

# The Politics of Financial Control and Reform in Korea

BYUNG-SUN CHOI

*Assistant Professor, Graduate School of Public Administration, Seoul National University*

## Abstract

Government control over finance has been a persistent feature of the politico-economic structure of Korea. This paper first seeks to explain the process in which the government's control over finance had intensified by the late 1970s, with a focus on particular episodes such as the dramatic interest rate reform in 1965, Emergency Decree in August 1972, and several recurring "restructuring (in effect, bail-outs)" attempts, and in relation to the changing industrialization strategy and the consequent relationship between the government and *chaebol*. And then it will review critically the financial liberalization policies in the 1980s: the privatization of commercial banks, the conflict between the banks and the non-bank financial intermediaries (NBFIs) in the process of the restructuring the financial industry, and the freeing of interest rate and to "policy funds." The central argument of this paper is that a considerable progress of financial liberalization notwithstanding, the financial system of Korea still serves as the fulcrum of Korean industrial policy and as a fundamental tool with which Korean policymakers can induce business cooperation and compliance.

## I. Introduction

Government control over finance has been a persistent feature of the politico-economic structure of Korea. In view of the repeated policy statements and some actual policy changes such as the privatization of commercial banks and the lowering of entry barriers to domestic and foreign banks in the 1980s, one may argue that Korea has been well on the course of financial liberalization. But these remarkable changes notwithstanding, the financial system still serves as the fulcrum of Korean industrial policy and as a fundamental tool with which Korean policymakers can induce business cooperation and compliance.

This paper first seeks to explain how Korea's financial system had evolved as it

was by the late 1970s, and why and in what process the government control over the financial system had been continuously intensified in this period. In explaining these, the focus will be placed upon particular episodes such as the dramatic interest rate reform in 1965, Emergency Decree in August 1972, and several recurring "restructuring (in effect, bail-outs)" attempts. In addition, in analyzing these episodes, the emphasis will be placed on the changing industrialization strategy and the relationship between the government and big business and *chaebol* groups that each industrialization policy necessitated.

This paper will then turn to financial liberalization in the 1980s. It will pay much attention to the source of reform ideas. Taking account of the fact that each component of financial liberalization has its own politics, it will analyze the privatization of commercial banks, the conflict between the banks and the non-bank financial intermediaries (NBFIs) in the process of the restructuring the financial industry, and the freeing of interest rate and the "policy funds" separately.

## **II. Political Origins of Financial Policy**

### **1. Experiment of Liberal Banking System: 1945-60**

A modern financial system of Korea was shaped during and under the Japanese colonial rule (1910-1945). With the inauguration of the independent government in 1948, it requested foreign advisors to prepare a financial reform plan. Reflecting the prevailing notion of independent central banking system at the time, the plan, submitted in 1950 and immediately accepted by Korean policymakers, envisioned a highly liberal financial system in Korea.<sup>1)</sup> No sooner the Bank of Chosun had been turned into the fully independent central Bank of Korea (BOK), based on the plan, than the Korean War broke out. The budding BOK's autonomy and independence was inevitably compromised. Instead, the Ministry of Finance (MOF) took over monetary policy, relegating the BOK as war-time money printer. Commercial banks, which came into the hands of the Korean government following the repossession of the Japanese-owned shares and had been planned to be privatized,<sup>2)</sup> were subject to tight government control as well.

As the reconstruction began from around 1954, the government reorganized the financial system. First, it strengthened the long-term development financing system. The MOF turned then Industrial bank into the Korea Development Bank (KDB). The KDB, however, depended heavily upon the BOK for its lending resources. And it was true for other developmental banks such as the Korea Agriculture Bank. These specialized banks' share of credit increased rapidly. By the end of 1955, the KDB's share alone accounted for over 40 percent of total bank lending.<sup>3)</sup>

Second, the government enacted the so-far defunct General Banking Act and hastened to privatize commercial banks. Initially the government tried to restrict, in response to public worry about economic concentration, the upper limit of private ownership of bank shares and the transfer between large shareholders. But these restrictions rendered futile all six successively held auctions in 1956. Only after those restrictions were significantly released, the privatization move could be completed in 1957.

As expected, major *chaebol* groups could acquire the controlling shares of the commercial banks. As a result, commercial bank loans began to be largely "monopolized" by those *chaebol* firms. And political funds were also raised through these privatized banks.<sup>4)</sup> But it should be noted that, after the privatization, the relative position of the four commercial banks in terms of their share of commercial banks in total bank credit outstanding declined substantially.<sup>5)</sup>

## 2. Developmental Roles Assigned to Banks: 1961-64

Quite liberal financial regime in the 1950s was almost completely demolished right after the military government took power in 1961. First of all, it promulgated the "Temporary Law Regarding Commercial Banks," which restricted the voting rights of large stockholders, and then "nationalized" the commercial banks by repossessing the shares held by large stockholders (being accused of as illicit wealth amassers).<sup>6)</sup> The tainted image of the commercial banks since their privatization in 1957 and the public's concern about economic concentration through financial monopolization, and the public anathema against corruptive political interferences provided partial justification to this nationalization move. The heavy reliance of the commercial banks on the government and the BOK loans for their lending resources at the time provided a further justification. Second, the military government emended the Bank of Korea Act in May 1962, and thereby made it explicit that it was the government, not the central bank, that was to be held ultimately responsible for monetary policy. It thereby effectively ended the recurrent controversy over the independence of the central bank and the continued struggle between them.<sup>7)</sup> The government made it clear that it would use the BOK as a ready source of government debt financing.<sup>8)</sup> Moreover, it authorized the BOK's direct acceptance of industrial finance debentures issued by the KDB, and indirect route for government borrowing from the BOK.

Third, it further expanded the list of specialized developmental banks: the Central Federation of Agricultural Cooperatives and the Medium Industry Bank (MIB) in August, and the Citizens' National Bank and the Central Federation of Fisheries Cooperatives in late 1962. The political motive behind the establishment of the first two banks could be found easily from the fact that farmers and medium and small businessmen had had to rely heavily on private moneylenders.

In addition, the military government revised the Korea Development Bank (KDB)'s charter to increase its capital, to authorize it to borrow funds from abroad, and to guarantee foreign loans obtained by private firms. In particular, the authorization of the KDB's foreign borrowing and loan guarantee indicated the military government's ready reliance on foreign capital as a major source of financing for economic development in the wake of the declining foreign aid and the changing U.S. aid policy.<sup>9)</sup>

Indeed, the level of foreign aid continued to decline and was to be terminated soon.<sup>10)</sup> The military leaders understood the changing U. S. commitment to loans instead of aid clearly and began to devise mechanisms to enhance foreign borrowing. It was under these circumstances that the Korean government promulgated the "Law of Guaranteeing Foreign Loans" in July 1962, whereby capital imports could be financed by long-term export credits and their repayment could be guaranteed. The government granted tax concessions for foreign borrowing, and sent an economic mission abroad to attempt to secure financing for major projects included in the Five-Year Plan.<sup>11)</sup> The speeding up of the "normalization of foreign relations" talks with Japan, the most promising source of foreign financing and technology, during 1961-65 was made in this context.<sup>12)</sup>

The government policymakers' turn to foreign loans, in lieu of foreign aid, as a major source of financing for economic development plans changed the role of Korean banks and the attitude of business greatly. First of all, the domestic banks became facilitators and guarantors of external finance.<sup>13)</sup> but they did not actually intermediate between the foreign lenders and domestic borrowers, as the foreign loan negotiations were conducted directly between them and approved by the Economic Planning Board (EPB). The banks basically issued the guarantees on instruction from the government and took little responsibility for evaluating either the economic or financial feasibility of the guaranteed-loan development projects. As a result, the banks played a very limited role in the decision-making process regarding these loans, and thus had little basis for being held accountable for bad loans. It was the government that had to take extraordinary measures whenever the guaranteed-loan projects proved unsound.

Big businesses began to look foreign borrowing as a new, rich ground for economic rent-seeking. By the early 1960s, as foreign aid declined and the single fixed exchange rate system was adopted in 1961 in lieu of the multiple exchange rate system, they realized that the two traditional rich grounds of economic rent-seeking — foreign exchange allocation and special import licensing — gave way to domestic and foreign credit.<sup>14)</sup> It was for this reason that foreign borrowing was embroiled so often with political and bureaucratic corruption.

### 3. Interest Rate Reform and the Boom and Bust of Foreign Borrowing: 1965-71

The interest rate reform of September 1965, which doubled the annual time deposit rate from 14 to 30 percent, while creating a negative spread between the commercial banks' lending and deposit rates, marked a watershed in the history of financial policy in Korea.<sup>15)</sup> First, it brought forth a nearly seven-fold increase of total bank deposits over the four years from 1965 through 1969. Second, more importantly, it triggered an massive inflow of foreign loans guaranteed by the KDB and commercial banks.<sup>16)</sup> The gap between the international and domestic interest rates, which amounted to 19% a year as a result of the domestic interest rate hike, prompted private investors to rush for foreign capital as a new and profitable source of financing.<sup>17)</sup> Moreover, the upsurge of foreign borrowing entailed a corresponding demand for domestic credit as operating capital, to which the government responded again by allowing even foreign cash loans.<sup>18)</sup>

Viewed in this context, one may argue that the real motive behind the interest rate reform of 1965 was to make business turn to foreign borrowing. This view is predicated on the fact that the policymakers realized that there was a self-evident limit to domestic money creation and that foreign borrowing should be a major conduit of long-term development financing.<sup>19)</sup> According to this theory, the sudden hike of interest rate was necessary to sterilize money supply created by an enormous increase in foreign exchange reserves. Only with a high interest rate the government could absorb excess money supply in the form of time deposits, and, at the same time, turn them into domestic credit. This mechanism seemed to work quite well. And a high growth of private sector investment was made possible during 1965-69.<sup>20)</sup>

But from around 1969, this high investment financing mechanism broke down, as foreign loan repayment began to rise rapidly. The foreign exchange reserve almost stopped increasing and it thus could no longer serve as a money creator. It meant that the interest rate reform ran a full circle by 1969. As the government and banks could not make up for the severely reduced money creation from foreign sector, it was inevitable that the foreign loan-based big business began to run into severe financial difficulties. Furthermore, partly under the IMF's pressure, as the government was forced to adopt economic stabilization policies in the wake of the 1969 presidential and general elections, many business firms, large and small, ran for private loan market and came to the brink of bankruptcy.

Under these circumstances, the government undertook "restructuring of the foreign loan-based firms" in 1969. Among 86 firms that borrowed heavily from abroad, 30 was subject to the restructuring attempt. The government directed the

concerned banks to turn their bad loans into equities, and to reschedule them in addition to new loans provided to meet foreign repayment requirements. This restructuring episode of 1969-70 set the first precedent of how the government would respond to the financial difficulties of big business, so long as they complied with the government directives.

#### **4. August 3 Emergency Decree and Further Intervention: 1972-79**

Despite the bail-outs, the high indebtedness and the consequent financial distress of Korean business firms continued.<sup>21)</sup> Particularly the 18 percent devaluation in 1971, undertaken in an effort to boost faltering exports in the worsening world trading environment, dealt a severe blow to large export firms which had borrowed heavily from abroad. In these circumstances, many large firms began to turn to the unregulated money markets.<sup>22)</sup> At the time, major private money lenders had such power as to drive even large *chaebol* group firms to bankruptcy overnight by turning in commercial bills they held to the banks at the same time. The rumors were around that the bankruptcy of certain large firms were imminent. It aroused worries of chain bankruptcies of smaller firms dependent upon them.

The Federation of Korean Industries (FKI), the association of influential business leaders in Korea, held daily meetings to respond to this menace. They put pressure to the government to take emergency measures to prevent the eventualities. They met with President Park a couple of times and explained the distressing situation. In July 1971, at the Monthly Meeting for Trade Promotion, presided by the President, they once again pleaded for urgent financial relief. Specifically they demanded the conversion of short-term curb market loans into long-term bank loans, the reduction of corporate tax burden, and lowering of interest rates. The Ministry of Finance reported that it would meet their request with a Special Loan program, but it was far short of their expectations.

Since around that time, at the President's personal instruction, the Presidential economic staff began to prepare clandestinely a drastic measure to cushion the financial burden of debt-ridden forms and to curb the expansion of private money markets.<sup>23)</sup> The measure, announced as the "Presidential Emergency Decree for Economic Stability and Growth" in August 3, 1972, was historical, indeed. It placed a moratorium on all private loans incurred by firms.<sup>24)</sup> Loans exceeding three million won were rescheduled for repayment over five years after a three-year grace period, at 16.2 percent annual interest rate. The curb loan lenders had the option to switch their loans into equity shares. Loans made by large stockholders or executives to their firms were converted mandatorily into stocks. The short-term commercial bank loans held by business firms were replaced by long-term bank loans at 8 percent annual interest rate.

Needless to say, the measure was a great boon to the enterprises, large and small, relieving their financial difficulties, at one fell swoop. In partial justification for the extraordinary measure, the government began to emphasize the disclosure of big businesses. In December 1972, it thus enacted the "Public Corporation Promotion Law," which empowered the Minister of Finance to designate big business firms eligible to go public and, in certain cases, even compel them to do so, while providing preferential tax incentives. However, the underdeveloped state of the capital market, which had been so much plagued by stock price manipulation by large shareholders, and the reluctance on the part of the big businessmen frustrated this policy initiative.<sup>25)</sup>

The August 3 Emergency Decree was "significant in that it marked the end of the partial financial liberalization policy the government had initiated with the reforms in 1965 and a complete return to the financial repression of previous years."<sup>26)</sup> But, even more significantly, it helped pave the way for the government's heavy and chemical industrialization drive in the 1970s, the success of which hinged so much on the availability of a cheap, sufficient, long-term capital.

As a follow-up measure, the Ministry of Finance enacted the "Short-Term Financing Business Act of 1972," and began to encourage the establishment of a variety of the non-bank financial intermediaries (NBFIs), including investment and finance companies, mutual savings and general finance companies. It was an effort to bring the unregulated money markets under control by diversifying financial intermediaries. Many of the NBFIs were privately owned. The greater freedom in managing their financial resources provided the NBFIs with a competitive edge vis-à-vis the banking institutions. Permitted to offer higher deposit interest rates, they could expand their market shares rapidly.<sup>27)</sup> As institutional investors and underwriters, they also played an important role in the stock market. For these reasons, many major *chaebol* came to acquire controlling shares of NBFIs by the late 1970s.

As the heavy and chemical industrialization drive began, the government further strengthened its control over banks over the 1970s. It established more of the specialized state-run banks, and earmarked part of funds of the commercial banks as "policy funds" and channeled them toward key heavy industrial sectors. As a result, policy funds proliferated in the 1970s and the financial market continued to be segmented, limiting the discretion of the financial institution's asset management. Increased financial segmentation and discretionary credit allocation was not confined to domestic financial resources, either. The allocation of foreign borrowing continued and it further constrained the allocation of domestic credit by the banking institutions, for the government was compelled to secure an adequate amount of working capital for the successful operation of the foreign loan-financed projects.

Of course, with this selective and discretionary credit allocation system in

place, the government could channel greater financial resources toward heavy and chemical industries designated as "strategic industries," and bring forth a high rate of economic and export growth, and the significant improvement in industrial structure and export commodities composition during the 1970s. But it was not without cost. Most importantly, big business and *chaebol*, the principal beneficiaries of cheap loans and other privileges, made excessive and "duplicative" investments in major heavy and chemical industries, further weakening their financial structure.

The continued and intensified control of the financial system in the 1970s produced devastating results by the late 1970s. As the second oil price increase and the consequent world-wide and domestic economic recession hit the economy,<sup>28)</sup> big business, rather than small enterprises, began to stumble first in the face of sudden economic recession. They could not even secure a huge amount of capital to meet their operating funds and foreign loan repayment requirements alone. Banks, which had already begun to accumulate a huge stock of non-performing debts, were not in a position to respond to their demand effectively.<sup>29)</sup> As will be seen below, this situation presented a formidable challenge to the new government in the early 1980s.

### III. The Politics of Preferential Credit

Direct government control over credit allocation has long characterized Korea's financial policy. Credit allocation prior to the mid-1960s, so much attuned to anti-inflation policies, had been made on the distinction of "essential" versus other industries. With the adoption of new economic development strategy geared to export promotion in the mid-1960s, credit allocation began to take a different tack. And the preference was given invariably to exporters. Again, in the early 1970s, with the institution of the heavy industrialization policy, its preference for large manufacturing and exporting firms became more evident. We will review first the basic feature of credit allocation policies in the 1960s and 1970s in connection with the prevailing trade and industrialization regime in each decade, and then analyze how these changes would relate to the growth pattern of large businesses and *chaebol* groups in Korea, and to the overall efficiency of the economy.

#### 1. Export Promotion and Export Financing

The shift in the trade and industrialization regime from import substitution to export promotion in the mid-1960s brought a major change in the credit allocation policy. The system of short-term export financing, the centerpiece of the credit allocation system in Korea, was streamlined in February 1960 into its mod-

ern form, and remained effective until 1972, when the light industry-based export promotion policy gave way to the heavy industrialization policy in the 1970s.<sup>30)</sup> The heart of the short-term export financing system was the automatic approval of loans by commercial banks to those who have received export letter of credit (L/C).

Initially, it was to cover the costs of production and collection (domestic purchase) of export goods. But its coverage expanded rapidly over time: for a sales to the U. N. Forces in Korea in 1961; for exports on a D/P (documents against payment), D/A (documents against acceptance), or consignment basis in 1965; for construction services (rendered to foreign governments or their agencies) in 1967; for imports of raw materials and intermediate goods for export use or purchase from local suppliers in 1967; for the preparation of agricultural and fisheries products in 1969; and so on. And each of this export financing was operated according to its respective regulations until they were unified into a Regulation on Export Financing in 1972. While these types of export financing have been granted on each L/C basis, a new system of export financing, called "export financing ceiling system," granted on the basis of past export performances for a certain period of time was also adopted in 1976. Exporters (or producers) eligible to apply to this type of export financing have been restricted to those whose past year's exports exceeded \$30 million (as of 1979) or the established (designated as "blue color") exporters.<sup>31)</sup>

This expansion of coverage exemplified the government's high responsiveness to the changing demands of exporters. Their exploration of new export opportunities and the diversification of export products and services were immediately rewarded in this fashion. Probably the most important conduit through which changing demands of exporters were communicated to the central policymakers must have been the Monthly Expanded Meetings for Export (Trade) Promotion, in which the President and all economic cabinet members participated and the leading businessmen were regularly invited. The Meeting was prepared by the Ministry of Commerce and Industry, which were attentive to the grievances of the exporters and kept track of overall export performance closely.

This short-term loans were granted at the preferential interest rate of 13.8 to 9.13 percent during 1960-63, 8.03 to 6.5 percent during 1963-76, 6 percent during 1967-73, and 7-9 percent since 1973. Commercial banks could obtain rediscounts from the BOK. The automatic short-term export financing has thus constituted a major source of the rapid growth of money supply, as export volume increased rapidly over time. When inflationary pressures mounted and the government responded by restricting the money supply, it was the non-export sectors that had to bear the brunt of monetary squeeze.

In addition to short-term loans, export producers have been granted various kinds of preferential long-term foreign and domestic loans both for capital invest-

ments and their operation. Unlike the short-term export financing, long-term facility loans were not provided automatically, but had to be approved by specialized banks (such as KDB and Medium Industry Bank) and commercial banks. Usually, the Ministry of Commerce and Industry was involved in the process. It almost always retained the right to examine the appropriateness of loan applications and to issue recommendations to the banks concerned. When foreign loan guarantees were involved, the Economic Planning Board (EPB), and the National Assembly in certain cases, stepped in the loan allocation process. Sometimes, a committee consisting of officials from related ministries was established, as was the case for the export industry equipment loans introduced in 1973. In most of these cases, it has been the MCI that specified industrial sectors eligible to receive such loans.

## 2. Heavy Industrialization and Selective Credit Allocation

The heavy and chemical industrialization in the 1970s once again brought a significant change in the politics of credit allocation. To understand why this was so, we need to review the political ramifications of the heavy industrialization drive briefly.

The push toward heavy industrialization represented Korea's political and military leaders resolve to develop defense industry, as a reaction to the dwindling U. S. military commitment to Korea, and to overcome the deteriorating world trading environment to sustain the high economic growth momentum built in the previous decade. Unfavorable domestic political situation provided the third direct impetus for heavy industrialization in Korea.

At the new year's press conference in January 1973, President Park presented a bold vision of "\$10 billion worth of exports and a \$1000 per capita income by the early 1980s" as a mid-term goal of the *Yushin* regime.<sup>32)</sup> At the same time, he proclaimed that "the government would direct all the energies to the development of heavy and chemical industries in an effort to achieve those goals." President Park's strong commitment staged heavy industrialization as the nation's highest priority task. To facilitate Park's personal direction of development of heavy industries, a new economic decision-making machinery (the Heavy Industrialization planning Council) was superimposed on the existing economic policy-making apparatus.<sup>33)</sup> The whole process was then driven by nationalistic passion rather than by economic principles.

For example, one of the strategic components of the accelerated development of heavy and chemical industries in the 1970s was the industrial targeting. And the so-called "strategic industries" selected by central decisionmakers included iron and steel, machinery, nonferrous metals, electronics, shipbuilding, and petrochemicals. The promotion of basic industries such as steel and petrochemicals

was indisputable for reasons of developing self-defense industry and a more stable supply of these key materials. Particularly, defense industry-related concerns prevailed in selecting nonferrous metals smelting industries (aluminum, copper, zinc, and lead), which are highly import-dependent and energy-intensive. The selection of the electronic and shipbuilding industries was motivated by another strategic consideration that these relatively labor-intensive industries could gain competitiveness within a short period of time.

Due to high market risks and uncertainties involved in making huge amount of investments in the technologically unfamiliar lines of business, however, major *chaebol* groups were unwilling and reluctant to participate in the state-led heavy industrialization drive. To induce them to actively invest in these sectors, therefore, the government needed to turn them into "privileged sectors." In other words, the government needed to assure them that once they commit some of their resources, the government would support them by all means.

In short, President Park's extraordinary commitment to heavy industrialization and his apparent control over the actual microeconomic policy actions was meant to reduce "strategic uncertainties" involved in heavy industrial investments, in the very sense that as long as private investors embodied the political leadership's vision of the desired politico-economic order, they could secure resources and support necessary to make their otherwise highly risky business undertakings economically valued.<sup>34)</sup> In this way, a "strategic interdependence" was also forged between the government and private investors in the sense that private investors could now reasonably expect that they could influence the government's economic policymaking.

The primary source of the heavy industries' long-term investment capital was the Korea Development Bank (KDB). It has provided long-term investment loans for heavy industries, underwrote corporate bonds and stocks, and guaranteed foreign loans. The KDB's share of total equipment investment lending, which had declined since the mid-1960s, rose from 40.3 percent in 1972 to 44.7 percent in 1975 and to 49.6 percent in 1979.<sup>35)</sup> Another new financial institution was the Export-Import Bank of Korea (EXIM). It provided medium- and long-term financing for domestic exporters and foreign importers of Korea's heavy industrial goods and underwrote export insurance for domestic corporations and financial institutions.

To finance the huge amount of capital investments, the Korean government further tightened its control over the financial system. The easiest and surest way to channel funds to specific sectors has been to earmark part of funds of the commercial banks as "policy funds." The result was the proliferation of policy funds in the 1970s and the increased segmentation of financial markets, limiting the discretion of asset management of the financial institutions. By 1980, there had been more than 30 different policy loans. Important examples include:

National Investment Fund (NIF), export financing, major raw material import financing, defense-industry assistance fund, regional industry promotion fund, medium and small-scale enterprise special fund, and export industry equipment investment fund.

Such expansion of preferential policy loans resulted in a sharp increase in their share of total bank credit from less than 40 percent in 1971 to over 55 percent during 1976-77 and to 68.7 percent in 1978.<sup>36</sup> Thanks to preferential policy loans, more than 77 percent (74.2 percent in 1976, 75.4 percent in 1977, and 82.5 percent in 1978) of total manufacturing investment during 1976-78 was undertaken in the heavy and chemical industries which accounted for only about 50 percent of total manufacturing output.<sup>37</sup> As of the end of 1978, the outstanding balance of various policy fund loans for the heavy and chemical industries was 1,017 billion won, representing 92.8 percent of the total loan.<sup>38</sup>

The National Investment Fund (NIF) instituted in January 1974 merits special mention. The major sources of the NIF fund have been compulsory deposits from the banking institutions, national savings associations, insurance companies, and various public funds managed by central and local governments and other public entities. The banking institutions have been required to contribute about 13 percent of the increase in their time and savings deposits to the NIF. The insurance companies and the national savings associations were required to contribute 50 percent of their insurance premiums and 100 percent of their saving funds, respectively. The sale of the NIF bonds to the public constituted only a small proportion.

The Ministry of Finance prepared an annual fund raising and loan plan, based on fund requests made by the other ministries such as the MCI (for major heavy industrial sectors) and the Ministry of Construction (for heavy industrial estates construction) and the EXIM Bank (for deferred payment exports assistance). The allocation of the NIF fund were specifically selective. With some exceptions such as the local machinery purchase promotion fund and the deferred payment exports fund, a substantial part of the NIF fund was distributed directly to major individual heavy industrial investment projects such as the Pohang integrated steel mill and many petrochemical plants. As long as the allocation of the NIF fund was specific and the demand for the preferential NIF fund was always in excess of the available fund, the final decision on the MOF's annual plan was brought up to the President for approval.

Compulsory deposits by the banking institutions at the NIF put a further constraint on the asset management of the banking institutions. The NIF's share in total equipment investment loan of commercial banks soared from 4.6 percent in 1974 to 16.3 percent in 1976 and to 20.3 percent in 1978.<sup>39</sup> Moreover, even when the KDB and NIF loans proved insufficient, deposit money banks were urged to make additional preferential policy loans available for heavy and chemi-

al industrial projects.

In addition to domestic credit, the government channeled guaranteed foreign loans massively into these privileged sectors. From 1973 to 1979, the EPB channeled \$3.8 billion (among them \$172.5 million were public loans), 32 percent of total foreign loans, whose payments were guaranteed by the KDB and other banking institutions, toward heavy and chemical industries.<sup>40)</sup> From 1977 onward the trend accelerated with these industries accounting for more than 80 percent of the total foreign loans (and all public foreign loans) in the manufacturing sector, leaving less than 20 percent for light industries.<sup>41)</sup> At the same time, public foreign loans increased rapidly to finance infrastructure investments. As a result, foreign debt increased more than 22 times during the 1970s.<sup>42)</sup>

### 3. Chaebol's Growth Strategies and Credit Allocation

Big business and *chaebol* have always stood to benefit from the credit allocation system in Korea.<sup>43)</sup> As long as the state and big business were strategically interdependent in the politicized market economy, big business or *chaebol* could exert strong influence on the government's credit allocation policy. Major changes in the government's credit allocation policy appears to coincide well with the diversification strategies of big business and *chaebol*. Of course, it is not easy to specify which side — the government or big business — got a handle over the changes in the credit allocation policy, because their interactions have been so closely intertwined. But much evidence can be adduced in support of this observation.

For example, the government have since 1975 designated general trading companies owned by the largest *chaebol* in Korea. The establishment of general trading companies had several policy objectives: strengthening overseas marketing capabilities, seeking economies of scale, and representing medium and small-scale producers for export. To these general trading companies the government granted a preferential treatment in international bidding, loosened restrictions on their importation of raw materials, and provided funds for stockpiling of finished export goods.

As the government used the actual export performances as a criterion for the renewal of the status of general trading companies, they have heavily relied upon and actively sought merger and acquisitions of medium and small-scale enterprises in broad lines of business. As a result, the number of medium and small-scale firms merged or acquired by 10 general trading houses increased from 96 in 1976 to 208 in 1979.<sup>44)</sup> The same pattern of corporate growth strategy of *chaebol* was repeated in overseas construction industry, another major recipient of preferential credits in the late 1970s and early 1980s. It is noteworthy that their vigorous pursuit of merger and acquisitions of medium and small-scale enter-

prises has usually been made in new industries to exploit the changing emphasis of the government's credit allocation policy.

The close match between the changes in the government's industrial policy emphasis and the diversification strategies of big business and *chaebol* may be a strong indication that the government actively supported the creation of market pressures that would compel big businesses to adjust to the changing economic conditions. In other words, by controlling the allocation of credits, the government could support the growth sectors actively.<sup>45)</sup> Insofar as big business and *chaebol* have represented the forerunner of the industrial structural change, they could enjoy a ever greater reservoir of preferential credits.

In controlling the allocation of credits to facilitate industrial adjustment, the government, for political reasons, have not withheld preferential credits that the traditional sectors of the economy, such as agriculture and textile industries, had received overtly, however. This objective has been achieved in a more subtle way. For example, even in periods of anti-inflation and economic stabilization, big business and *chaebol* could evade harsh monetary squeeze more easily on account of their diversified lines of business, as some of them always stood to benefit from special treatment. The corollary of this argument is that the other sectors of the economy have had to bear the brunt of monetary squeeze in such times. Furthermore, as policy funds were granted almost automatically, they not only constituted major source of monetary inflation, but severely constrained the central bank's capacity to control liquidity.

As another example, although the commercial banks have been required to make available a minimum of 30 percent of their total loans to small and medium-scale enterprises, they have tended to ignore the regulations. Neither has the government ever punished the commercial banks for their non-compliance. In addition, under such political tactics, it is natural that the number of industries that had received preferential credits continued to grow and the structure of Korea's preferential credit system got increasingly complicated over time. And such fragmented and consequently extremely complicated structure of preferential credit may have encouraged credit diversion.<sup>46)</sup>

*Chaebol's* active participation in the financial industry has also enhanced their privileged position in the preferential financial system. As they have been allowed to acquire a controlling shares of the non-bank financial intermediaries (NBFI's) since the 1970s and as they could increase their equity holdings of commercial banks directly and indirectly after their privatization in the 1980s, they could not only borrow much of their working capital from the NBFI's, but they could influence the decision-making of commercial banks as their large stockholders. Moreover, it is not a secret that they utilized idle funds through the NBFI's under their control. In particular, it is noteworthy that the conglomerate structure has been conducive to making each of their headquarters, equipped with better in

formation about overall financial and market conditions, a focal point of each *chaebol's* internal financial market.

#### IV. The Politics of Reform

##### 1. Two Restructuring Episodes Leading to Reform

As briefly mentioned above, the policy legacies of the heavy industrialization in the 1970s were immense. In particular, the excessive investments made by *chaebol* and big business in major heavy industrial sectors were problematic. Their incipient heavy industrial factories remained almost idle for insufficient market demand within and out, and many other large investment projects were in the midst of construction, while crying for a huge amount of additional capital for loan repayment and operational purposes. But banks were not in a position to respond to their demand effectively. The growth of the financial sector was so much retarded that it failed to keep pace with the rapid growth of the real sector.<sup>51)</sup>

Under these circumstances, the Chun government attempted to restructure the excessive and "redundant" investments made by rival *chaebol* groups by fiat in an effort to alleviate their capital demands. During 1980-81, it initiated a restructuring program toward such industrial sectors as power generation and heavy construction equipment, heavy electrical equipment, electronic switching systems, and diesel engines, in which the financial problem was more pronounced. Despite the unusual threat to the concerned firms that the government would no longer support their future projects unless they complied with the government directives, however, the restructuring attempt failed.

Certainly the economic planners' inconsistent restructuring guidelines or the resistance and protests submitted by foreign lenders or joint venture companies contributed to this failure. But a more fundamental reason for the failure consisted in the highly politicized heavy industrialization drive itself and the consequently distorted incentive structure of big business. Insofar as excessive investments into the heavy industrial sectors were made by the government direction, and private investors knew that terminating financial assistance would be disastrous not only for themselves but probably more so for the political leaders, they tended to disavow the government's threat. In fact, the government had never enforced its threat.

The new government's another attempt at improving the financial structure of big businesses in September 1980 showed more clearly the unavoidable result of the highly politicized industrialization process.<sup>52)</sup> In this attempt, the government obligated firms and business groups (or their owners) that owed bank loans of 10 billion won (for a firm) and 20 billion won (for *chaebol*) or more to report all of

their land holdings to the banks in twenty days, and sell land held for other than business-related purposes.<sup>53)</sup> In addition, the largest twenty *chaebol* groups were required to trim minor lines of businesses.<sup>54)</sup> The government declared that it would not provide relief loans any more, unless these *chaebol* groups complied with the government directives. But this attempt failed to produce visible result.<sup>55)</sup>

The lesson to policymakers from these two unsuccessful and frustrating attempts was clear enough: The direct and selective intervention by the government in the allocation of financial resources had only entailed far more intricate problems and distorted incentives on the part of both big business and banks. In particular, they were struck by the fact that in neither of these unsuccessful episodes, banks were held accountable.

Looking ahead, the financial system was also a problem, frustrating the government pursuit of a stable economic growth policy. Under the prevailing regime of low interest rate and the consequent excess demand for funds, economic stabilization policies, much needed at the time, could not be sustained, as it would deter the recycling of business loans and encounter mounting political pressures to increase the monetary supply.<sup>56)</sup> In short, given the extremely weak financial structure of big business, economic stabilization would only result in the increase in bad loans, necessitating the further supply of relief loans, and thereby negating the effects of economic stabilization.

Among others, this bitter experience and a tremendous frustration that the government policymakers had undergone during the difficult period of economic adjustment in the early 1980s constituted the backbone of the financial liberalization. In fact, however, financial liberalization was only part of a wide-ranged economic policy reform in the decade.<sup>57)</sup> But it expected to send a strongest signal that the government-business relations would be fundamentally changed. It had political import, too, for the new government committed itself to the building of a more equitable economy and society.

Big business also favored the financial liberalization policy.<sup>58)</sup> Undergoing the restructuring episodes, they abhorred the situation in which they could not but leave their fate at the disposal of the government policymakers and at the peril of fickle political judgment. In addition, to meet their rapidly increasing fund requirement more flexibly, they felt the need to own and control financial institutions by themselves.

It was only natural that the Bank of Korea (central bank), commercial banks, and other financial intermediaries welcomed financial liberalization policy. The recovery of self-autonomy was what they had long desired. Of course, under the existing oligopolistic structure of the financial industry, they might well favor the status quo. But the government's continued intervention had since the 1970s continued to deteriorate their profitability, putting their survival at stake. Among

others, they hated the situation in which they were forced to take care of bad loans made ultimately under the direction of the government. As for the foreign bank subsidiaries, financial liberalization was a first step toward expansion of their business.

Finally the media and academic circle made a strong case for financial liberalization, although they did not necessarily view financial liberalization from the same perspective as above. They tended to regard it as a means to assure a more equitable allocation of financial resources and to eliminate political corruption and bureaucratic interference into the financial system.

In principle, there existed no disagreement about the desirability of financial liberalization. There was something from which they could expect to benefit. Nonetheless, when it comes to concrete details of the policy, they differed from one another, making actual implementation process very difficult and complex. It would thus be useful to look at three different main components of financial liberalization separately: privatization of commercial banks, the deregulation of entry and business boundaries, the freeing of interest rate and the "policy loans."

## 2. Privatization of Commercial Banks

The first move toward financial liberalization was made in the area of privatizing commercial banks.<sup>59)</sup> Under the pressure of the EPB, which had long advocated the financial sector reform as an essential part of the economic policy change in the 1980s, the newly appointed Finance Minister prepared a report to the President at a Blue House Economic Policy Meeting on November 17, 1980.<sup>60)</sup> The policy proposals included in the report were; (1) reducing policy funds gradually for the autonomy of commercial banks' asset management; (2) reducing various sorts of regulations imposed on the internal management of commercial banks (e.g., budget, personnel, and organization); (3) privatizing one of the five nation-wide commercial banks in 1981 and preparing for continued privatization of the remaining banks; and (4) taking precautionary measures to prevent monopoly of financial resources by *chaebol* groups and to protect interests of depositors.

According to the President's approval, the MOF announced in April 1981 that it would soon privatize the *Hanil* Bank. Obviously the primary objective of the privatization was to let banks have owners who would really mind the efficiency of the banking operations. But a strategic consideration that it would contribute to government revenue also played an important role. Furthermore, it was expected that the provision of "good stocks" would help boost the weak stock market.

Indeed the choice of Hanil Bank as the first target of privatization was made in

view of these policy objectives. Among five commercial banks to be privatized, Hanil Bank was regarded as having the best managerial performance and thus most promising prospects for successful divestiture in the stock market. But more importantly, that its equities were more widely distributed than other banks figured prominently in the selection process. Indeed, in the light of the *chaebol's* control of privatized banks in the 1950s, the media and academicians warned against that possibility. With regard to the choice of Hanil Bank, some argued that as long as the policy goal of privatization consisted in making commercial banks financially more healthy by giving them greater autonomy, other banks with poorer performance should be the first target.

As expected, however, when the divestiture of government equities of Hanil Bank was completed in June 1981, two major *chaebol* groups came forth as major shareholders. While voicing objection to this result, the media and scholars contended that what was more important than the privatization itself was the government's commitment to allow privatized banks a real autonomy and to discontinue its traditional role of caretaker. In other words, they warned that as long as the government insisted on economic planning and industrial targeting, the privatization would betray itself. The powerful business associations such as the Federation of Korean Industries (FKI) concurred to this view.

In the aftermath of the privatization of imposing the upper limit to the ownership of privatized banks and to their credit to a single beneficiary (or firm), the qualifications of the bank board members, and providing for methods of enforcing "responsible" bank management. All of these matters were supposed to be regulated by the General Banking Act to be amended. The most contentious provisions were about the first two. And they would affect significantly the financial positions of big businesses which had already incurred debts heavily from the banks to be privatized. Entangled with these controversies, the MOF delayed the introduction of the amendment to the National Assembly. The opposition party submitted its more restrictive amendment to the National Assembly. But it was rejected in the face of strong business resistance championed by the FKI.

In the meantime, as the economy continued to slacken and the business suffered from the shortage of funds in the midst of the sustained economic stabilization policy, the MOF's plan of successive privatization came to a deadlock. By this time, the MOF came to a conclusion that a hasty implementation of the privatization plan would backfire, given that the commercial banks were accumulating a huge amount of non-performing debts in the midst of sustained economic recession and the restrictive financial policy at the time. In fact, new Finance Minister disavowed the MOF's privatization plan.

Instead, the MOF began to roll back various government directives which had regulated internal management of the commercial banks in an effort to give them

greater autonomy. In addition, to give more freedom to the deposit banks in managing their financial resources and thereby to boost their operating profits, the MOF gradually lowered the required reserve ratio from the average rate of 23 percent in 1979 to 3-5 percent level in 1981. And then, in January 1982, the MOF switched the method of controlling money supply from direct credit controls (credit ceilings and quotas by individual banks) to indirect reserve requirement method with a view to increasing the autonomy in their fund operations.

Little progress has since been made until May 1982, when the largest curb market incident broke out. Chang Yong Ja, a woman distantly related by marriage to President Chun (her husband's brother was Mrs. Chun's uncle), and her husband had netted a huge sum — approximately \$300 million — by trading promissory notes in the curb market. Four commercial banks were involved. The disclosure of this incident dealt a severe blow to the public confidence in the Chun government. Opposition quarters demanded President Chun's resignation.<sup>61)</sup> In the face of this political crisis, President Chun replaced the Prime Minister and the Finance Minister swiftly. It provided an unexpected opportunity for the advocates of financial liberalization from the EPB, who came to occupy the upper echelons of the MOF through an unprecedented personnel change between the EPB and the MOF early in that year, to push their plan forcibly ahead.

In the wake of the incident, the newly appointed Finance Minister announced two drastic policy measures. One was a sharp reduction in interest rate by an average of 4 percentage points to stimulate the economy and the elimination of preferential interest rates applied to policy funds including export financing. The elimination of preferential interest rate on export loans represented a big stride toward the reduction of policy funds. And it was partly motivated to avoid increasing disputes on export subsidies raised by the advanced industrial countries.

The other measure was a "real name" system to be applied to all financial transactions from 1984. The new system was devised as a supplementary measure to the new "comprehensive income tax" system. It meant to treat all kinds of income equally by levying tax on interest earnings which had been subject to lower tax rate. For this purpose, banning anonymous financial transactions was an imperative. Despite its applaudable aims (retrenchment of curb market and more equitable taxation), it came under fire for its radicalness and uncertain impact on the economy. After a bitter exchange between the executive branch and the National Assembly, the government and the ruling party decided to postpone its implementation beyond 1986.<sup>62)</sup>

Right after the incident, in which four commercial banks were involved, the so-far deadlocked privatization resumed. But this time, the public opinion was against it. In particular, academics and the financial community argued that the

privatization of the commercial banks accumulating a huge amount of bad loans would deteriorate the financial position of these banks further unless they could discontinue financing the debtor firms. Admitting that the argument was basically right, Finance Minister, predisposed to hasten privatization, counterargued that it would take countless time.

According to the new plan, the MOF sped the privatization of three other commercial banks: Korea First Bank and the Bank of Seoul and Trust Company in 1982, and the Chohung Bank in 1983. In this privatization move, being very much intent on completing the move as quickly as possible, the government eased the requirement, which had been imposed in the previous move, of the minimum equity ratio of firms that would participate in the bidding. Thus with the Commercial Bank of Korea already in private hands since 1972, the denationalization of all the five leading commercial banks was completed.<sup>63</sup> But on occasion of this privatization move, large *chaebol* came to acquire a controlling shares of commercial banks by way of indirect holding of shares through the non-bank financial intermediaries under their control.

In December 1982, the National Assembly passed the amendment of the General Banking Act. To materialize the real intent of privatization, the MOF initially planned to allow a big business firm to acquire a maximum of 10 percent share of the privatized bank, thus making it possible for three to four big business firms to control the bank. But in the process of consultation with the ruling Democratic Justice Party, which insisted that the limit should be further reduced to 5 percent to prevent any individual or business group from exercising managerial control of the privatized bank, the MOF agreed to limit the maximum ownership of any single shareholder of a commercial bank to 8 percent of the total number of shares. The revised Act also limited loan guarantees and acceptances for single beneficiary to the maximum of 50 percent of a bank's net worth.

To promote competition in the banking industry and to strengthen its link with international financial markets, the MOF also lowered since 1981 entry barriers significantly. As a result, the number of foreign bank branches that opened business in Korea increased tremendously both in 1981 and 1982.<sup>64</sup> It further licensed two joint-venture commercial banks: Shinhan Bank, capitalized by Korean businessmen residing in Japan, in July 1982; and the Korean Bank, subscribed to by the Bank of America and major companies in Korea, in March 1983. In 1985, the MOF permitted foreign bank branches to make use of rediscount facilities at the Bank of Korea for export financing and to enter the trust business. Since 1986, they have been entitled to make use of rediscount facilities for all of their operations.

Due to continued deregulation of entry, the number of commercial banks increased from 7 in 1985 to 10 in 1990. In addition, the Korea Foreign Exchange Bank was turned into a commercial bank in 1990. And in 1991, as will be seen

below, two commercial banks have been created through a merger and conversion of several investment and finance companies. as result, there are 13 nationwide commercial banks in Korea.

The deregulation measures explained thus far may suggest that now privatized commercial banks can enjoy a certain degree of autonomy in their business operations. But, it should be reminded that even after the privatization, the government has still retained the control over the appointment of bank presidents and executive board members through "consultation." and that major operational decisions of banks have been under scrutiny through "administrative guidance."

### 3. Entry Deregulation and the Conflict between Commercial Banks and NBFIs

As seen previously, since the August 3 Emergency Decree in 1972, the Korea's financial system has bifurcated: commercial and specialized banks on the one hand, and non-bank financial intermediaries (NBFIs) on the other. Being allowed relatively greater freedom in their asset management, the NBFIs witnessed a rapid growth in the 1970s. But without any restrictions being imposed, it has become the turf of large *chaebol* groups. As a result, in the 1970s, ten investment and finance companies came under the control of each major *chaebol* group. Six general financing companies, partly financed by foreign capital, also came under their control.

On occasion of the failed attempt to establish a commercial bill trading center, they organized the Association of National Investment and Finance Companies (ANIFC) in 1979 and began to call for further deregulation in the growing mood of financial liberalization. Their aim was to secure a position to compete squarely with the banking institutions, which often led to interse conflict between them.

For example, they successfully persuaded the government to eliminate the discriminatory tax rate on the interest earnings through shour-term financing compaines in 1980. In 1982, they asked the Federation of National Banks (FNB) to reduce interest rate on their overdrafted checks, to no avail. The curb market incident in 1982 helped them advance their position, as the curb market became the target of the government to crack down further. Within months after the incident, the MOF decided to lower the entry barrier to the non-bank financial industry. As a result, the number of non-bank financial institutions such as the investment and finance companies and the mutual savings and finance companies increased conspicuously. Within a year, 12 new short-term finance companies and 57 mutual finance companies were chartered.<sup>65)</sup> Again most of them came under the control of major *chaebol* groups. This time, new *chaeblo* groups also rushed into the industry in view of their utility as a more convenient avenue of fund management.

On the other hand, as the share of domestic deposits of the NBFIs increased rapidly, banks through the FNB now began to press the government to allow them to extend their business.<sup>66)</sup> In 1982, the MOF allowed them to engage in the business of the sales of commercial bills discounted by themselves. This change greatly pitted against the NBFIs with fewer regional branches and weaker public confidence. The NBFIs were strongly opposed this change. Nonetheless, the MOF continued to allow new business to banks such as factoring, credit card, trust, and the repurchase of government and public bonds. Furthermore, in 1984 the negotiable certificate of deposit (CD) business was opened to all commercial banks. In 1985, new savings deposits and household installment savings deposits which are high-yielding deposit schemes for households were opened to all banks.

In the face of the continued extension of business on the part of banks, the NBFIs requested further deregulation over the entire areas of business except for entry regulation, the MOF only grudgingly granted them. But the MOF established a commercial paper (CP) market for investment and finance companies and merchant banking corporations in 1981, Right after the privatization of Hanil Bank, and for large securities companies in 1984. The Cash Management Account (CMA), a Korean version of Money Market Account in the U.S., was introduced in 1984 for investment and finance companies and merchant banking corporations.

The watershed which pitted NBFIs against banking institutions was made in 1985. Due to the structural depression in overseas construction and ocean shipping industries, many domestic firms in such industries began to accumulate non-performing debts, putting enormous burden on the related banks.<sup>67)</sup> In the face of this crisis, the government hastened to prepare measures to facilitate the industrial restructuring. Most importantly, the MOF revised the Tax Reduction and Exemption Law to grant tax privileges to banks and prospective owners, and revised the Bank of Korea Act to provide cheap "special loans" to banks involved. In the meantime, it felt the need to boost the deposits to banks and permitted banks to provide high interest-yielding deposit programs, while lowering the deposit and lending rates of the NBFIs.

As a result, deposits to banks increased considerably, while that of NBFIs declined abruptly. This triggered a heated debate on the direction of the restructuring financial industry. First of all, the Federation of National Banks (FNB) argued that the differential financial regulation of banks and NBFIs had retarded the growth of banks and suppressed their profitability. And they pressed for further deregulation of business boundaries based on the general banking system. On the other hand, the Association of National Investment and Finance Companies (ANIFC) stressed that the MOF should broaden their business boundaries to make them compete squarely with banks.

Generally siding with the FNB, the Federation of Korean Industries (FKI) maintained that to make investment capital cheaper and abundant, financial liberalization toward banks should be accentuated. Reflecting their interest in many of NBFIs under the control of *chaebol* groups, however, the FKI emphasized the importance of the function of screening investment projects and the application of differential interest rate on the basis of the soundness of the project on the part of banks and NBFIs.<sup>69)</sup> Their position contrasted with that of the Korea Chamber of Commerce and Industry (KCCI), more sympathetic to small and medium business. The KCCI maintained that the distinction between banks and NBFIs should be preserved.<sup>70)</sup> It dealt a severe blow to the short-term finance companies.

Without significant changes despite much debate, the issue of the restructuring financial industry was handed over to the current government. In a report prepared in 1988, the MOF envisioned a further deregulation of entry into the financial industry in the spirit of the general banking system. At the same time, however, it declared that it would promote the conversion of NBFIs into banks or other forms of NBFIs and merger between them. And most recently in October 1990, it promulgated a "Law Regarding the Conversion and Merger of Financial Institutions" in anticipation of opening-up of the Korea's financial market to foreign countries. Currently, a significant reshuffling of the NBFIs is underway.

#### 4. Freeing of Interest Rate and Policy Funds

Despite the fact that the freeing interest rate constitutes the integral part of financial liberalization, the freeing of interest rate has made little progress. This delay seems more conspicuous when it is compared to a considerable progress made in the areas of privatization and the deregulation of entry. The fundamental reason for this delay consists in the fact that Korea's business has borne a relatively high capital cost due to their high level of indebtedness.<sup>71)</sup> Moreover, the term structure of loans have been extraordinarily skewed toward short-term loans, while much of them have been used, in fact, as long-term loans through continuous rollong over.<sup>72)</sup> In this situation, a small change in the shour-term interest rate would effect a significant change in the financial position of business.

For these reasons, the government has been reluctant to hasten the freeing of interest rates, while acknowledging that it would distort allocative efficiency. Instead, therefore, it has put more effort in fostering general conditions for eventual interest rate liberalization by reducing the gap between the formal, administrative interest rates and the unregulated market interest rates. In fact, as the inflation rate subsided significantly since the mid-1980s as a result of the successful implementation of the continued economic stabilization from time to time by

allowing banks and the NBFIs to provide various kinds of new deposit programs and lending services. But their impact on the interest rate liberalization was minimal.<sup>73)</sup>

However, the prevailing low interest rate in the economy with a constant state of excess demand of funds should not lead one to conclude that the scarce financial resources have been dissipated. The rapid growth of the NBFIs has not only served the function of absorbing private market loanable funds into the regulated financial system. But, taking advantage of their relative greater freedom of setting interest rates, they have by the early 1980s come to form the "third" money market distinct from either the regulated money market or the unregulated private market, and served the function of bridging the interest rate gap between these two markets.

Furthermore, actual interest rates has been drawn closer to the market interest rates as the NBFIs and banks have continued to charge high commissions and rely on such illegal practices as the forced savings. Under the mechanism, borrowers are forced to deposit considerable part of their loans at the creditor banks or NBFIs at the time of borrowing.

Combined with the sustained restrictive monetary policy geared to economic stabilization in the 1980s and the actual increase in the lending rates has continued to harass business in general and big business in particular. It was under these circumstances that big business attempted to own and expand their control of NBFIs and pressed, as seen before, for the adoption of differential lending rates system on the basis of the creditworthiness of borrowers.

Under these circumstances, the MOF began to consider the concrete schedule according to which they would seek interest rate liberalization. In May 1988, it submitted a policy proposal to the Deliberation Committee for the Development of Financial Industry. According to the proposal, the MOF would, first of all, liberalize gradually the lending rates of commercial banks and NBFIs and adopt prime rate system. Second, it would delay the liberalization of the deposit rates of banks and NBFIs until it could assure that it would not disrupt the existing market shares. Instead, it would accentuate the liberalization of interest rate on corporate bonds, finance bonds, negotiable certificate of deposit (CD), commercial paper (CP), and other savings programs such as CMA, the interest rates of which are determined according to the actual portfolio management.

The MOF put this proposal into effect in December 1988. But in fear of sudden hike of interest rate, it increased the money supply at the same time. In the wake of the General Election in April 1989, as the rate inflation went up, the MOF took an extraordinary measure to absorb over-supplied money by forcing banks to roll back a huge amount of loans. This episode indicated clearly that how difficult it would be to liberalize interest rate, given the financial status of business and instability of financial markets. Nonetheless, the government have

not abandoned the cause of interest rate liberalization. One additional factor of increasing importance for the commitment has been the foreign governments' (the U. S. in particular) to open up Korea's financial market.

Contrary to one's expectation, the "policy funds" rebounded also in the 1980s. The share of policy loans in total bank credit outstanding fell in 1981 and 1982, but it has since 1983 been on the rise again. The share of policy loans in total credit fell from 68.2 percent in 1980 to 62.1 percent in 1982, but it rose to 67.9 percent in 1983, 96.9 percent in 1984, and to 70.5 in 1985.<sup>74)</sup> A more recent statistics is not yet available. But it would be fair to say that it has continued to stay at this level. One important reason for this high level of policy funds may be the growing demand for such fund in the process of economic democratization since 1988. It should be noted, however, that the nature of policy funds as a low-cost loans has given way to the increase in the availability of funds for specific policy purposes.

As seen before, in the wake of the curb market incident in May 1982, the MOF reduced in interest rate by an average of 4 percentage points to stimulate the economy and eliminated the preferential interest rate attached to policy funds. It was a significant step toward the reduction of policy funds. But the expansion of policy funds have been inevitable, given that the government budget (public finance) cannot be expected to take its stead.

From the mid-1980s on, the government has tended to make the specialized banks such as the Korea Development bank bear the brunt of policy funds. But without replenishing their capital, there exists an evident limit. As a result, commercial banks have been invariably called for to provide policy funds. But in respect of the spirit of privatization, the MOF has tended not to insist that they comply with the government plan to channel financial resources to pre-specified sectors and policy purposes literally.

## 5. An Aberration: Recent Restructuring Attempt

Probably the most important roadblock in the course of financial liberalization appears to be the existence of financially unhealthy firms (called *Pulsilgiop*). Most of these firms were the by-products of the heavy industrialization drive in the 1970s. To them new firms in the structurally depressed industries such as overseas construction and ocean shipping were added. Due to these firms the major commercial banks were accumulating a huge amount of non-performing debts.<sup>75)</sup> Without resolving this problem, therefore, the government could not successfully implement economic stabilization and financial liberalization.

Under these circumstances, the government decided to undertake a massive restructuring attempt. In preparation for the attempt, the MOF revised the Tax Reduction and Exemption Law to grant tax privileges to banks or prospective

owners. And it also revised the Bank of Korea Act to authorize its provision of cheap "special loans" to banks involved. These actions erupted a heated debate on the desirability and the legitimacy both in the National Assembly and the general public. The massive "restructuring" took place in six episodes between May 1986 and February 1988. Among 78 firms, subjected to rationalization, 57 firms changed hands, 19 merged, and the remaining 2 were liquidated.<sup>76)</sup> The government directed the concerned banks to reschedule the repayments of their debts and to grant new credit called "seed money". Total financial assistance and tax benefits thus provided to such group of firms amounted to 11,418 billion won (about 14.27 \$ billion, estimated at 800 won: 1\$).<sup>77)</sup>

Like those in the previous restructuring attempts in the late 1960s and the early 1970s, the restructuring episode in the 1980s again confirmed the entrenched vicious circle of financial repression in Korea and illuminated the underlying logic of continued intervention in the financial system by the government. That is, insofar as the government is ultimately responsible for the accumulation of non-performing debts in the banking system, it cannot avoid to rescue the banks. In addition, because of the problem of "moral hazards" on the part of the commercial banks, the government cannot abdicate its control over the financial system entirely.

In the early years of the current Sixth Republic, the restructuring attempt became the target of political attack by the opposition parties. They contended that it was a prime example of the politics-industry nexus (*chungkyungyuchak*) in Korea. They charged the government on the grounds that in the process of selecting new owners of the restructured firms the government, in effect, a further concentration of economic power in the hands of businessmen in particular allegiance to the Fifth Republic.

Indeed, the phenomenon of "monopolization" of financial resources by large *chaebol* groups were alarming. First of all, bank loans provided to thirty largest *chaebol* groups (676 firms) amounted to 19,704 billion won, 26.9 percent of the total, while they accounted for 40.2 percent of manufacturing sales, 41.3 percent of manufacturing exports, and 17.6 percent of manufacturing employment.<sup>78)</sup> This statistics showed that although their share of bank loans declined from 34.1% in 1977. But it also showed that the economic concentration has intensified remarkably over the 1980s.<sup>79)</sup>

Second, in addition to bank loans, they have taken up a lion's share of the financing facilities of the non-bank financial intermediaries (NBFIs) as well. In addition, they have multiplied the number of firms under their control mainly through mutual stock investment in violation of the Anti-Monopoly and Fair Trade Law.<sup>80)</sup> The same statistics showed that the financial structure of *chaebol* groups grew weaker. The ratio of bank credit (except loan guarantee) to total assets of the thirty largest *chaebol* groups reached 22.3 percent on average.<sup>81)</sup>

Under these circumstances, the government (the Bank Supervisory board) has since April 1988 further strengthened the control over the credit to the *chaebol* groups. The newly instituted "credit management basket system" froze bank credit (loan + loan guarantee) to the thirty largest *chaebol* groups at the end of October 1987 level. In addition, the government has tried to induce *chaebol* groups to rely more on the booming stock market.

## V. conclusion

Over three decades of economic development, the Korean government has persistently relied on big business. The major vehicle with which the government could induce them to invest in sectors that the government regard as strategic or important has been invariably the credit allocation. In the mid-1960s, for example, the government instituted a system of export financing to make big business turn their eyes to foreign market. To meet their rapidly growing demand for capital, it opened a new avenue for foreign capital inflow via a mechanism of foreign loan guarantee intermediated by the specialized state-banks and commercial banks.

In the 1970s, the government launched a massive program of heavy industrialization which should be undertaken mainly by big business. To induce them to commit to invest in these unfamiliar industrial sectors, it needed to intensify intervention into the financial system. Due to the sheer size of heavy industrial projects, the credit allocation became even more direct and selective. The government's task was to give which amount of investment capital to whom. There was little space in which banks could exercise its discretion. Once a specific investment project was sanctioned by the government, it meant that the needed capital would be provided at the direction of the government.

In this way, a "strategically interdependent" relationship has been forged between the government and big business. As long as the government needed the active cooperation of big business, the latter could influence the government's economic policymaking greatly.<sup>82)</sup> Under this relationship, it was only natural that the financial system under the complete control of government could not have an independent voice. It was simply forced to support and sustain this relationship.

Among others, the "restructuring (in effect, bail-out)" episodes, which recurred in 1969-1970, 1972, 1979-81, and 1986-88 are an eloquent testimony to the existence of a vicious circle of financial repression produced by the strategic interdependence between the government and big business. To begin with, the "strategic interdependence" between the government and big business has fostered, rather than sanctioned, the weak corporate financial structure of big business. When their highly-leveraged investments come to face financial difficulties

for whatever reasons (it may be economic recession, structural depression, and others), it has never been their problem alone. The related banks have been forced to accumulate bad loans. In this situation, the failure to prevent their bankruptcy would mean the bankruptcy of banks. So the government has been forced to step in to rescue banks and to facilitate industrial adjustment. Unintentionally, the repeated practice of bail-out has only encouraged big business to rely on further indebted growth. The government's compensation of the loss incurred by banks only intensified the banks' habitual reliance upon the government. As a result of all the above, the government's control over the financial system has perpetuated itself.

The unsuccessful heavy industrial restructuring attempts made by the new government in the early 1980s taught a bitter lesson to government policymakers, big business, and banks. It was in this context that the autonomy of banks has come to be highly valued and the turn to financial liberalization was made indisputable. The process of financial liberalization was made indisputable. The process of financial liberalization has not been smooth, however, for the following reasons.

In the first place, the government could not abdicate financial control, its major industrial policy tool, abruptly. In the period that the continued and accelerated industrial adjustment is required to meet the challenges posed by economic democratization and the foreign pressure to open up Korean market, the government has been forced to intervene in the financial system. The most recent restructuring undertaken during 1986-88 exemplified the government's policy predicament.

Second, big business have seen financial liberalization as an opportunity to get rid of government intervention in their decision-making. Nonetheless, they have been extremely reluctant to give up the privileges (low interest rate, for example) that had enjoyed and so much accustomed to for a long period of time. In addition, they have now evolved as a financial interest group themselves, as they have continued to expand their ownership and control of most of the non-bank financial intermediaries and, to a considerable degree, banks. With the privatization of commercial banks and deregulation of entry, the structure of financial industry has become highly complex, provoking a turf struggle among them and distorting the path of financial liberalization.

The imminent opening up of the financial market in Korea would cause the process of financial liberalization to accelerate. Unfortunately, however, the future course of the financial liberalization and its implications for the prevailing government-business relation, the most vital aspect of financial liberalization in the Korean context, remains highly uncertain.

## Notes

- 1) A. I. Bloomfield and J. P. Jensen, *Banking Reform in South Korea* (New York, 1951).

- 2) *Ibid.*, p. 73.
- 3) David C. Cole and Yung Chul Park, *Financial Development in Korea, 1945-1978* (Cambridge, Mass.: Harvard University Press, 1983), p. 52.
- 4) Myo Min Im, *Han'hukui Unhaengsa* (the History of Banks in Korea)(Seoul, 1963), pp. 133-136.
- 5) Cole and Park, *op. cit.*, pp. 54-55 (Table 11).
- 6) Instead of punishing the accused leading businessmen as criminals or appropriating their illicit wealth outright, the military government took this opportunity to elicit their support for and active participation in the economic development plan.
- 7) On the controversies since around 1957 over the constitutionality of the Bank of Korea Act and the proper relationship between the government and the central bank, see Byong Kuk Kim, *Central Banking Experiment in a Developing Economy* (Seoul: The Korean Research Center, 1965), The Korean Studies Series, Vol. 12, pp. 77-90.
- 8) In the period of 1950-1962, a maximum of 97 and a minimum of 86 percent of the total government debt financing was made by borrowing from the BOK. *Ibid.*, p. 105 (Table 6-1).
- 9) For the background of the change in the U. S. commitment, see David C. Cole and Princeton N. Lyman, *Korean Development: The Interplay of Politics and Economics* (Cambridge, Mass.: Harvard University Press, 1971), p. 90.
- 10) Foreign aid received continued to rise between 1953 (201.2 \$ million) and 1957 (382.9 \$ million). In 1957, aid as percentage of imports amounted to 86.6%. From 1958 on, the amount of foreign aid began to decline sharply: 1959 (222.2 \$ million), 1961 (207 \$ million), 1965 (134 \$ million), respectively. See Ann O. Krueger, *The Developmental Role of the Foreign Sector and Aid* (Cambridge, Mass.: Harvard University Press, 1979).
- 11) Krueger, *op. cit.*, pp. 110-111.
- 12) The normalization talks and settlement with Japan was an extremely hot and controversial political, economic, and social issue in the early 1960s. On the detailed description and analysis of this process, see Cole and Lyman, *op. cit.*, pp. 98-118.
- 13) Cole and Park, *op. cit.*, pp. 60-61.
- 14) Leroy P. Jones and Il sakon, *Government, Business, and Entrepreneurship in Economic Development: The Korea Case* (Cambridge, Mass.: Harvard University Press, 1980), p. 273.
- 15) This reform was undertaken on the advice of Gurley, Patrick, and Shaw. See John G. Guley, Hugh T. Patrick, and Edward S. Shaw, "The Financial Structure of Korea," United States Operations Mission to Korea, July 1965.
- 16) Total foreign loan guarantees almost doubled in 1966, and were nearly equal to the total of outstanding domestic bank loans. From 1968 on, commercial banks assumed a significant role in the guaranteeing activity. Cole and Park, *op. cit.*, p. 62 (Table 12).
- 17) Soon Chough, *Han'guk Kyongjeui Hyonshilgwa Chinro* (Seoul: bibong Press, 1981), p. 194.
- 18) The outstanding balance of foreign loan increased from \$210 million in 1965 to \$2,250 million in 1970.
- 19) Kyu Dong Lee, *Kyongjenonliwa Choch'aekpungto* (Economic Logic and Policy Practices)(Seoul: Chongusa, 1982), pp. 61-63.

- 20) The gross investment ratio to the GNP rose from 15.0 percent in 1965 to 28.8 percent in 1969. See, the bank of Koera, *Flow of Eunds Accounts in Korea*, 1975.
- 21) The ratio of net equity to total assets of manufacturing firms precipitated from 51.6 percent in 1965 to 24.2 percent in 1971. To put it differently, the debt/equity ratio rose from 83.7 percent in 1965 to 313.4 percent in 1972. The Bank of Korea, *Financial Statements Analysis*, 1978.
- 22) Cole and Park, *op. cit.*, p. 160.
- 23) The basic proposal was prepared by Mr. chungryum Kim, then Presidential chief of staff. And the preparatory work was directed by Mr. Yonghwan Kim, then Presidential Secretary and later the Finance Minister. On the other hand, the President Park confidentially directed the Presidential Council on Economic and Scientific Affairs and an ex-Finance Minister to report to him a proposal to overcome the financial problems, and they individually suggested the same idea. For a detailed description of the background of the August 3 Emergency Measures, see Chungryum Kim, *Han'guk Kyongjehongch'aek Samsipnyunsa: Hoegorok* (thirty Years history of Korea's Economic Policy:Recollections)(Seoul: Chungan Kyongjeshinmunsa, 1990), pp. 255-69.
- 24) The total amount of curb market loans reported in a week period amounted to 345.6 billion won, which was equivalent to 80 percent of the money supply (on M2 basis) and 34 percent of the outstanding domestic credit held by the banking sector. See ministry of Finance, *Chaejong Kumyung Samsipnyunsa*, *op. cit.*, p. 155.
- 25) the number of firms which went public remain at 42 until 1969. It did not increase right after the measure. In view of the recalcitrance on the part of big business, President Park issued a special directive to urge them to go public in May 1974. Only after that time, the number of disclosed firms rose significantly. It reached 128 in 1974 and 355 in 1979.
- 26) Cole and Park, *op. cit.*, p. 159.
- 27) Their share of total deposit rose from about 14.3 percent in 1974 to 23.9 percent in 1979 and to about 42.4 percent in 1984, shrinking the share of the banking sector. See Yoon Je Cho and David C. Cole, "The Role of the Financial Sector in Korea's Structural Adjustment," Development Discussion Paper No. 230, Harvard Institute for International Development, May 1985, pp. 9-11.
- 28) It should be reminded that the political vacuum created by the assassination of President Park in October 1979 presented a high degree of uncertainty about the future course of economic policy in general and the heavy industrialization in particular.
- 29) As of 1984, non-performing debts accounted for 9 percent of total credit outstanding by five commercial banks, reaching 1.65 times their equity. See Joong Woong Kim, "Sanopbaljongwa changch'aekkumyung (Industrial Development and Policy Loans)," in Korea Development Institute (KDI), *Korea Development Research*, Spring, 1986, p. 58.
- 30) On the export financing systems prior to 1961, see Wontack Hong, *Trade, Distortions, and Employment Growth* (Seoul: Korea Development Institute, 1979), pp. 117-118; and the Ministry of Finance, *Han'gukui Kumyungjongch'aek* (Financial Policy in Korea)(Seoul, 1979), pp. 212-215.
- 31) To maintain eligibility, their exports' foreign exchange earning ratio should exceed 30

- percent and they should be clear of violation the regulations to this type of financing. See the Ministry of Finance, *op. cit.*, p. 225.
- 32) Per capita GNP and exports in 1972 were \$295 and \$16.2 billion in current prices.
  - 33) For a detailed description on this, see Byung-Sun Choi, "Institutionalizing A Liberal Economic Order: The Strategic Management of Economic Change," Unpublished Ph. D Dissertation, Harvard University, June 1987, Chapter 3.
  - 34) For the differentiation between the market uncertainty and strategic uncertainty and the use of these concepts in analyzing private investors' decision-making, see Michael Barzelay, *The Politicized Market Economy: Alcohol in Brazil's Energy Strategy* (Berkeley: University of California Press, 1986), Chapter 3.
  - 35) The Korea Development Bank (KDB), *Han'gukusanopunhaeng Samsipnyonsa* (Thirty-Year History of the Korea Development Bank; Seoul, 1984), p. 850.
  - 36) Sang-woo Nam, "Korea's Stabilization Efforts Since the Late 1970s," Korea Development Institute Working Paper 8405, March 1984, p. 8.
  - 37) *Ibid.*, p. 10. (Table 3)
  - 38) Soogil Young, "Sanopjongch'aekui Kibongwajewa Chiwonshich'aekui Kaepyonban-gan (Basic Issues of Industrial Policy and A Scheme for Rearranging Assistance System)," Korea Development Institute Research Report 82m09, December 1982, p. 48.
  - 39) The Bank of Korea, *Economic Statistics Yearbook*, 1984, pp. 54-55. the NIF's share declined to 18.5 percent in 1979 and to 13.5 percent in 1981.
  - 40) The Bank of Korea, "Foreign Loans by Industry, 1962-82."
  - 41) *Ibid.*
  - 42) Korea's foreign debt rose from \$2,250 million (28.6 percent of the GNP) in 1970 to \$8,460 million (41.8 percent of the GNP) in 1975 and to \$27,370 million (48.5 percent of the GNP) in 1980. The foreign debt repayment and interest payments amounted to \$3,830 million in 1980. See EPB, "Urikyongjeui Huonshilgwa Kwaje," February 1984, p. 56.
  - 43) The bank loans provided to thirty largest *chaebol* groups (676 firms) amounted to 19,704 billion won, 26.9 percent of the total in 1988. Compare this figure with their share of manufacturing sales (40.2%), manufacturing exports (41.3%), and manufacturing employment (17.6%) in 1985. These statistics are based on *Dong-A Ilbo*, September 3, 1988. On the other hand, the ratio of bank credit (except loan guarantee) to total assets of the thirty largest *chaebol* groups reached 22.3 percent on average, ranging from 45.6 percent of Hanil Synthetic Fiber to 7 percent of Lotte. For more detail, see *Maeil Kyungje Shinmun*, July 19, 1988.
  - 44) Dong-Sung Cho, *Han'gukui Chaebol Yongu* (A Study of Chaebol in Korea)(Seoul: Maeil Kyungje Shinmun, 1990), pp. 194-97.
  - 45) On a detailed account of the French government's political tactic to use the financial system for industrial adjustment, see John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca: Cornell University Press, 1983), pp. 133-38.
  - 46) Joong Woong Kim, *op. cit.*, p. 58.
  - 47) Wontack Hong and Yung Chul Park, "The Financing of Export-Led Growth in Korea," in Augustine H. Tan and Basant Kapur (eds.), *Pacific Growth and Financial*

*Interdependence* (Boston: Allen and Unwin, 1986), pp. 163-182.

- 48) Joong Woong Kim, *op. cit.*, pp. 58-66.
- 49) Byong Kuk Kim, *op. cit.*, pp. 239-41.
- 50) The Ministry of Finance, *Han'gukui Kumyungghongh'aek, op. cit.*, pp. 463-480.
- 51) For example, total bank deposits increased only 6.7 times during 1970-77, while total sales of manufacturing firms increased ten times in the same period. See The Bank of Korea, "Keumyungsanopui Nakhusanggwa Kaesonbanghyang (The Backward State of Financial Industry and Its Improvement Policy)," in KDI, *Kyongjeanjonghwa, op. cit.*, p. 561.
- 52) This attempt was announced, in less than a month from President Chun's inauguration, as the "Measures to Strengthen the Business Resilience." Apart from the stated objective, it was significant in that it represented the new government's pledge toward amelioration of economic concentration by a number of *chaebol* groups.
- 53) The number of firms that were subjected to the Measures counted 1,217, most of which were owned by 30 to 40 largest *chaebol* groups.
- 54) According to the report of the Bank Surveillance Board, the largest 26 business groups owned 540 firms. The largest five business groups owned 139 firms (Hyundai 60, Lucky 53, Daewoo 48, Hyosung 39, and Samsung 39). *Donga Ilbo*, October 25, 1980.
- 55) Certainly, this attempt met with many technical difficulties. For example, it was controversial how to separate out businessunrelated land. Moreover, there was nobody other than *chaebol* who could buy such lands in a short period of time. It was no less controversial how to single out main line of businesses in their extermely diversified lines of business.
- 56) Korea Development Institute, "Keumyungchedo Kaepyuunbanghyang (Directions for the Restructuring the Financial System), in KDI, *Kyongjeanjonghwa, op. cit.*, p. 589.
- 57) For a broader economic policy changes in the 1980s, see Choi, "Institutionalizing A Liberal Economic Order," *op. cit.*, Chapter 6.
- 58) Unch'an Chung, *Keumyung Kaehyukron* (Discourse on Financial Reform)(Seoul: Pummunsa, 1991), p. 41.
- 59) The government-owned equity shares of commercial banks ranged from 20 to 30 percent.
- 60) Ministry of finance, "Measures for Deregulation the Commercial Banks," KDI, *Kyongjeanjonghwa, op. cit.*, pp. 699-718.
- 61) But it was once again deferred indefinitely under the Sixth Republic in 1990.
- 63) The Bank of Korea, *Financial System in Korea*, September 1985, pp. 5-6.
- 64) In 1987, 57 foreign bank branches accounted for 10.8 percent in total assets, and 63.3 percent in foreign exchange loans of all deposit banks. See Chung, *op. cit.*, pp. 113-4.
- 65) Yung Chul Park, "Economic Stabilization and Liberalization in Korea, 1980-1984," in *Monetary Policy in a Changing financial Environment* (Seoul: BOK, 1985), p. 95.
- 66) The Bank of Korea, *Financial System in Korea*, Sep. 1985, pp. 48-50.
- 67) As of July 1988, total amount of non-performing assets, which should be written off by default, owned by 7 nation-wide commercial banks and 17 local banks reached 250 billion won (about 3.3 \$ billion, estimated at 750 won: 1\$). See *Maeil Kyungje Shinmun*, July 23, 1988.

- 68) As of June 1988, 30.6 percent of the total commercial paper (CP) discounts was made by the 19 largest *chaebol* groups. See *Maeil Kyungje Shinmun*, August 2, 1988.
- 69) The Federation of Korean Industries, *Mingan Kyungjebaekso* (Private Sector's White Paper on the Economy), 1985, pp. 8-11.
- 70) Korea Chamber of Commerce and Industry, *chayukiopjuuiui Ch'angdalul wuihan Cheon* (Suggestions for the Development of Free Enterprise System), 1985, pp. 87-101.
- 71) Compare the average debt ratio, in 1988, of Korea's manufacturing firms (296.0) with Taiwan (84.3), Japan (243.), and the U. S. (138.2). The Bank of Korea, *Kiop Kyonyong Bunsok* (Analysis of Financial Status of Firms), 1989, p. 22.
- 72) The share of operating funds in total bank loans hovered between 74 and 78 percent during 1982-88. The Bank of Korea, *Yearly Economic Statistics*, various years.
- 73) Chung, *op. cit.*, pp. 286-87.
- 74) Joong Woong Kim, *op. cit.*, p. 54.
- 75) As of July 1988, total amount of non-performing assets, which should be written off by default, owned by 7 nation-wide commercial banks and 17 local banks reached 250 billion won (about 3.3 \$ billion, estimated at 750 won: 1\$). See *Maeil Kyungje Shinmun*, July 23, 1988.
- 76) In selecting firms to be subjected to industrial rationalization, the government used the following somewhat ambiguous criteria: 1) structurally depressed industries necessitating industrial restructuring; 2) minor lines of businesses under the control of *chaebol* beeding streamlining; and 3) firms continuously accumulating non-performing debts.
- 77) *Maeil Kyungje Shinmun*, July 21, 1988. In this calculation, the BOK's "special loans" to related commercial banks is included.
- 78) Kyu Uk Lee, "Kyungjeryukjipjungui Hyunhwanggwwa Kongjonggoraejongch'aek (The current state of economic power concentration and the fair trade policy)," KDI, 1988. The corresponding share of the fove largest *chaebol* groups amounted to 14.6 percent. See *Dong-A Ilbo*, September 3, 1988.
- 79) The corresponding figures in 1977 were 38.5%, and 20.5%, respectively, while its contribution to employment declining.
- 80) Mutual investment refers to a fictitions (just on paper) movement of investment fund between firms. As of the end of March, 1988, the amount of mutual investment by the forty largest *chaebol* groups amounted to 284.8 billion won. See *Donga Ilbo*, July 20, 1988.
- 81) It ranged from 45.6 percent of Hanil Synthetic Fiber to 7 percent of Lotte. For more detail, see *Maeil Kyungje Shinmun*, July 19, 1988.
- 82) See footnote 34.