-manager family. Second, most of the member firms were of a significant size, and they worked under the coordinated initiative of the centralized management at the top. Third, they tended to be involved in multiple sectors, with the managers transferred from one sector to another, thus ensuring unity of strategy and cross-fertilization of experience.

The mid-1960s saw a furious competition among entrepreneurs to enter the club of *chaebol*. Chungang and Ssangyong competed for the license to construct a cement factory, Han’guk and Yönhap Steel for a cool strip iron mill, and Taehan Electric Wires and Gold Star for production of electrical products. The winners of licenses were provided with state-guaranteed foreign loans, which were the ticket to corporate expansion. The foreign-loan financed projects of the mid-1960s went to Kumsöng Chemicals, Ssangyoung Cement, Sinjin Motors, Samyang, Taehan Industries, Inchön Heavy Industries, Yönhap Steel, and Hyundai Engineering and Construction, many of which formed close alliances with Park.<sup>16</sup> The Lucky-Gold Star Group also consolidated its political edge when it beat its rival, Taehan Electronic Wire Company, in securing foreign and domestic loans at preferential rates. In particular, Park formed a special partnership with Chöng Chu-yöng of Hyundai, based on their shared vision of rapid industrialization and their similar orientation toward risk taking, “can do” spirit, and sheer drive. In spite of its second-tier status within South Korean big business at the time of the 1961 coup, Hyundai was chosen over other more established business groups as a partner in national reconstruction because of its owner-manager’s credibility as a risk taker.

The 1960s’ competition for loans and licenses dramatically restructured big business. Faced with a politically driven high-risk and high-payoff marketplace, four of the ten largest *chaebol* in 1960 dropped from the top ten list by 1965. The second- and third-largest *chaebol* of 1960—Samho and Kaep’ung—joined the list of declining *chaebol* and dropped from the top ten list by the early 1970s. In their place was a new group of bold risk takers: Hanjin, Sinjin Motors, Ssangyong, Hyundai, Hanhwa, and Taenong. These new *chaebol* invested more in the heavy and chemical industries, Park’s strategic sector, whereas the old *chaebol* were largely involved in light manufacturing and in commerce. By the end of 1969, foreign loans were concentrated in the hands of the largest *chaebol*, including

Ssangyong, with a total of \$150 million, and Lucky-Gold Star, with \$123 million.<sup>17</sup>

The rise of Hyundai during the late 1960s was particularly spectacular. Established in 1947, Hyundai Construction remained a solo operation without affiliate companies and subsidiaries until 1955, although it made its name as a construction magnate during the Korean War (1950–1953) by signing numerous exclusive construction contracts with the U.S. military to build barracks and other army facilities along the rapidly changing front lines.<sup>18</sup> With many of the lucrative businesses, including the three white industries, under the control of the older *chaebol* groups, Hyundai could find new markets only through a major expansion of the economy.<sup>19</sup> The military coup created opportunities for corporate growth for the latecomers by shaking up the state-business nexus that had been previously mediated and constructed by the Liberal Party and through opening up the heavy and chemical industries as a new frontier of growth without any established front-runners. The 1960s saw Hyundai transformed into an industrial conglomerate with six affiliate companies by entering these new frontiers of growth: Hyundai Construction (1947), Hyundai Marine and Fire Insurance (1955), Hyundai Securities (1962), Inchön Iron and Steel (1964), Hyundai Oil Refinery (1964), and Hyundai Motors (1967).<sup>20</sup>

By contrast, Samsung's case was more turbulent. After close collaboration during the junta, its relationship with Park soured when one of its affiliate firms was charged with the smuggling of saccharin in 1967. Yi Pyöng-ch'ol was forced to "donate" to the state its foreign loan-financed Han'guk Fertilizer Company as part of an effort to win back Park's trust. The damage was already done, however. In spite of the nationalization of the fertilizer company, the public remained furious, accusing Samsung of illegally profiting from state-guaranteed foreign loans and charging the Park regime with corruption. To appease the populace, Yi Pyöng-ch'ol's son, Ch'ang-hüi, was arrested, while Yi Pyöng-ch'ol stepped down from his position as Samsung's group chair.<sup>21</sup> After this incident, Yi Pyöng-ch'ol kept a healthy distance from politics and sought ways to secure less politically vulnerable sources of capital, including joint ventures with foreign capital. He was also more guarded regarding the use of state-controlled and, hence, politically vulnerable bank loans than Hyundai's Chöng Chu-yöng and Daewoo's Kim U-jung because of his less adventurous management style. Moreover, because Samsung was already in control of many of the commanding heights in the South Korean economy as its largest *chaebol*, Yi Pyöng-ch'ol could afford the luxury of letting other *chaebol* groups enter state-designated strategic industries and test the waters before he decided on his business options.

In spite of the differences in management styles, however, the powerful and charismatic owner-managers of both old and new *chaebol* groups, from Yi Pyöng-ch'ol of Samsung to Chöng Chu-yöng of Hyundai and Ku Cha-gyöng of Lucky-Gold Star, were all self-made visionaries with distinct management styles. The founders typically tapped the resources of their entire extended families, recruiting brothers and in-laws into the management and pooling together the family wealth.<sup>22</sup> Later they became powerful CEOs, making up what the press called the "royal family of the founder," enjoying unparalleled access to top managerial posts and making strategic and operational managerial decisions unilaterally, without the watchful eyes of auditors and minor stockholders. The "imperial" corporate governance structure relied on the leadership of owner-managers for firm growth, making the *chaebol* organizationally flexible in adjusting to changes in market signals, but at the cost of hasty decision making.

#### Financial Crisis and Corporate Restructuring, 1968–1972

Backed by Park's expansionary drive, manufacturing firms increased in number at a rate of roughly a thousand per year during the 1960s. Although most of the newly established manufacturers were small- and medium-sized enterprises in light industry, the decade also witnessed the launching of 509 large-sized enterprises. The takeoff period of 1963–1969 was particularly productive, with 409 large firms newly established. Industrial concentration increased as well, as the *chaebol* diversified into unrelated industries. Industrial concentration had been high even before Park's big push, with 12.5 percent of business firms accounting for 39.8 percent of South Korea's total value-added and 36.6 percent of its total production in 1960. By 1968, however, large firms, accounting for 12.4 percent of South Korea's total number of business enterprises, were responsible for 65.2 percent of the total value-added and 64.8 percent of the total volume of production.

However, it was at the height of hypergrowth that the South Korean economy began showing signs of trouble. The root cause lay in Park's failure to fine-tune the conflicting requirements of competition and concentration. On the one hand, South Korea had to concentrate resources in a few strategic projects if it was to exploit the economies of scale within its given conditions of limited markets and scarce resources. On the other hand, for firms to have an incentive to cut costs and open up new markets, there had to be competitors. The challenge was to establish the "right" number of

firms, neither too many nor too few, that would ensure market competition without getting caught in a downward spiral of surplus capacity, low profits, and financial distress. By the end of the 1960s, it became clear that Park had failed in getting that right number of firms. The intrinsic difficulty in forecasting future market conditions was part of the problem, but Park also faced intense business lobbying for entry licenses. Consequently the heavy concentration of wealth in the leading *chaebol* took place with too much duplication of investment projects, which began to pose a serious threat to the sustainability of not only those *chaebol* but the entire national economy. A large number of foreign loan-financed *chaebol* started to show signs of insolvency by 1967, but Park could only defer adjustment because of great political pressure to increase the money supply to ensure a DRP victory in both the National Assembly and the presidential elections of 1967.

Park faced the grim reality of the financial crisis only in 1968. The crisis was attributed to three factors.<sup>23</sup> First, the *chaebol* had become heavily indebted after five years of hypergrowth, with a large portion of capital financed by short-term private loans on the curb market and foreign commercial loans. The high debt-equity ratios meant that the economic recession then triggered by a global downturn immediately turned into a corporate crisis, as many of the firms could not even pay the interest they owed out of their declining profits. Of the total corporate funds available in 1968, debt totaled a hefty 72.5 percent, of which 24.5 percent were foreign loans and 15 percent were informal curb-market loans.<sup>24</sup> To ease pressures on the current account, the state tightened regulations on foreign capital and raised interest rates, only to see the financial burden on small- and medium-sized enterprises increase. Real interest rates were near two-digit figures in contrast to the negative rates the *chaebol* enjoyed.<sup>25</sup> The interest rates for private curb-market loans ranged from 40 to 70 percent,<sup>26</sup> further aggravating not only the SMEs' but also increasingly the *chaebol*'s financial positions.

To make the situation worse, the United States, South Korea's leading export market, was under rising protectionist pressures, preventing the South Korean textile industry from leading economic growth through exports. The economy was in a slump throughout 1970. The decade of export-driven hypergrowth based on labor-intensive industries, moreover, had brought about a decrease in surplus labor and a rise in real wages, resulting in the loss of comparative advantage. As the global economy hit a deep recession with a downturn in the economies of industrialized nations, South Korean began feeling the crunch.<sup>27</sup> More than 200 firms went bank-

rupt in 1971, although the state tried to come to the rescue by taking over 30 of them.<sup>28</sup>

The FKI stepped in to voice the collective needs of *chaebol* conglomerates, calling on the state to take the steps necessary to tackle the liquidity crisis. To underline the gravity of corporate financial distress, which macro indicators like the annual GNP growth rate concealed, the FKI even proposed cutting the government budget and tax revenue by half. Realizing the gravity of the situation, Park announced an Emergency Decree for Economic Stability and Growth (EDES) on August 3, 1972, on the recommendation of FKI chairman Kim Yong-wan, as we saw in Chapter 7. The EDES had been in preparation since September 1971, with Kim Yong-hwan of the Ministry of Finance in charge of the working-level task force established within the Blue House. The announcement of the measure was originally planned for January 1972, but was put off until political conflict over the legislation of a special law on national security subsided. To prevent any leaks of the emergency measure, Kim Yong-hwan, as the secretary for foreign capital, received the signatures of the prime minister, the EPB deputy prime minister, and the MoF minister, among other relevant cabinet members, without explaining the contents of the decree.<sup>29</sup> Despite this secrecy, the press later charged that information on the EDES had been leaked to a few *chaebol* conglomerates so that their owner-managers could secretly prepare for the shock of the emergency measure.<sup>30</sup>

To rescue the financially weak business community, the EDES allowed corporate debtors to repay their private curb-market liabilities over five years with a three-year grace period at a monthly interest rate of 1.35 percent (or an annual rate of 16 percent), when the monthly interest rates in the curb market stood at 3.84 percent on average. The emergency measure also allowed debt-equity swaps at the request of lenders. It was estimated that the EDES reduced corporate borrowers' financial burden by two-thirds on average.<sup>31</sup>

The emergency decree was successful in relieving the pressures of the liquidity squeeze, but at the cost of paralyzing the private curb market that had served as a source of capital for hard-pressed firms, when regular bank financing was unavailable or when a quick loan without extensive paperwork was needed to cover unforeseen operational costs.<sup>32</sup> Although the EDES was originally designed to help firms of all sizes, the greatest beneficiaries were the *chaebol*, because they accounted for 64 percent of the private curb-market loans. Parallel to the freeze on curb-market loans, the state banks lowered interest rates by 3.5 percent from 19 to 15.5 percent, again benefiting the *chaebol* the most, as the largest debtors.<sup>33</sup> More-

over, the *chaebol* conglomerates with heavy investment in strategic industries and export sectors were given the additional benefit of financial subsidies in the form of "industry rationalization funds."<sup>34</sup> In return for their participation in the state's risky program of heavy and chemical industrialization during the uncertain 1970s, they received generous state support, including low interest rates on bank loans, tax cuts, state guarantees on foreign loans, and preferential licenses. Saved by the emergency decree, big business came back strong, leading the economy to grow by a phenomenal 16.5 percent in 1973.

In the end, the EDESG had the effect of consolidating the *chaebol's* place in the South Korean economy by not only putting the *chaebol* on a more financially sound base but also enabling them to exploit new opportunities in HCI-led corporate growth from that position of financial strength. The EDESG, followed by heavy and chemical industrialization, sealed a rock-solid partnership between the state and the *chaebol*.<sup>35</sup> Once the front-runners among the *chaebol* entered strategic heavy and chemical industries after the mid-1970s, the entry opportunities were rapidly closed down, with the effect of protecting the front-runners' market share and political privileges. The HCI *chaebol* grew exponentially during the 1970s. Daewoo, established only in 1967, became the Cinderella of the following decade, growing over 54 percent annually. Hyundai also grew at 38 percent to become the largest *chaebol*, surpassing Samsung. The business community's internal hierarchy, once it had been reordered by the EDESG and HCI drive during the 1970s, was to survive for decades to come.

First, the top-ranking *chaebol* groups' conglomeration and diversification into unrelated business sectors intensified with the HCI drive. Whereas Lucky-Gold Star concentrated on producing electrical appliances and electronic goods, Hyundai embodied the image of heavy and chemical industry *chaebol* by expanding its presence in the automobile sector and entering the shipbuilding and steel industries. The synergy effects accruing from myriad backward and forward linkages were seen as justifying their respective specialization into electronics and HCI. Nonetheless, the sectoral specialization of these *chaebol* conglomerates should not be exaggerated. Hyundai went on to enter the electronics industry in 1983 and the oil refinery business in 1993. Moreover, its corporate origins traced to Hyundai Engineering and Construction, yet by 1971 it was also operating department stores and hotels. Lucky-Gold Star similarly operated large businesses outside the electrical appliance and electronics industry, running an oil refinery from 1963 on, setting up as a metal maker in 1971, and diversifying into the financial sector in the late 1980s.

Second, the *chaebol's* pattern of investment since the late 1960s closely

maps onto and followed the Park regime's economic planning and was concentrated in the state-designated strategic industries, demonstrating that state subsidies and support played an important role in investment decisions made by the *chaebol*. Apparently, by coming to the rescue of faltering firms between 1968 and 1972, Park succeeded in making his pledge of support politically credible to the *chaebol*, which helped his mobilization of business support behind the post-1972 HCI drive.

Third, by the mid-1970s, many *chaebol* conglomerates began to enter the construction industry to exploit the growing domestic real estate market and the Middle East construction boom. Non-bank financial institutions (NBFIs) also attracted major investment when the Ministry of Finance chose to develop NBFIs under the private sector's leadership with the goal of developing new sources of capital and reducing demands on state bank loans. The financial and corporate distress of the early 1970s had persuaded the MoF to develop the stock market as a supplement to the existing bank-centered financial system.

Finally, by the early 1970s, the two older and largest *chaebol* groups—Samsung and Lucky-Gold Star—diversified into not only the light and heavy manufacturing sectors, but also the services sector, including non-bank financial institutions, hotels, and department stores. Unlike Hyundai and Daewoo, the aggressive front-runners among the new *chaebol*, which were known to be favored by Park for their risk taking, Samsung and Lucky-Gold Star did not seek extensive loan packages as aggressively as Hyundai and Daewoo. Consequently, they were slower in growth and in diversification. When they entered the state-targeted heavy and chemical industries, they did so much later and on a smaller scale, after the front-runners had tested the waters. The late entry into HCI was owed in part to their top management's conservative business strategy of following the proven path of specializing in the production of consumer goods. However, in Samsung's case, politics also factored in to delay its entry into HCI. Since 1966, when Samsung's fertilizer firm had been caught smuggling 60 tons of OTSA (used for the manufacture of saccharin) with the help of state-guaranteed foreign loans, Samsung's relationship with Park had remained uneasy, preventing it from forging close-knit ties to his industrial projects and goals.<sup>36</sup>

Of the Big Three, Hyundai was the most dynamic. By 1972, Chŏng Chu-Yŏng laid the foundation to become the heavy and chemical industry magnate of South Korea, with six of his eight major firms each building an empire in the construction, iron and steel, oil refinery, and automobile industries. As Yi Chun-lim once recalled, the Hyundai Group's diversification was driven by its desire to control the markets:

[Chŏng Chu-yŏng] established an iron and steel plant to secure a reliable source of steel for Hyundai Construction. The public then complained about shoddy buildings, but at the time, there could be only shoddy buildings. We could secure steel supplies from a U.S. supplier only at the end of the year, when there were only a few months left to meet the construction deadline . . . [W]e ended up constructing gray concrete buildings with steel beams in the middle of the winter cold, when the cement kept getting frozen. That was why Chŏng Chu-yŏng decided to build his own iron and steel plant.

Besides, Hyundai was the largest construction company, capable of building the iron and steel plant with a steady demand for its products . . . All in all, this was a good deal. Chŏng Chu-yŏng's ideas in establishing Hyundai Motors and Hyundai Oil Refinery were similar: Hyundai was its own largest supplier and customer. Why should Hyundai pay another company for what Hyundai could produce?<sup>37</sup>

As each of the *chaebol* conglomerates expanded its empire through diversification and conglomeration, it came to need a new corporate governance structure to help the owner-manager *ch'ongsu* (commander in chief) maintain his tight rein over subsidiaries and affiliate firms. The structure of family ownership-management had to be modernized if the *chaebol* were to remain an effective business organization in spite of rapid conglomeration and diversification. The pioneer in organizational innovation was Samsung, who as South Korea's largest *chaebol* had already faced the dilemma of family ownership-management and entrepreneurial effectiveness in the late 1950s *chaebol*. The establishment in 1959 of a secretariat, with full-time staff members to help the *ch'ongsu* systematically manage the growing Samsung Group, was a precursor to the modernized corporate governance structure that emerged out of the 1964–1972 corporate expansion. Yi Pyŏng-ch'ol once argued that the secretariat “must become one with the group chairman, putting into practice his management philosophy.”<sup>38</sup> To enable the chairman to control and direct the burgeoning business group as if it were a single business entity, the secretariat enjoyed the prerogative of making policy and investment decisions for each of the member firms from the collective perspective of the entire business group. The Samsung chairman's secretariat consisted of some twenty staff members, neither too many to threaten the autonomy of affiliate firms by hoarding power, nor too few to be unable to make strategic business decisions. Yi Pyŏng-ch'ol saw the secretariat as his eyes and ears to monitor performance and advise on strategic issues from a macro perspective.

Needless to say, the ultimate source of the power wielded by Yi Pyŏng-ch'ol and his secretariat lay in the myriad cross-shareholding and circular shareholding that glued the member firms together. Through this mechanism, Yi Pyŏng-ch'ol and his family were able to launch new business enti-

ties with a minimum input of family wealth. Once Yi controlled parent companies with a large personal stake, he used the parent companies to establish new firms and the subsidiaries to launch still another layer of business firms. Then, from his secretariat, Yi Pyŏng-ch'ol effectively controlled the entire business group without any checks and balances by professional managers or, more important, by minor stockholders. Even after some of the member companies went public under Park's pressure to ameliorate societal discontent over the concentration of wealth in the mid-1970s, the opaque corporate governance structure of cross-shareholding and centralized managerial power enabled Yi Pyŏng-ch'ol to make strategic business decisions for the firms listed on the stock exchange as if they were still family businesses.

#### Completion of the *Chaebol* Structure, 1973–1979

The HCI drive announced by Park on January 13, 1973, allowed the *chaebol* to complete their structure. Aware of the need to concentrate resources in order to realize economies of scale in the capital-intensive heavy and chemical industries, but also wary of the risks and dangers of stagnant monopolies, Park chose the strategy of getting the *chaebol* to construct an oligopolistic structure of competition in five industries: nonferrous metal, petrochemical, machinery, shipbuilding, and electronics. The sixth industry selected for massive state support—steel—was reserved for state ownership and management. Selected on the basis of Park's trust in their owner-managers' commitment, ten *chaebol* groups became the dominant players in the other five heavy and chemical industries.<sup>39</sup> As the HCI drive progressed, business concentration accelerated. Some 70 percent of investment funds were channeled into a few large *chaebol* in support of Park's HCI drive, and most of the top ten *chaebol* conglomerates, except Samsung and Lucky-Gold Star, came to be Park's creation, pulled out of the second tier of the South Korean business community by him and diversified into unrelated industries under his patronage. These *chaebol* were chosen by Park as national champions on the basis of their performance, their loyalty, and their willingness to take risks. The risk taking was rewarded handsomely with oligopoly rights in strategic industries.

This is not to argue that the *chaebol* itself was Park's creation. On the contrary, as was already visible in Samsung's choice to supplement the strategy of funding industrial projects with state-brokered loans with joint ventures after the political fiasco of saccharin smuggling in 1967, the two largest business groups in South Korea—Samsung and Lucky-Gold Star—

chose the option of teaming up with MNCs to secure scarce resources and minimize risk when they entered the electrical and electronics industry in the 1970s.<sup>40</sup> Samsung gained contracts for technology transfers for Samsung Electronic Devices from Nippon Electric and Joowoo (Japan) and for Samsung Electronic Parts from Sanyo, among others.<sup>41</sup> Similarly Lucky-Gold Star collaborated with firms such as AT&T (United States), Mitsubishi Corporation (Japan), and Siemens Aktien Gesellschaft (West Germany).<sup>42</sup> Lucky-Gold Star opted for joint ventures outside the electrical and electronics industry, too. Among its affiliate companies, the Honam Oil Refinery signed a 50:50 joint venture with Caltex, Gold Star Company secured direct investment from the International Finances Corporation, and Lucky partnered with the National Plastic Company of Japan.<sup>43</sup>

Despite the variation in the *chaebol* groups' readiness to grow through risky state-brokered bank loans, or with MNCs as their partners in joint ventures, the HCI-driven 1970s were for all conglomerates—whether the old or new, the cautious or adventurous, or the political cronies or entrepreneurs—a lifetime opportunity for hypergrowth. To be sure, Samsung and Lucky-Gold Star fell behind, but still grew fast enough to remain within the Big Four. The two older *chaebol* groups annually grew by 17.2 percent in terms of total assets. The HCI drive of the 1970s, then, promised hypergrowth for all conglomerates. Equally critical, the continued corporate growth of Samsung and Lucky-Gold Star demonstrated that although state support and guidance were important, they were not the whole story. They showed that there were alternative ways to prosper, even in the most dirigiste period of the Park era.

Once Park decided to pursue HCI, export promotion became an added reason to strengthen business concentration. In the absence of sufficient domestic demand, Park designated the heavy and chemical industries as export sectors when they were only infant industries. He set the goal of increasing HCI exports to a level of 60 percent of total exports by 1981. Incredibly, the target goal was achieved.<sup>44</sup> The success was partly owed to the establishment of general trading companies (GTCs) in the mid-1970s. Shaken by the 1973 oil crisis and challenged by the rising tide of trade protectionism in the markets of advanced industrialized nations, Park pushed through the legislation of a law on GTCs in 1975 on the recommendation of the *chaebol*. Modeled after the Japanese *sogo shosa*, organized to deal with exports and imports of diversified products in multiple markets, the GTCs, it was hoped, would put limited resources to their best use.

From the standpoint of the state, the establishment of the GTCs was crucial to its goal of export growth. In the eyes of the *chaebol*, the GTCs

became another instrument of conglomeration and diversification. The acquiring of a GTC instantly provided the *chaebol* with additional privileged access to preferential policy loans. The trading house also helped the *chaebol* in bringing small- and medium-sized producers into their network of vertical and horizontal *kyeyōlhwā* (affiliation). There were also the benefits of building up high-quality manpower, gathering quality information on overseas markets, and acquiring managerial expertise inside the *chaebol* organization, which could assist their pursuit of new business opportunities. Moreover, because the *chaebol* were forbidden to own commercial banks, GTC export credits could help finance their sprawling industrial empires. The organization of *chaebol* came to look like a concentric circle of firms, with the GTC at the core, assisting affiliate firms with export credits, market information, and managerial expertise and coordinating their collective actions. By 1979, half of South Korean exports were handled by *chaebol*-owned GTCs.<sup>45</sup>

The Park regime was shrewd in utilizing export credits as both carrot and stick to discipline the *chaebol* in the direction of government goals. Every year, the Ministry of Commerce and Industry (MCI) announced the minimum amount of paid-in capital and total export volume, as well as the minimum number of export items, export destinations, and overseas branches, that a GTC had to meet to retain its GTC status. For those that met the requirements, the state banks provided loans up to the dollar amount on their letters of credit at preferential foreign exchange and interest rates. GTCs with exceptional export records were even exempt from showing their letters of credit in order to receive credit from domestic banks and could borrow up to 1.5 months' worth of their past export record.<sup>46</sup> Conversely, in the case of a GTC that failed to meet the target goals, the MCI immediately revoked its GTC license. During the 1974–1978 period, it was those *chaebol* with HCI affiliate firms and GTCs that grew into a formidable power bloc in the South Korean economy.

As in the case of launching GTCs in 1975, it was the *chaebol* that initiated the idea of exploiting the Middle East boom of the mid-1970s to earn badly needed foreign exchange to stabilize the South Korean economy and fund HCI-led economic growth. This period looked extremely gloomy for the resource-poor, export-dependent South Korea, with the 1973 oil crisis shaking it from its foundations by pushing up the price of crude oil from \$1.75 per barrel to over \$10 in less than two years. Whereas the Japanese automakers developed fuel-efficient cars on the basis of their technological capabilities to break out of the dual challenges of rising oil import bills and stagnating export sales, Chōng Chu-yōng looked to the Hyundai Construction Company rather than to Hyundai Motors for an exit strategy. He

had no choice; Hyundai Motors, only established in 1967, was struggling to raise the local content of its products, let alone innovate with foreign technology. By contrast, Hyundai Construction had more than ten years of experience building infrastructure in Thailand and South Vietnam.

Hyundai went to the Middle East in the fall of 1975, with the same spirit of learning-by-doing that had proved fruitful in Southeast Asia in the 1960s. A breakthrough came when Chŏng Chu-yŏng successfully bid for the Jubail Industrial Harbor project in Saudi Arabia, the crown jewel of Middle East construction projects worth \$931 million,<sup>47</sup> which was nearly half of South Korea's annual national budget. The state became aware of the vast opportunities to earn foreign exchange in the global recycling of oil money and swiftly changed gears in a way typical of Park. The MoF channeled massive policy loans, while the Ministry of Construction (MoC) relaxed regulation on overseas construction and restrained "excess competition" among South Korean construction companies bidding for construction projects in the Middle East through the formation of cartels. Taking these measures as the state's signal to emulate Hyundai, second-tier *chaebol* companies rushed into the Middle East construction market. Until the bubble burst in the mid-1980s, the boom was to provide South Korea with massive foreign exchange earnings with which to weather the 1973 and 1979 oil shocks. It is estimated that the earnings in the Middle East construction markets contributed about 10 percent to South Korea's GNP growth from the late 1970s to the early 1980s.<sup>48</sup>

In the areas of state guidelines and regulations too, the *chaebol* proved crucial in prodding the state to look into new ways to achieve its policy goals. The EPB came to learn about the new possibilities for raising funds in international markets when Daewoo became interested in pioneering this frontier. Daewoo's mid-level managers worked closely with mid-level MoF career bureaucrats, who defined their role as facilitating the business activities of private firms, to devise new regulatory rules on international financing.<sup>49</sup> Similarly, when the Ministry of Transportation (MoT) announced broad long-term guidelines to modernize the South Korean transportation system, Hyundai Motors quickly responded with its own plan in August 1973 to help the MoT realize its goal.<sup>50</sup>

As each of the *chaebol* dramatically expanded its empire during the 1970s to seize the business opportunities of HCI, it felt the pressures of further centralizing its corporate governance structures. As in the 1960s, the innovator was Samsung. The Samsung chairman's secretariat enhanced its responsibilities for strategic decision making and business monitoring and grew in personnel. The secretariat became the "brain" of the Samsung Group, establishing mid- and long-term goals for the entire conglomerate,

coordinating personnel policy among the member firms, making strategic investment decisions, analyzing the impact of state policy and the trends of overseas markets, and providing support to member firms in the areas of public relations, overseas market expansion, and computerization, among others.<sup>51</sup> The secretariat grew to seven teams with 40 elite staff in 1972, and to twelve teams with 71 staff by 1978. By 1980, it was to have ten teams with 139 staff.<sup>52</sup> The other *chaebol* conglomerates soon came to look at the Samsung chairman's secretariat as a model. Ssangyong established a Central Office for Coordination in 1969, Sŏn'gyŏng (Sunkyong, which later became the SK group) an Office of Planning and Coordination in 1974, and Hyundai a Central Office for Planning in 1979.<sup>53</sup>

In 1978, Samsung pioneered another managerial innovation to strengthen its coordination capabilities by dividing up highly heterogeneous member firms into six smaller subgroups along the sectoral lines of trading, heavy and chemical industries, light manufacturing, electronics, construction, and services. The reorganization allowed the Samsung Group to balance the business requirements and goals of specialization and conglomeration, managerial professionalism and family control, and group control and firm autonomy. Through the reorganization, member firms came to work more effectively within a unified small subgroup structure while Samsung retained its family-management style.

FROM THE standpoint of the *chaebol*, the Park era presented a tremendous opportunity for corporate growth as well as for corporate crisis. For those *chaebol* willing to work with Park under the rules of high risk and high payoff and capable of achieving the goals set by the regime, the state promised and delivered privileged access to resources. Whereas Hyundai was given lucrative government contracts, Daewoo was offered opportunities to take over and turn around insolvent business firms with generous loan packages. On the other hand, what Park perceived as a breach of the political exchange he had contracted for with the *chaebol* met with harsh punishment, as in the case of Samsung with the Han'guk Fertilizer incident. At the same time, however, Park's ability to wield the stick was a variable, not a constant, being formidable during the early years of his political rule, when strong preexisting ties between the state and the *chaebol* were lacking. As the ties between the two deepened and widened with the launching of FYEDP projects, and as Park committed political support in return for the *chaebol*'s entrepreneurial leadership, the state saw its stick getting shorter and thinner.

The Park era was one of reorganizing big business in South Korea. Of the ten largest *chaebol* groups of the early 1960s, only three remained in

the same exclusive club of the Big Ten by the early 1970s. The number was to fall to two by 1980. Thus the 1960s were a turbulent time for the old *chaebol*, but a tremendously profitable time for the new *chaebol*. By the early 1970s, there existed a group of highly motivated *chaebol* owner-managers who were poised to take advantage of state subsidies to build the heavy and chemical industries. The Park regime rewarded their risk taking by limiting other firms' entry into HCI development, which conferred on the entrants oligopolistic profits with which to weather the difficulties of HCI projects. This strategic choice resulted in the segmentation of big business, with the Big Four undergoing the process of remarkable conglomeration and diversification within the heavy and chemical industries. The structure of big business created by Park's HCI drive remained the same until the Asian financial crisis shook the *chaebol* from top to bottom in 1997–1998.

The *chaebol* groups' business success sustained South Korean economic development in spite of the oil shocks and rising trade protectionism, and economic development in turn allowed the Park regime to acquire instrumental legitimacy and sustain itself. The *chaebol* were dynamic players, sometimes following Park, other times leading the state, and still other times partnering with multinationals rather than with the state in their search for corporate growth.

## The Automobile Industry

*Nae-Young Lee*

SOME SAY THAT the rise of South Korean automakers was a miracle. Others portray it as a necessary outcome of the work of a technocratically driven developmental state, visionary entrepreneurs with a “can do” spirit, or their partnership based on asymmetric political exchanges. Still others argue that it was neither a miracle nor a product of a superior state or *chaebol* institutional capabilities. They brush automaker success aside as growth generated through a massive injection of resources rather than as a continuous improvement of productivity. For some, the automakers had an easy way to growth, with the state subsidizing their entry into new lines of production, taking over the costs of adjustment during crisis, and awarding rents with which to make up business losses. Chapter 10 takes the South Korean auto industry as a case study to critically review all three schools of thought. By tracing the industry's volatile history of hypergrowth, structural crisis, and top-down restructuring, and through identifying the formidable challenges of forging a national champion, it will argue that, in contrast to developmental state theories, the South Korean state pursued a strategy technocratically full of limitations, but successful in achieving an auto industry take-off because it not only backed the automakers with massive support but also let failing ones go under.

The problem with the miracle thesis is that by focusing on the outcome of hypergrowth, it ignores the politically and economically challenging processes of coalition building, risk taking, innovation, and restructuring