

# **The Ebb and Flow of Government Regulation: An Exploratory Study on the Regulation of Business Groups in Korea<sup>1)</sup>**

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**Abstract:** When and why does government seek to introduce and strengthen the regulation of big business corporations, and when does government withdraw the regulation? In answering these questions, this study examines the ebb and flow of regulatory policy, which may be called a "regulatory tide." This study focuses on the effect of crucial political and economic changes such as presidential elections and economic recession. We propose that political changes tend to enforce the government and the ruling party to strengthen regulatory policy on business corporations. Economic forces tend to press the government and ruling party to weaken regulatory policy and, in turn, regulatory policy tends to alternate strengthening and weakening periods. These propositions are examined using Korean regulatory policies on business conglomerations during 1980-2002.

## **INTRODUCTION**

Choi Byungsun (2000) explored the current academic situation that few studies have analyzed social-economic reforms tasks in light of regulatory theory or regulatory reform. He pointed out that policy studies in Korea tend to be quick tempered, only to identify specific goals and strategies. The consequence is the academic failure to examine, in a higher and broader dimension, the state-society structure or the political ramifications that may change the whole direction of regulatory policies and the failure to examine the mutual interdependence of various reforms and evaluate consistency. Choi found the reason for this failure in the tendency of social scientists, including students of public administration, to engage in a normative and one-dimensional analysis and in the theories and analytical tools that those social scientists employ for their analysis.

Consequently, despite some academic achievements that have identified specific conditions under which regulations occur and why they occur (Peltzman, 1976; Stigler, 1975; Wilson, 1980), we do not know the general political and economic structures under which government is likely to introduce or withdraw certain regulatory policies. That is to say, beyond the fragmented and microscopic analysis of certain cases of regulation, we need to develop a more comprehensive theory of regulation that can explain government's regulatory policy changes.

In this sense, this study asks a question: When and why does government seek to introduce and strengthen its regulation of big business corporations, and

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when does government withdraw regulation? In answering these questions, this study examines the ebb and flow of regulatory policy, which may be called a "regulatory tide." These questions are very important in that the proper level of government regulation is a necessary condition for the state and the national economy to be stable and progressive.

Government's regulatory policies never stay still they move constantly. Just as the economy changes from boom to recession, government regulation changes from flow to ebb and then from ebb to flow. This study proposes that in a country such as Korea, government regulation is likely to be stronger whenever a new administration is launched, although it may be delayed for a while. This is the case especially when new presidents come to power through presidential elections or military coups with a strong passion for "social justice." Government regulation is likely to be weaker when the economy runs into trouble. This is because the president and his ruling party, concerned with winning elections, cannot implement strong regulatory measures that would harm the viability of the economy.

This study is an exploratory work to conceptualize the regulatory policy fluctuation that will lead to an eventual theory of the "politically induced regulatory cycle." Thus, the review of government regulation focuses on the contingent political environments, interests, and ideas of policy actors. It covers only the time period after the Chun Doo Whan administration in Korea because until that time, business regulation policy did not exist for the state's instrumental role in the development process. Extensive interviews with party officials, high-ranking bureaucrats, and think tank members are adopted.

## **THEORETICAL FRAMEWORK: THE REGULATORY POLICY TIDE**

In this study, "business regulation policy" refers to total government activities regarding business groups that seek permanent corporate interests through oligopoly, monopoly, or restrictions on free competition in the market. However, in a broader sense, any activities that eradicate inefficiency and inequity surrounding corporation formation, operation, management, and the distribution of profits may be included in regulatory policy. Generally, regulatory policy aims to protect or promote the interests of the majority by restricting the exercise of property rights or the behavior of individuals and groups (Lowi, 1972).

### **The Politically Induced Business Cycle**

Public policy is the product of a political game played by various social actors. Here, analysts point to the relationship between the politics and economic policies. In the classic study of politically induced business cycle, W. Nordhaus (1975) suggested that before election, the government and its ruling party can

implement financial and economic policies to promote general economic conditions in a short period of time by reducing the unemployment rate, increasing disposable income, and increasing welfare benefits. But after election, the government tends to return to austerity policies to control inflation and overheat the economy. That is, there is an important change before and after election in the government's economic, especially fiscal and financial policies.

What Nordhaus suggested is that the government and ruling party can manipulate a country's economic policies to pursue special interests in violation of free-market principles and the national welfare. The consequence of the politically induced business cycle is the distortion of free-market principles and the undermining of a country's optimal efficiency. The politically induced business cycle brings about economically undesirable effects. The economic condition brought by the cycle is not optimal but suboptimal, and unnecessarily high price increases follow.

Nordhaus's hypothesis was tested by D. A. Hibbs (1977), who compared the financial economic policies of the socialist parties and conservative parties. Hibbs found that, after winning the election, the socialist parties in Europe and Democratic Party in the United States (compared with the conservative parties in Europe and Republican Party in the United States) preferred high price increases and low unemployment rate. Viewing politics as a wealth-redistribution process, Hibbs concluded that socialist parties, by expanding economic policies, redistributed wealth to the lower working classes and widened the political basis for support.

In Korea, study of the dynamics between politics and economics has been a scholarly interest among some social scientists. Among them, Kum Rok Yoo (1996), using time-series and spectrum analysis, found that the politically induced tax cycle was about 2.3 years in Korea. This study suggested that political factors played very important role in the tax policy, which provides a very useful analytical perspective for this study.

Although earlier scholars have focused on the relationship between election and economic policies, we are looking for the relationship between regulatory policies and critical political changes such as presidential elections. We call this tentative relationship between politics and regulatory policy the "politically induced regulatory cycle."

### **The Politically Induced Regulatory Cycle**

As Nordhaus indicated, the business cycle can be induced by politics. But this study suggests that the regulatory cycle also can be induced by politics. Because regulatory policy is more closely associated with politics, if one wants to know about regulatory policy one first needs to know about politics. James Q. Wilson (1980) stressed that any discussion of regulatory policies must be based on an analysis of the political situation. If political conditions are not met, even though all other economic conditions may be present for regulatory policies to come, the regulatory policies do not occur. Depending on political conditions,

the form of regulation and behaviors of regulatory agencies vary significantly. There, the most important factor is the perceived costs and benefits distributed among the actors.

In fact, many studies about business regulation policy have examined the political conditions under which actual regulatory policies occur. George Stigler (1975) viewed business regulation policy can take place basically in two cases. First, regulation is introduced primarily for the protection and benefit of the public at large or some large subclass of the public. Second, regulation takes place when political leaders take actions out of moral virtue. Sam Peltzman (1976) argued that regulation occurs when contending interest groups pursuing wealth redistribution put pressure on the government to take actions that benefit those groups. The government, in turn, viewed as elected politicians, arbitrates among the interest groups to maximize its majority that is, the probability of election or reelection.

In Wilson's analysis, regulation takes place when a proposed policy imposes heavy costs on a small, organized segment of the economy (say, a particular industry) but supplies benefits to the public in general. That is, for a proposal to become a law, it must be enacted on behalf of an unorganized majority over the objections of an organized minority that stands to lose money if the bill passes (so-called entrepreneurial politics). For entrepreneurial politics to happen, some preconditions must be met. For instance, as Wilson suggested, someone must galvanize public opinion, mobilize congressional supporters, and mount a vigorous effort to enact a law that will face strong interest group opposition and little or no interest group support.

But, usually, it is not easy to meet these preconditions. Business is well organized to wield tremendous lobbying power, and the potential beneficiary groups are not well organized nor active. Practically, business regulation is possible only under special circumstances. In a developing country such as Korea, where the civil society has not yet been developed, the most common chance for entrepreneurial politics to happen is critical political changes such as presidential elections, congressional or local government elections, or some other socioeconomic crisis. These political changes provide leaders with significant political momentum to generate a public mandate and to control business groups.

### **Regulatory Policy and Business**

One reason, among others, that business regulatory policy cannot be easily implemented is that politics is dependent on the economy. On one hand, government officers have the authority and discretionary power to control business to promote the public good. Taking advantage of business groups' weak financing structure, public officers can always take regulatory measures such as loan regulations. Also, they almost always take public opinion polls as a rationalization of regulatory measures.

On the other hand, government officers, especially the president and ruling party, are dependent on business groups. Thus, Nordhaus (1975) suggested that

government regulation is likely to be weaker at the later stage of each administration because the outgoing government boosts the economy in an effort to get more political support from voters. Business groups, using their tremendous financial ability and organizational power, seek to promote bargaining power. In doing so, they use strategies and tactics such as diversifying business areas, holding further capital investment, and factory closeouts. Business groups also recognize the importance of public opinion and seek to neutralize regulatory policies by litigation, lobbying, and other means. Consequently, it is very difficult to implement regulation policy as well as to formulate one. That is, the probability of achieving a policy goal is very low because the government and big business are strategically interdependent on each other in most capitalist democracies (Shin, 1994).

More important, regulatory policy is greatly affected by the business cycle. The business cycle points to the cyclical pattern of labor management disputes (Kaufman, 1983). Similarly, government regulation of business groups also points to the cyclical pattern of business cycle because the changed economic condition changes the objective condition of the behaviors of political actors, too.

Although economic booms are likely to promote conditions for business investment and improve the standard of living of the public in general, they are likely to aggravate the public's sense of relative deprivation (Gurr, 1970). Thus, the public wants a greater share of the wealth monopolized by a few business groups. The government and ruling party seek to expand the political support by realizing the public's wants. During economic booms, business groups have sufficient room to take government regulation because of the relatively improved conditions for capital investment and high capital profit rates. Business groups do not need to take radical steps such as factory closeouts or moving abroad.

However, as a result of the business cycle, the economy also suffers from recession. During this time, government regulations are likely to be weaker because of changed political conditions for the government. Economic depression, by producing a large number of unemployed workers, decreases the job-approval rate of the government and the ruling party. The government tries to create jobs for the unemployed, and this forces the government to return to an economic growth policy, which inevitably calls for deregulation of business groups. Some analysts (Lindblom, 1977) have pointed out that business corporations enjoy special treatment from the government because of their strategic positions in the capitalist democratic system. This special treatment is almost inevitable because both the public sector and the private sector share responsibility for the employment of the mass public. The government, to assure tax revenues to maintain a sufficient level of economic growth and to create jobs for the reelection of its partisan politicians, must be dependent on the business sector (Pzeworski, 1990).

Furthermore, the owners and chief executive officers of business groups can manipulate capital investment at their will. They have full control of capital investment to determine whether, where, when, and how it is made. Plus, the essential features of the economic regulation policy mentioned previously the stra-

tegic interdependence of state and business do not leave the relationship of the two independent.

### **Politics and Business in Korea**

Since Korea adopted an unbalanced growth policy during the early 1960s, the share of big business groups in the national economy has grown greatly. As a consequence, the working classes, largely urban laborers and the white-collar middle class, have been isolated from the benefits of economic growth and dissatisfied with the government. The government has effectively controlled them through physical power using secret police and sometime military interventions. However, after democratization, these were no longer applicable and useful. Therefore, the expansion of social welfare and wealth redistribution became the only useful alternatives to the old authoritarian measures.

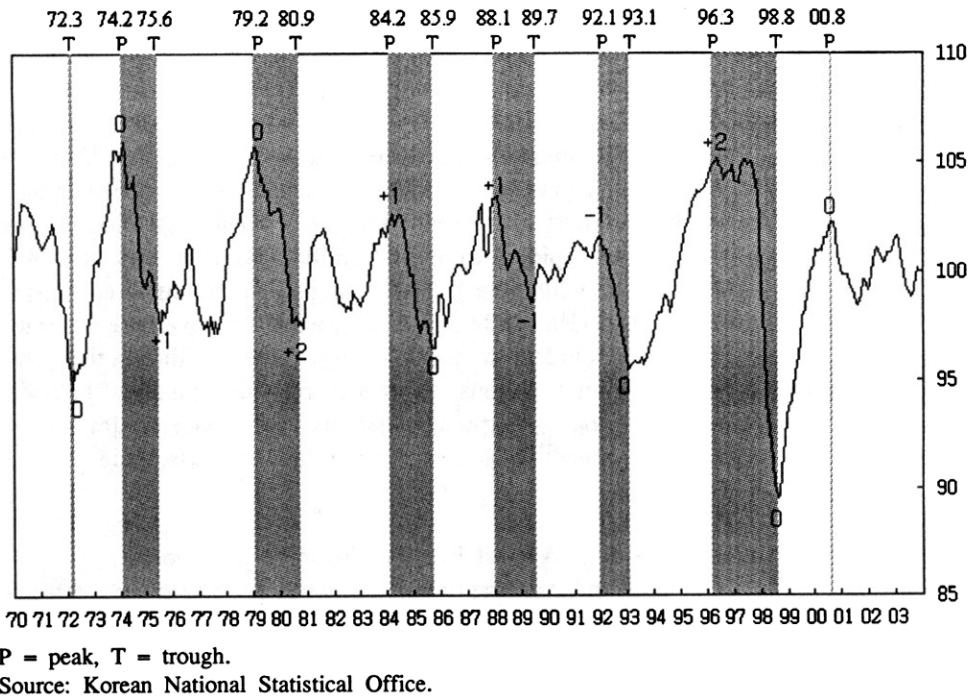
Korean politicians, like most politicians in liberal democracies, have promised in their campaigns to establish social justice (roughly understood as social equity) by bringing economic inequality to an end. If elected, the politicians almost always come up with powerful regulatory measures to fulfill their campaign promises. A former executive board member of the Korean Fair Trade Commission (KFTC) said that "any government came with a passion and determination to do well. And it tends to make most incoming administration appear to be a strong regulatory regime"(personal interview, July 2004). Thus, regulatory policies are likely to be strong, at or least appear so, during the early period of any administration. However, in the face of economic recession, government regulation gets moderated after a brief augmentation period. The former KFTC executive board member said, "New administration that came with a passion in the beginning gets tired of reform as time passed. Yet, even more importantly, what matters most for all politicians is to win the next election" (personal interview, July 2004).

To mention briefly about business, the business cycle in Korea shows a couple of interesting characteristics. Figure 1 shows there have been five business cycles since 1980, and each cycle has a three- to five-year duration period. In each business cycle, the trough points are September 1985, July 1989, January 1993, August 1998, and September 2001.<sup>1)</sup> Theoretically, around these times, government regulators were under pressure to stop or suspend regulation. Considering the close relationship between politics and the economy, this pressure would be effective.<sup>2)</sup>

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1) Provisional determination by the author; no official date is available.

2) Yet, these trough points may not match precisely with the time period of regulation decline because of the time lag and influences of other factors.



**Figure 1.** Business Cycle Expansions and Contractions in Korea since 1970: Cyclical Component of the Coincident Composite Index

Korean regulators have not maximized economic benefits by deregulating business groups. Rather, they seek a structure of costs and benefits that maximizes political returns. This search for maximum political return leads the government to suppress some economic forces that might otherwise affect political structure. As a traditional egalitarian society that constantly pursues social equity, if not perfect equality, successive governments in Korea have pursued the redistribution of wealth from business groups to the public. The likely result of this pursuit is the strengthening of regulatory policy on business groups whenever there are political changes.

However, this theory of regulatory policy tide is still tentative. The change of the tide is likely to be irregular and hard to measure. With this theory in mind, let's examine regulatory policy changes in Korea to see whether these political and economic changes have had any effect on government regulation of business groups.

## REGULATORY POLICY CHANGES IN KOREA

Although government regulation of business groups has ever expanded, it has fluctuated over successive administrations. First, government regulation increased in terms of both the size of bureaucracy and its budget. The Korean Fair Trade Commission, the body responsible for controlling business, has grown rapidly. The total number of KFTC staff increased from 75 in 1981 to 438 in 2004, and its budget also increased rapidly, from 263 million won in 1981 to 34,751 million won in 2005 (see [www.ftc.go.kr](http://www.ftc.go.kr)). These increases outnumbered those of the nation in a relative sense (Ha, 2004). The expansion of government's role in regulating business groups is evident in the statistics. Table 1 shows the growth of government sanctions against various types of irregular business behavior--market-dominating business abuse, corporate mergers, the concentration of economic power, inappropriate collective actions, and unfair business trade.

**Table 1. Government Sanctions Against Irregular Business Behavior**

	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	97	98	99	00	01	02
Market-dominating business abuse	-	-	2	1	1	1	4	-	-	2	-	6	2	1	3	1	2	5	2	0	4	0
Corporate mergers	22	51	24	43	27	22	35	37	32	12	22	19	24	13	23	36	47	29	19	48	45	46
Concentration of economic power	-	-	-	-	-	-	1	27	11	21	4	37	5	8	3	14	6	11	38	19	16	80
Inappropriate collective actions	-	-	-	7	10	4	6	15	11	12	20	9	16	19	26	36	22	37	34	49	43	47
Competition-restricting behavior	5	9	11	5	8	37	16	41	24	23	31	45	58	56	40	66	53	##	93	##	88	100
Unfair transaction	37	37	145	50	138	264	240	275	320	177	336	292	320	337	353	339	509	406	173	121	169	210
Unfair business practices with subcontractors	-	-	4	85	##	##	141	##	##	97	##	149	##	##	##	##	534	##	##	##	##	1632

Source: Korean Fair Trade Commission, White Papers on Fair Trade, 19802002

Second, since the government began to regulate business groups, it has fluctuated like the ebb and flow of tide, which may be called the politically induced regulatory cycle. To find this fluctuation of the regulation tide, let's take a look at the business regulation of each administration since the early 1980s.

### The Birth of the Chun Doo Whan Regime and the First Regulatory Wave

The Korea Fair Trade Act (KFTA), which had long been debated only within the Economic Planning Board, was finally enacted just after the military coup



of General Chun Doo Whan, who later emerged as the new political leader in May 1980. In August of the same year, the interim government under Chun's control proclaimed its intention to enact the KFTA to promote fair and free competition, thereby encouraging creative enterprising activities, protecting consumers, and striving for balanced development of the national economy. It has done so by preventing the abuse of market-dominating positions by enterprisers and the excessive concentration of economic power and by regulating undue collaborative acts and unfair trade practices (KFTC, 1980). Chun's deep interest in the KFTA was well expressed in the episode of Kim Jae Ik, Chun's chief economic adviser. Kim was confronted with business leaders and military officers who strongly opposed the legislation of the KFTA (Ha, 2004).

The Chun government was launched when the nation was in bad shape, both politically and economically. The government-led unbalanced economic growth strategy ended up in crisis because of business groups' overinvestment in heavy chemical industries. This led to the serious social problems of economic concentration and market monopoly by a handful of business groups. Above all, the economic concentration by a few business groups was excessive, resulting in a legitimacy crisis. During the period from 1973 to 1978, the economic concentration ratio of the top 20 business groups increased from 7.1% to 14.0% (KFTC, 1980).

Under this situation, the introduction of the KFTA was very helpful for compensating Chun's weak political legitimacy. Chun, who came to power through a military coup, judged that regulating excessive economic concentration by business groups, as well as the expansion of social welfare system, might be very well regarded by the public as a good-faith effort to establish social justice and economic justice. In other words, the regulatory policy of the Chun government was politically motivated to widen the basis for political support for the government, as well as to enhance the efficiency of the national economy.

Thus, in the early period of the Chun administration, the regulatory tide was on the rising flow. Yet, it soon began to ebb as time went by. The government could not strongly enforce the regulatory measures stipulated in the KFTA law for three reasons. First, the national economy fluctuated. Figure 1 shows there were two economic recessions during the Chun government, 198283 and 198586, which obviously had a detrimental effect on the regulations. Second, the legislation of the KFTA was politically motivated in the beginning and largely symbolic in its nature. Once Chun's political objective was obtained, the government quickly lost interest in the regulation of business. Third, President Chun fell captive to business groups, as revealed in the "Grand Bribery Scandal." The regulation was no more than a political gesture to allure votes. The activities of the KFTC were centered on symbolic measures such as recommendation, warning, and administrative order without due provisions for penalties in case of violations. Business groups continued their economic expansion by way of undue business practices such as intragroup transaction and cross-shareholdings. The government's initial will to regulate business groups was considerably mitigated in the middle of the Chun administration's term.

Near the end of Chun's administrative term, the regulatory tide was on the flow again. Fortunately, the economic boom resulting from "three lows syndrome" (interest rate, foreign exchange rate, and price index) recorded an average annual growth rate of 12.8% during 1986-88. At the end of 1986, a year before the historic 1987 democratization movement, Chun and the ruling Liberal Democratic Justice Party (LDJP) prepared plans to maintain his power, if not his reelection. It undertook a series of economic reform measures, including the first amendment of the KFTA. It introduced articles concerning the ceiling on the total amount of equity investment among subsidiaries, the prohibition of cross-shareholding, and the prohibition on finance holding companies, which were quite effective in controlling business groups with market-dominant positions.

This action clearly aimed to appeal to the public during the forthcoming presidential election in 1987 and to draw popular support to the regime. The LDJP was well aware that the excessive concentration of economic power in a few business groups would not be helpful for maintaining political power (interview with a former LDJP officer).

### **The Election of Roh Tae Woo and the Second Regulatory Wave**

The Roh government, which emerged after the June 29 Declaration in 1987 and following presidential election through popular vote, needed more political support from the beginning. President Roh, elected by only 36% of the popular vote, considered welfare policy and wealth redistribution his main strategies for recovering his weak political mandate. Roh tried to meet popular demands to reform the existing economic system running around the business groups and to correct the unequal distribution of wealth. Naturally, reforming business groups became a chief policy objective.

However, Roh could not and did not seek active regulations on business. First, the economic decline around 1989 (see Figure 1) had a negative effect on the active implementation of the regulatory policy. The three-lows syndrome was over as Roh was inaugurated. Second, Roh was elected through tremendous monetary support from business groups, as revealed in his involvement in the bribery scandal.

Roh's dilemma was well revealed in such cases as he sought in vain to adopt a series of reform measures to sharply reduce the exclusive policy finance for business groups, increase the tax rate for land-owning business groups, and introduce the Real Name System for all Financial Transactions (RNSFT). Thus, the early period of the Roh government may be characterized as a time of ebbing regulation.

In 1990, however, the regulatory tide flowed again. A couple of events account for this shift. A new political event took place that would have a positive effect on the regulation of business groups. The ruling LDJP failed to gain a majority in the general election for the National Assembly in April 1988. This failure certainly put pressure on the government to control the giant business

groups and to handle the sensitive issue of social equity. In February 1992, the Democratic Liberal Party was born through the merger of three political parties that claimed to be more concerned with the economic reform and political stability. It obviously created sufficient room for the government to handle business groups.

As the concept of "public land" was adopted in 1990, the tax rate for land-owning business groups was sharply increased. In May 1990, the government issued an order for business groups to sell off all of their land and buildings held for nonbusiness use within six months. If they did not follow, the government would use its public authority to do so. In the same year, the second amendment of the KFTA was passed to strengthen the regulation of business groups. It included strict restrictions on cross-shareholding among subsidiaries. In addition, financial insurance companies were included as a group subsidiary for close surveillance.

In 1992, the third amendment of the KFTA adopted new clauses concerning debt guarantees among subsidiaries. The government came up with the business specialization policy. Business groups had to choose only three subsidiaries for specialization among all of its business group subsidiaries. Other nonspecialized subsidiaries were excluded from access to bank loans, which were very much controlled by the government (Yoo, 1996). The government closely monitored business groups, whether they were engaged in business-expanding activities such as the cross-shareholding, cross-assistance, or mutual investment among subsidiaries.

### **The Kim Young Sam(YS) Administration and the Third Regulatory Wave**

The YS government was born with a tremendous popular mandate in December 1992, as its campaign promise implied the end of military rule. "Military rule" implied not only rule by the military elites but also liberty for business groups. The coming of the YS government meant the regulatory tide would be flooded.

As soon as YS was inaugurated, he was determined to eliminate the inefficiencies of the politics-business tie and bring the economic injustice and inequality resulting from the ownership structure of business groups to an end. The Roh government had debated the issue of using RNSFT. Yet it takes a new president and a new regime to take action. RNSFT was supported by the public at large. Nongovernmental organizations such as the Public Coalition for Economic Justice and the National Solidarity for Citizen Participation strongly criticized the market domination of business groups and called for the immediate legislation of RNSFT. Public opinion polls showed overwhelming support (86%) for the legislation, and the YS government was enjoying high popular support, well above 80% (Korea Gallup Poll, August 1993). This case clearly showed that economic reform and business regulations were closely associated with the political engineering of the YS government and the ruling New Korean Party to

widen political support from the middle class.

The fourth amendment of the KFTA in December 1994 also strengthened penalties on business groups for unfair trade practices and market-dominating behavior. The cap on total equity investment decreased from 40% to 25% of the net assets of business groups, preventing economic concentration in a few business groups. The YS government separated KFTC from the Department of Finance, making it independent of bureaucratic politics. The organization size of KFTC expanded, with the total number of employees at 343.

As the YS government passed the middle point of the administration's term, it encountered an economic recession. And the recession was so bad that even YS could not sustain the policy stance. The overheated economy finally resulted in a deficit in the balance of payments, which recorded a surplus of \$400 million in 1993. The balance of payments went down to a deficit of \$4.5 billion in 1994, \$8.9 billion in 1996, and \$23.7 billion in 1998. The price of semi-conductors, a chief export of the nation, plummeted from \$50 to \$4, and the overvalued Korean currency damaged the competitiveness of domestic goods in the foreign market (Bank of Korea, 1990-1999). The recession finally dragged the midterm Kim government into the ebb tide of regulation.

The economic recession had a strong negative effect on the public's evaluation of the YS presidency. Popular support dropped to around 40% to 50% from a high of nearly 90% (Chosun Daily, 1995). In this situation, YS had no choice but regulatory retreat. This practically implied a return to the old unbalanced growth policy, in which business groups played a dominant role in the national economy. The government began to control the labor sector under the guide of "globalization." By 1995, government regulation had become substantially weaker. The cap on total equity investment and the prohibition on debt guarantees were not observed. There were too many exceptions for business groups in the statutes of the KFTA. The YS government allowed the entrance of Samsung into motor manufacturing industries and lifted sanctions against Hyundai Group. In 1995, the government decided to lift the ban on loan allocations and economic concentration if the 30 business groups' cross-shareholdings went below 20% of pure assets.

Consequently, the economic concentration of business groups continued and was aggravated. During the period from 1994 to 1996, the time of worst economic recession, the Korean Development Bank increased special loans to business groups 26.1%, 24.0%, and 18.3% every year, and investment in manufacturing industries also increased 38.5% annually (KDB, *Monthly Research Paper*). By 1995, the relationship between government and business had recovered its traditional tie and, consequently, the regulatory tide was ebbing again.

Near the end of the YS administration, the regulatory tide shifted to flow again. The government undertook a series of reform measures to regain its political power using its regulatory power against business. This was because YS and his ruling party viewed the reform of business groups and their financial system as the only route to keep economic growth and maintain political power. In April 1997, just several months prior to the presidential election, YS pro-

claimed a new policy for business groups. A couple of political and economic changes may account for this new rise in regulation. First, in 1996, the New Korean Party was born after YS and the ruling party lost in the 6.27 local government election, which needed some kind of political momentum to widen its basis of political support. Second, naturally YS and the ruling party were concerned with the forthcoming presidential election at the end of 1992. The government was determined to reform business groups to win the economic war by passing the fifth amendment of the KFTA, which, among other things, prohibited debt guarantees for subsidiaries until March 2001 and strengthened the penalty for violating the prohibition clause on unfair transactions. Also, an emergency arbitrary order measure was introduced to strengthen the KFTC's regulatory power.

### **The Kim Dae Jung (DJ) Government and the Fourth Regulatory Tide**

The DJ government, which changed the ruling party for the first time in the nation's history, would undertake a hard-line regulatory policy against business groups. At the time, the nation was under the International Monetary Fund's (IMF) crisis-management system, which required Korea to meet several pre-conditions for loaned money. The IMF requirements included the reform of business groups' financial structure, the prohibition of debt guarantees for subsidiaries, rules for writing consolidated financial sheets to meet international standards, and allowance of hostile mergers and acquisitions by foreigners.

While pursuing regulatory reform to liberalize the government-led market system, the DJ government executed the life-long prepared programs to regulate business groups. Nevertheless, DJ's regulatory programs could not be implemented immediately because of the economic recession that began with the IMF. Rather, the traditional regulatory measures to control business groups, such as the cap on total equity investment, were abolished by the sixth amendment of the KFTA. Financial holding companies were legalized by the seventh amendment of the KFTA. In a deep economic recession, stock prices went down by almost half and the unemployment rate ran high. President DJ had to wait about two years (about the time Korea "graduated" from the IMF management system) until he could operate his regulatory programs.

When the economy "graduated" from the IMF, DJ began to tighten the regulation of business groups. Through the eighth amendment of the KFTC, the cap on total equity investment was restored in the KFTA, the penalties for inappropriate assistance within the business groups were strengthened, and the top 10 business groups were required to open their internal information. And DJ carried out the big deal among the most powerful business groups in the nation. By the middle of DJ's term in 2000, the regulatory tide was on the rising flow.

The political effect of the business regulations is evident when one looks at public opinion polls evaluating the DJ government, which actively sought the structural reform of business groups. The public showed a high approval rate for the administration. In the summer of 1998, the public's support for the DJ

government was 40%; it jumped to 63.9% in December 1998 and to 70.7% in February 1999 (WIN, Feb. 1999).

Entering 2001, the government regulatory tide was ebbing away, as critics had argued, to return to the old growth policy that favored business groups. In the excuse of "changed international and domestic environment," the government gave up the system of designating 30 business groups for monitoring. The article on the cap on total equity investment, which was revived in 1999, was again practically abolished in two years without having been applied to a single case in practice. The tenth amendment of the KTFA passed in January 2002, removing clauses concerning fine money and the stock sell-off order for business groups. Plus, the government resurrected the self-determining power for subsidiaries' financial insurance companies. There were too many exceptions for the cap. From this point on, critics argued, the KFTA existed in name only (Kim, 2003).

A couple of political and economic changes explain this regulatory ebb. First, entering the later stage of its administrative term, the political priority of the DJ government shifted quickly from economic justice and reform to national unification. Second, beginning in 2001, the nation ran into another economic decline under the influence of worldwide economic recession. Third, the ruling coalition between DJ and JP, the conservative Liberal Democratic Party, was finally broken apart, and DJ's ruling party fell into a minority status in the National Assembly. In the face of this changed environment, the government had to compromise with the business groups.

Unlike previous administrations, DJ could (did) not seek regulatory augmentation at the end. This is not because he did not want to reproduce the power but because, perhaps, he did not use the regulation as political leverage. A former party official stated that "DJ believes in a market principle. This is especially so after a couple of years he served the presidency" (Interview, February 2005).

### **The Beginning of the Roh Moo Hyun Government**

The election of President Roh Moo Hyun forecast the high tide of business regulation. Like his predecessor DJ, Roh was elected primarily by votes from the middle and working classes and progressive social groups. He believed the business groups ought to be controlled because they are a product of "favor and unfair trade practices."

President Roh clearly proclaimed these principles from the beginning. First, by introducing the Subsidiaries Separation Order System, the government mandated business to give up the financial sector. Second, by introducing the comprehensive tax system for inheritance and donation, Roh sought to prohibit business's expedient inheritance practices and illegal tax evasions. Third, by introducing collective litigation system in the securities market, the government sought to reform the corporate governing structure. Fourth, the government intended to strengthen existing regulatory measures, such as the cap on total equity investment and the prohibition on cross-shareholding and debt guarantee among subsidiaries.

In reality, however, strong regulation was not realized, as had been expected,

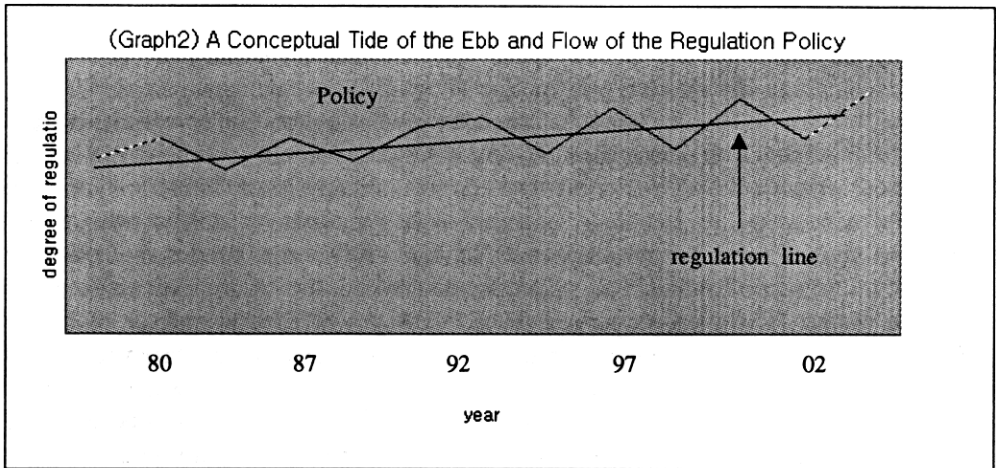
because of an economic recession. In 2003, the first year of his presidency, the Roh government staked all in the revival of the economy but was not active in regulating business. The regulation focus moved from economic concentration to the fairness of the market and the transparency of business management.

Although we will have to wait for the later evolution of the government's regulatory policy, the Roh administration has not succeeded in honoring any of its proclaimed principles. Roh's regulatory policy already took a retreating step when lawmakers in the National Assembly took measures to nullify bills to reform the market and business groups. In late 2004, the proposed Collective Securities Litigation System was about to die, while the "Cartel of Silence" of business groups effectively destroyed the KFTC's power of oversight.

However, given the regulatory trend of the past, the Roh government would recover its original policy stance as soon as the economy recovered. Table 2 summarizes the ebbs and flows of the regulatory tide as we have discussed so far. Figure 2 depicts the regulatory tide, with the general trend for expansion.

**Table 2.** The Ebb and Flow of the Regulatory Tide

Administration	Political and economic changes	Changes in government regulation	Tide
Chun Doo Whan, 12/1980-12/1987	5/1980 12/1980 2/1985	1982 1986	High
	1985-86 6/1987		Low
			High
.Roh Tae woo 12/1987-12/1992	12/1987 4/1988	1988 1990 1992	Low
	1988-89 2/1990		High
Kim Young Sam 12/1992-12/1997	12/1992 1993-94 6/1995	8/1993 1/1995 4/1997	High
	1996		Low
			High
Kim Dae Jung 12/1997-12/2002	12/1997	2/1998 1999 1/2002	Low
	1998-99 12/1999		High
	9/2001		Low
Roh Moo Hyun 12/2002-present	12/2002	Aborted reform measures	Low



## SUMMARY AND IMPLICATIONS

This paper has tried to find a general tendency from the development of Korean regulatory policies on business groups. In Korea, government regulation of business groups has changed over time in close relationship with political and economic changes. Generally, regulation gets stronger whenever there are political changes such as presidential elections or congressional or local government elections.

But the economy declines as a result of the business cycle, and business groups fight back. They push the government to suspend regulations on themselves, and the government practically has no choice but to compromise with them. The consequence is a swinging of government regulation between augmentation and decline, like the ebb and flow of the tide.

According to Nordhaus's politically induced business cycle, business regulation will be stronger during the early period of each administration and weaker at the later stage of each administration. Yet this study suggests that is not always the case sometimes it is the contrary. Generally speaking, business regulation in Korea becomes stronger at the later stages as well as at the early stages of administrations. This is the case for three out of four administrations, except for DJ. This may be because all of the presidents and ruling parties, once in power, are eager to maintain political power and presidency needed to demonstrate their concern for social justice. Korean politicians use business regulation as a political strategy to gather votes, whereas Western politicians use expenditure expansion, as Nordhaus indicated.

What if political changes coincide with economic recession? Would regulatory policy be stronger or weaker? Which factor is more influential?<sup>3)</sup> This study suggests that the economy usually goes first. Both the DJ and Roh Moo Hyun



administrations, despite their strong tendency toward the regulatory philosophy, could not execute strong regulatory measures because of economic crisis and recession. Roh Tae Woo could not do it either. This fact leads us to conclude that government regulation under economic recession is, in fact, a mere political gesture to show off politicians' will. Politicians could hardly overcome the pressure from business to deregulate business groups and boost the economy.

In conclusion, political considerations always play an important role in the process of government regulation. Government regulation operates within two kinds of structural constraints. One is the nature of liberal democracy, in which politicians take popular demands for more social equality into consideration. The other is that business groups have always been the engine of growth, which demands the principle of free enterprise and deregulation. Of course, there are some other constraints that influence government regulation at the middle-range level, such as party competition (Wilks, 1999) and the level of political support. Certainly, further studies are called for to determine the precise effects of these factors.

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3) These questions are adopted from the comments of referee; the author appreciates.

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