Developmental State, Business Concentrations and Financial Repression: the case of the Republic of Korea

„Steel is national power”
Park Chung-Hee

PhD Radu Muşetescu
MBA Dana Gârdu
ASE-REI
PhD Adina Muşetescu
Universitatea Crestina Dimitrie Cantemir

The issue of whether a state has the ability to foster economic development despite what seems to be adverse conditions confronting it lies at the core of the field of international economics. Besides economic theory, public policy-making has a strong interest in such a debate. Why some states are more developed than others? How did public policies explicitly targeting economic growth succeed in certain cases and fail in others? Such an issue is critical not only for the developing countries but also for the developed countries one. The former are tempted to emulate a certain model. The latter are debating the role of public policies.

This article criticizes the mainstream argumentation advanced in the international economics literature that not only accepts the possibility of a state to induce development but strongly promotes such a perspective. In the field of public policies, such a perspective lies at the core of the philosophy of international organizations such as United Nations (see the Millennium Development Goals) or World Bank (as its name remembers us, it is the International Bank for Reconstruction and Development). The scientific truth is that the only role a state can play in fostering development is to clearly define and enforce private property rights in accordance with natural ethics. Any other task performed by the state (which assumes the historic role of a "developmental state") not only doesn't promote development but actually it delays, blocks or distorts this natural process.

Key words: developmental state, financial repression, planning
JEL classification: H 11.

Development is a natural process that results from an unhindered exercise of private property rights and free exchange. As the stock of capital goods increase in a society, there will be a widening of the division of labor and an increased specialization of private producers. The sense of prosperity which is associated with development is highly subjective and comes from a perceived abundance of consumer goods (both as a quantitative supply but also as a set of choices), high income and stability of the currency and of the purchasing power[1].

However, a developmental state does not simply wait to witness such a natural process of development. On the one hand, protecting private property rights and guaranteeing their free exercise implies a *laissez faire* policy. In the last century at least, these weren't the priorities of the state. On the other hand, there is an archetypal conflict between the nature of the state and that of the markets. As mainstream economics argues, the state emerged as a consequence of market failure[2]. This is a highly debatable issue but an immediate question arises: how a state should promote markets? Such a perceived paradox may logically be explained in the following manner: the state promotes markets only when the perceived outcome of the market processes is the one desired by the state. Markets – in fact, private individuals acting on markets – attempt to satisfy consumers and they will reward the most capable entrepreneurs in this task. When the state has other goals than the easy-to-guess outcome of the market, it will act in an opposite manner.

A developmental state declares that it is not happy with the task accomplished by the markets in promoting development. Instead of promoting markets in order to foster development, the state assumes the role of the markets and replaces them. As a consequence, the state will choose to speed up development (whether it is able to do so or not is the core dilemma) by artificially inducing economic processes that would not appear – or would take longer – in the absence of intervention (and, of course, in the absence of markets).

Historically, any state interventions in the market processes had at least the claim of fostering development. The fiat expansion of credit in order to promote growth and reduce unemployment is the traditional mechanism of monetary policy. These are, at least, the formally declared goals. Such a manipulation of economic processes will always induce a widespread redistribution of wealth in society. The specificity of the action of self-invoked development states lies not only in their engagement in macroeconomic manipulation of economic processes but also in the micromanagement of industries and companies. The developmental state not only manipulates credit but it specifically allocates it to individual industries and companies.

[1] The present article does not attempt to define the concept of development, which is by itself an interesting enterprise. It is debatable whether Gross Domestic Product per capita is the correct indicator of the level of development. However, while it is difficult to say whether Germany is more or less developed than United States, it is noticeable that Romania is less developed than Switzerland. Terms such as abundance, high income and stability of the currency are highly arbitrary.

[2] This is the perspective of a romantic saga. Other perspectives are less romantic, like the Marxian and classical liberal ones.

Past lessons: ignored

The debate on development is somehow new in the context of international economics. It vividly emerged after the World War Two, when the process of decolonization and gaining of independence in a large number of states in Africa or Asia started. Almost all of these states engaged in a fundamental process of social engineering where development played a key role. While it is interesting to note that nobody took care of the historic processes of development and industrialization in the Western World in XVIII and XIX centuries, the issue of how the states failed or succeeded in Third World seems to be more important for today public policies both in developing and developed states. The core reason lies in the difference in nature between the two periods. Development in past centuries in Western World was mainly the result of spreading of capitalist relations and free exchange. This is a pill difficult to swallow for the social engineers and left wing academics of the twentieth century. Somehow paradoxically, among the small number of countries that promoted development through liberalization is China, a formally socialist state.

One of the Jewels of the Crown in the debate on development is the case-study of Republic of Korea: „among those countries that were seen, beginning in the early 1970s and lasting through the 1990s, as the "miracle economies" of Asia, perhaps none performed quite as miraculously as South Korea"[1]. As the usual argument goes, at the beginning of the 1960s, Korea was poorer than Philippines, Bolivia or Mozambique (according to GDP per capita levels). At the end of the century, it was richer than Greece or Portugal, being the eleventh economy in the world and the second in Asia. In 1996, the East Asian nation becomes a member of the Organization for Economic Cooperation and Development, the club of the "rich nations"[2]. Its success was epically called the "Miracle of the Han River" and it seems to be the definitive argument supporting the developmental state.

Planning the development?

The state-induced development processes can be characterized by four core dimensions: planning, financial repression, internal protectionism (and nationalism) and export orientation. The four dimensions are intertwined and cannot be separated. All of them are, at the bottom line, institutional aggressions against the private property rights of national citizens.

The state is considered to be able to foster growth by picking "strategic" sectors and companies (*cherry picking*) and forcing their expansion through the artificial allocation

[1] Graham, Edward – "*Reforming Korea's Industrial Conglomerates*", 2003;
[2] Setting aside Turkey, Korea and Japan are the only OECD members which are not from Europe, North America or Australia. Korea, Turkey and Mexico are the only OECD members once qualified as developing nations. The grave crisis that shook these nations still questions their quality of mature economies.

of capital for investments. This is how they can grow. Such a forced allocation of capital may be realized only through what is called financial repression, that is, the total control of the financial intermediation. As national markets are underdeveloped because of poverty, the economic growth may be accomplished mainly through exports to foreign markets. The state assure these companies a "safe heaven" in the national markets in order to built their international competitiveness and protect from foreign takeovers. The success of these industries and companies will be later spilled-over the entire national economy.

As a typical argument goes, „during this period, the respective governments stressed economic growth as the primary goal of the country and directly intervened in the economy by means of industrial policies and preferential treatment for Korean conglomerates (called "*chaebols*"). As a result, the country enjoyed an annual economic growth rate of more than 7 per cent until the 1980s"[1].

Markets versus plans

Such an argumentation is very attractive due to its simplicity. We may almost be intrigued: why haven't all the states in the world implemented it? Unfortunately, as Frederic Bastiat warned, "there are things which can be seen as things which cannot be seen"[2].

The fundamental counterargument comes from the incompatibility between planning and what is called economic calculation. It is a theoretical battle long ago won in economics[3] but largely ignored because of its undisputable verdict. The state simply cannot successfully plan. In the planning process, the state uses prices that lack any economic meaning. It expands production of goods that are not demanded by anybody. Industries that produce goods demanded by the consumers are deprived of resources. Private entrepreneurs are crowded out as the distorted prices induce them into malinvestments. Savings are penalized as interest rate is manipulated for "strategic" objectives. The growth of the economy is artificial and has to be corrected at a certain point in time through a deep recession, when malinvestments should be revealed. At such a point, the state will socialize the costs. The strategy of the developmental state is even more haz-

[1] Transparency International – "*National Integrity Systems, Country Report, Korea 2006*". It is not very clear from a logical point of view the causality relation between the first affirmation and the second. The rate of economic growth of 7% may have been recorded despite state intervention.
[2] Bastiat, Fréderic – "*Ce Qu'On Voit et Ce Qu'On Ne Voit Pas*", Paris, 1850: "Dans la sphère économique, un acte, une habitude, une institution, une loi n'engendrent pas seulement un effet, mais une série d'effets. De ces effets, le premier seul este immédiat ; il se manifeste simultanément avec sa cause, on le voit. Les autres ne se déroulent que successivement, on ne les voit pas ; heureux si on le prévoit. Entre un mauvais et un bon Economiste, voici toute la différence : l'un s'en tient a l'effet visible ; l'autre tient compte et de l'effet qu'on voit et de ceux qu'il faut prévoir. Mais cette différence este énorme, car il arrive presque toujours que, lorsque la conséquence immédiate est favorable, les conséquence ultérieures sont funeste, et vice-versa".
[3] Ludwig von Mises was the economist who logically demolished all the socialist claims. See Mises, Ludwig von – "*Human Action*", 1947;

ardous than in the case of plain interventionism because the bet is restricted to a number of particular industries[1].

In this process, the state will also create wrong incentives for individual actors. Private entrepreneurs will depend less on the consumer and more on the state. Their survival is a result of how they can channel resources from the state and not sell to the consumer. Corruption, insider trading (and not only on the securities markets), tunneling and transfer pricing are just few collateral examples of interventionism.

Political elite and state bureaucracy do not have any rational means to correctly choose the "strategic" industries to be supported. A "Big Push" at an industry-wide level further aggravates overproduction as private investors, on a free market, would usually enter one by one the production of certain goods, paying attention to the real demand of consumers. State bureaucracy has several options:
- copy another "model" from the past: a past receipt may however not always work in the present and the efficiency of the implementation is different;
- choose industries which are politically motivated: usually by military use;
- put itself in the shoes of private entrepreneurs: it is an illusion as there are totally different incentives for somebody (state officials) who risks the wealth of others (taxpayers) and is not in any way responsible for their decisions;
- simply gamble.

The paradox of planning is that it is an instrument that works only on a free market, employed by private entrepreneurs. Such entrepreneurs will risk their own capital (together with outside capital which was competitively bidded) in order to invest in the highest rewarding (at least from an *a priori* calculation) activities of production. The natural relative structure of prices as well as the ability to anticipate the preferences of the consumer allows them to successfully plan production. The state never creates wealth by its own strategies and decrees. Wealth is the result of market-driven production. Public intervention can only redistribute wealth from certain categories of individuals to others. Any public policy that allocates resources has such an impact.

Planning in Korea

In 1961, a military coup seized power in Korea, putting an end to a period of popular unrest that caused the fall of the firstly elected president, Syngman Rhee. The central leader of the military junta that emerged was Park Chung-Hee, who retains the power for 18 years. While it is very difficult to find hard-line free-market liberals inside the military corps of officers, Park was even suspected of being a "closet communist" by United States. It is not the purpose of this paper to debate the political system in Korea

[1] On the other hand, in case of a bust, there should be only the "strategic" industries that are shaken. In the non-favored industries, investments and production should be more in accordance with the desires of the consumers. It is an argument that may explain the rapid revival of the Korean economy after the 1997 crisis.

but it should be noted that the economic policies of the Korean leader wholeheartedly embraced planning and nationalism. Maybe the ideological conflict with North Korea prevented him from introducing more widespread state ownership and keeping, at least formally, the private property as dominant.

President Park is acclaimed for granting a large degree of independence to state bureaucracy in formulating and implementing economic policies. One of its first decisions in 1961 is to form an Economic Planning Board that formulates five years economic plans. Such plans designate different industries as strategic, forcing the allocation of investments. Through specific acts, different industries are also qualified as critical for the development: the industrial Machinery Promotion Act of 1967, the Shipbuilding Promotion Act of 1967, the Electrical Industry Promotion Act of 1969 and the Steel Industry Promotion Act of 1970 are just few examples.

However, till 1973, light industries played an important role in the growth of the Korean economy. Based on what seemed to be a national competitive advantage (even Japan, during its colonial rule, despite widespread confiscations and favoritism of the Japanese companies, allow the development of Korean local companies), they were supported to expand their exports. However, the year 1973 mark the start of the big push, when the government chooses heavy and chemical industries (HCI) as national priorities.

The timing of this decision as well as the choice of these industries was not determined by a change in the economics textbooks. They seem to be first of all politically motivated and development *per se* wasn't, paradoxically, among top priorities. The 1973 decision was mainly motivated by security reasons.

After keeping at least the semblance of a democracy at the pressures of the United States, General Park is almost ousted from power in a 1971 election. He adopts the Yushin constitution that names him President for life. Such a rapid transition to a military dictatorship seemed to have forced United States to a political reaction which is the withdrawal of almost a third of its forces from the peninsula. The American leadership probably seriously limited its security commitments towards a dictatorial Seoul.

Different analysts consider that faced with abandonment from Washington, President Park chooses to develop a self-sufficient economy, strongly focused on local arms production. "It is noteworthy that HCI Development Plan was also motivated by the policy of self-defense against North Korea"[1]. All the big business groupings that emerged in the period and later will be acclaimed for their growth have a deep involve-

[1] Cho, Myeong-Chin – "*Restructuring of Korea's Defense Aerospace Industry. Challenges and Opportunities?*", Bonn International Center for Conversion, 2003, http://www.bicc.de/publications/papers/paper28/paper28.pdf, page 17;

ment in the military production. Hyundai, Samsung and Daewoo were also the largest producers of military hardware in the country[1].

Competing investment project

Let's assume that a private entrepreneur must choose between two investment opportunities. We ignore risk and assume that the first investment opportunity is in industry A and is *ex ante* more profitable and the second investment opportunity is in industry B and is *ex ante* less profitable (at least for the individual entrepreneur). *Ceteris paribus*, in such a situation, the normal incentive of the private entrepreneur is to invest in the first project. Suppose however that industry B is considered to be "strategic" by the state and qualifies as a national priority. The state interest is to determine the private entrepreneur to invest in the second investment opportunity as it cannot accept the natural outcome of the market (investments in sector A).

The state will even claim the existence of a market failure (the markets do not perform in the interests of the nation) in sector B and it will "feel obliged" to correct it. It has the two fundamental options, "the carrots and the sticks". In the first category, there are all the mechanisms through which the state subsidized the investment in sector B in order to make it more profitable for the private entrepreneur that the investment in sector A. In the second category, the state will use different kinds of penalties in order to inhibit the investment in sector A. It may use informal mechanisms (visits of fiscal agents, environmental or labor conformity controls, etc.), boycotts (refuse to deal with the entrepreneur in the future) and, more frequently, outright prohibition (like imposition of licenses to invest in sector A). The fundamental problem in the first type of mechanisms is the direct cost. In the second type, there are the wrong incentives that emerge for private entrepreneurs. In both of them, the calculational chaos will be imposed on society.

The case of Korea is not different. As different authors argue, „the real rate of return in the Heavy and Chemical Industries was actually lower than in non-favored sectors"[2]. The fundamental issue that is not discussed in the development literature becomes: how can a state foster economic growth by inducing private entrepreneurs to invest in less productive activities, that offer lower returns than those who are market-oriented? "The Bank of Korea, in its periodic financial analysis, compares profit rates in the Korean manufacturing sector with those in the manufacturing sectors of the United States, Japan and Taiwan Province of China and finds that the aggregate profit rate in Korea has fairly consistently been the lowest one of the past two decades"[3].

[1] To give just few examples: Hyundai – tanks and naval ships, Samsung – self propelled howitzers, helicopters, KIA – towed field guns, Daewoo – armored personnel vehicles, helicopters. In the production of naval ships, different smaller companies (as compared with the big groups) emerged.
[2] Graham – [2003];
[3] Borensztein, Eduardo and Jong-Wha Lee – "*Credit Allocation and Financial Crisis in Korea*", IMF working paper, Research Department, February 1999;

The analysts who "see" the success of Republic of Korea in the development process "do not see" the alternative development path of a non-interventionist state. Protecting private property rights and promoting free markets would have had better development results, in Korea as well as anywhere else.

Financial repression in Korea

As several authors argue that „the developmental state's greatest leverage over the market is its ability to allocate credit. Finance is the state's lever"[1]. The state prevents financial intermediaries to competitively allocate capital to the highest bidders (best investment projects) as the latter may not follow the official strategy. As the commercial banks can be more easily manipulated than securities markets[2], the financial repression usually means blocking the development of securities markets and tightly controlling the banking sector. Meanwhile, the state attempts to foster national savings by inhibiting consumption (controlling foreign exchange market, inhibiting consumer credit, blocking consumer-oriented foreign direct investments, etc.).

Korea nationalized the entire banking system during the first 5-year plan. Even later, it „liberalized" the banking sector only to the extent that the state, even if not formally an owner, names the Board of Directors[3] of each bank and has final authority on the credit decision. The granting of credit is a matter of public policy: „if an industrialist applied for a bank loan to expand his plant and it was a priority industry, such as producing textiles for export market, he would almost immediately get the money. If the business was in a low priority category, such as noodle production for domestic consumption, a bank loan was virtually impossible to obtain"[4].

We may interpret such facts in the following manner: the industrialist applied for a credit to expand his noodle production because it was *ex ante* more profitable. If it wasn't the case, he (or other entrepreneurs) surely would have applied for a credit to expand textile production. If the bank would allocate credit competitively (attempting to maximize profits and reduce risks), it surely would have granted the credit for the noodle production.

[1] Pang, Eul-Soo – "*The Financial Crisis of 1997-1998 and the End of the Asian Developmental State*". Contemporary Southeast Asia, December 2000, 22, 3;

[2] While there is an entire literature on the comparative merits of the securities markets (market-based financial systems) vis-à-vis commercial banking industry (bank-based financial systems), we should mention that the state can also manipulate the former as efficiently as the latter. However, it does seem that the intervention is more macro-economic oriented (general expansion of credit and manipulation of interest rates) while the intervention through the latter may be more micro-oriented. That is, in a bank-based financial system, the state can even choose the individual economic agents that can be credited ("*cherry picking*").

[3] The idea of "liberalization" is of Orwellian meaning.

[4] Levi-Faur, David – "*The Developmental State: Israel, South Korea, and Taiwan Compared*", Studies in Comparative International Development, Spring 1998, 33, 1;

But noodle production is less probable to be qualified by state authorities as a strategic industry – even if housewives are ready to pay the price demanded by noodle entrepreneurs and not for the steel and chemicals offered by the „strategic" entrepreneurs – the control over financial system becomes critical: "banks were allowed no voice over the allocative decisions, and had to passively accommodate the loans irrespective of their portfolio strategies"[1].

As the allocative decision seemed not to be enough[2], the banking system was used to subsidize the companies that attempted to expand in the "strategic" sectors. The mechanism was the so-called policy loans, which were offered at subsidized rates. At some point in time, there were 221 types of policy loans.

Year	Nominal Interest rate	Policy Interest rate	Market Interest rate (on the curb market)	Inflation	Real Interest rate	Real Policy rate
1971	22,0%	6%	46,4%	12,9%	8,1%	-6,1%
1972	15,5%	6%	37,0%	16,3%	-0,7%	-8,9%
1973	15,5%	7%	33,4%	12,1%	3,0%	-4,5%
1974	15,5%	9%	40,6%	30,4%	-1,1%	-16,4%
1975	15,5%	9%	41,3%	24,6%	-7,3%	-12,5%
1976	18,0%	8%	40,5%	21,1%	-2.6%	-10,8%
1977	16,0%	8%	38,1%	16,6%	-0,5%	-7,4%
1978	19,0%	9%	39,3%	22,8%	-3,1%	-11,2%
1979	19,0%	9%	42,4%	19,6%	-0,5%	-8,9%
1980	20,0%	15%	44,9%	24,0%	-3,2%	-7,3%
Graham – [2003]						

The size of these policy loans became significant. They reach a weight of 60% of all the loans granted by the banking sector and "the annual interest subsidy grew from about 3 percent of GNP in 1962–71 to approximately 10 percent of GNP on average between 1972 and 1979". Such figures suggest a widespread malinvestments in the Korean industry, ignoring the needs of the Korean society.

[1] Levi – [1998];
[2] Normally, it should have been enough to allocate credit only to preferred sectors. But it seems that private entrepreneurs weren't flocking in. The state had to artificially make these sectors more attractive through different "carrots". They subsidized the interest asked for credits towards these sectors.

Foreign Direct Investments

The financial repression of the credit market was accompanied by political nationalism that prevented foreign companies from investing in the national economy. As a consequence, the Korea's ratio of foreign direct investment (FDI) to the gross domestic product (GDP) remained among the lowest both in Asia and among the OECD nations. According to UNCTAD statistics[1], the stock of inward FDI in Korea was in 1980 of just 1.33 billion USD. Even if it raised in 1990 to 5.19 billion USD, it represented at that date only 2% of Korean GDP. This figure is significantly lower than the average of East Asia at that point (9.3%) and the developing nations as a whole (9.8%) or world (8.5%). The fact that in 1990, the ratio was of 3.4 for the Democratic People's Republic of Korea is highly significant for the economic repression in South Korea. The figure is close to the situation in the Syrian Arab Republic or Islamic Republic of Iran, countries that explicitly blocked FDI in their economy.

Moreover, the FDI generally took the form of participations in joint ventures, where the local partner – and the Korean state – maintained usually a tight control. It is an interesting question whether a large number of participations of foreign companies – especially American – were not politically motivated. The same may be discussed about the willingness of Japanese companies to transfer know-how and technology[2].

As several authors stress, „until the financial crisis started in October 1997, the Korean corporate sector was virtually closed to FDI. Individual foreigners could obtain only 5% of the outstanding shares of a company, and overall, foreigners could hold a maximum of 20%. In December 1997, the limit was raised to 50% for an individual investor and 55% for foreigners collectively. In May 1998, the limits on foreign ownership in most of the corporate sector were eliminated"[3].

Moreover, "inward FDI was permitted in only a limited range of sectors, and was further discouraged by requirements governing minority ownership, technology transfer (in the absence of any intellectual property rights enforcement), and export". The only comparison can be made with India, an acknowledged leader in Third World planning. Needless to say is that the situation for foreign portfolio investments was absolutely similar. Till 1997 – deep into the "globalization era" – foreign ownership of listed companies was limited to 20%.

[1] *** - "*World Investment Report 2006*", UNCTAD;

[2] Japan was the former colonial power in Korea. Its role – whether positive or negative from the point of view of development – is still debated. After the moment of normalization of the relations between the two countries (courtesy of President Park in 1965), a country like Korea, which had a strategic significance in the geopolitics of the region, might have used a strong bargaining power vis-à-vis a defensive and introspective Japan which attempted to accommodate with its own past. An imaginative Korean government might have asked for – and obtained – the commitment of cooperation of Japanese government and Japanese key companies regarding, for example, subcontracting and technology transfer.

[3] Freund , Caroline and Simeon Djankov - "*Which Firms Do Foreigners Buy? Evidence from Korea*", 2000;

Economic nationalism is highly consanguine with planning. The "efficiency" of planning and economic repression decrease in an open for investment economy as state bureaucracy usually lacks the leverage towards foreign companies. Foreign companies would have invested in noodle production and other consumer oriented industries, "reducing" savings of the population and successfully bidding local factors of production.

The political elite and state bureaucracy

As usual, despite the higher ideals of development, the political elite do not miss any chance to extract private rents. „With the exception of current President Roh Moo-Hyun, every South Korean president since Park Chung-Hee, at least one of his sons or both have been imprisoned on corruption offenses"[1]. Such a reality puts into question conventional statements in the development literature such as: "the economic success in Korea challenges the assumption … that government intervention degenerates into rent seeking"[2].

Meanwhile, one of the frequent myths that strongly emerged in the debate on economic development lies in the supposedly key role played by state bureaucracy. As Chibber argues, "for states to be successful in fostering development, they need a considerable degree of internal cohesiveness, which is generally supplied by the presence of a robust, Weberian bureaucratic corps"[3]. The argument is that the independence of state bureaucracy from political pressures will guarantee the success of designing and implementing public policies.

As Barkey puts is, „it is the high autonomy of the Israeli state [in the sense of bureaucracy] that is responsible for the success of Israeli plan while the low autonomy of the state [bureaucracy] in Argentina explains the failure of the state there"[4]. While it may be true that political pressures may generate economic catastrophes (as in the socialist experience), the failure of public interventionism is not caused by the type of behavior of public agents but by its core nature.

Moreover, the lack of corruption seems to be considered a key element in the success of the operation of the state bureaucracy. Such a perspective misses the same point. The fact that the general manager of the Pohang Steel was a military officer and the enterprise was managed "like" a military unit is seen as admirable by several commentators.

[1] Transparency International – [2006];
[2] Alice Amsden, cited in Kand;
[3] Chiber, Vivek - "*Bureaucratic Rationality and the Developmental State*", The American Journal of Sociology, January 2002, 107, 4;
[4] Cited in Levi-Faur – [1998], page 68;

The impossibility of economic planning is not dependent on who has the power to plan. Whether it is the political elite or the state bureaucracy, both of them face the same impossibility.

Private entrepreneurial elite

As long as the developmental state does not socialize the ownership of capital goods in a society, their holding will remain in private hands. However, such a formal private ownership may be depleted of its significance. The core exercise of private property rights, namely the liberty to choose the type of investment, was blocked. The Korean government not only imposed a license system to enter industries (which it granted only in conformity with the development strategy) but informally and formally induced the private actors to follow state directions. An executive from Daewoo explicitly recognized: „taking advantage of the success, Daewoo diversified into heavy machinery industries in late 1970s. *It was the Korean government that pushed for this diversification*. Due to the worldwide recession and the energy crisis, the Korean government's industrial restructuring drive toward heavy machinery and petrochemicals faced great challenges [sic] … the government and the financial community consistently pushed us to do more acquisitions. Some people criticize us for the acquisition drive but *we were compelled to acquire many of the current Daewoo companies*"[1].

Such a policy in fact socializes the exercise of private property rights. By being forced to allocate capital towards investment projects that aren't attractive on their own, they are prevented from freely choosing the kind of activities they would like to perform.

The nature of the relation between private entrepreneurs and political elite and state bureaucracy is heterogeneous and complex. At the one end of the spectrum, there are entrepreneurs who in a repression environment may be compared with public clerks. They implement decisions taken by state bureaucracy or political elite and cannot oppose such measures. Their incentives become to extract private rents as their property is socialized through public repression.

On the other end of the spectrum, there may exist private entrepreneurs who may succeed in manipulating the process of policy making. Whether the political elite and state bureaucracy manipulate the private entrepreneurs or whether private entrepreneurs manipulate them in order to get privileges is a very complex and hardly to prove relation. Different authors characterize the relationship between political elite and private entrepreneurs as a "mutual hostage" situation[2]. It seems however, from the anecdotal evi-

[1] Park, Chanhi - „*Daewoo's Globalization: Uz-Daewoo Auto Project*", Harvard Business School, case-study, 23 March 1988;

[2] Kand. The Marxists would argue that state bureaucracy and political elite are the "puppets" of the capitalist class. They largely ignore the opposite direction of influence. Political elite may use the private entrepreneurs, through economic repression, in order to reach its ends.

dence, that political elite and state bureaucracy had the upper hand: „one story often told about the HCI drive is that an entrepreneur's access to subsidies was ultimately a function of his relationship with Park Chung-hee. To be sure, Park had always preferred those entrepreneurs who demonstrated that they were capable of meeting government's goals. But no Korean would deny that of all the entrepreneurs who might have had such a capability, those who actually received subsidies were individuals who found favor one way or another with the Korean president"[1].

For example, Kim Woo-Chung, the entrepreneur who founded Daewoo, had a direct personal connection to Park Chung-Hee as his father was the teacher of the president. His close political connection may explain why Kim, who succeeded in growing at a pace unmatched by the other groups, records the biggest failure when his group goes bankrupt in 1999. On the other hand, Lee Bung-Chol, the founder of Samsung group, was already the wealthiest person in Korea at the time of the arrival of Park leadership. He and his son seemed to not have been so much dependent on state support in the process of growing of their group. As several authors argue, "Samsung had the reputation of being better managed".

Collateral effects of the development policy: redistributionism and business concentrations

The explicit goals of the development policy can be understood. They can be declared noble even if the means of reaching them – state interventionism and planning – can be easily qualified as wrong. A large number of commentators argue that some of the sins of the developmental state can be forgiven taken into account its historic task. However, the "road to hell is paved with good intentions".

Besides explicit goals, any developmental state may follow a hidden agenda. It may be an agenda where the most important end is social engineering. Public policies derived from the goal of fostering development have a powerful redistributionist effect. As the developmental state directs the resources of society in another direction than would have resulted on a free market, the social and economic effects are powerful. While some may argue that this is a unintended product-by of the official policy, any state is not indifferent to the impact of its policies and others may argue that these are the main goals[2].

The development literature that see the large companies and their associated groupings (the chaebols) that emerged during the "big push", does not see the private entrepreneurs, more dependent on the market than on the state support, that disap-

[1] Graham – [2003];
[2] As Rothbard argues, we cannot know whether the queues of the population waiting for basic consumer goods that characterized socialist societies was an undesired effect of the chaos of economic calculation or whether the socialist elite used such shortages in order to better control the society.

peared. They were crowded out by the official policies. And they are not just the noodle entrepreneurs.

On the one hand, a fact that is usually neglected is that the growth of the chaebols was usually made through external expansion, that is, by acquiring in a large number of cases already existing businesses. For sure, such businesses were not probably forced to disinvest but their financial failures may have been provoked in a large degree by public policies and actions. Nobody can know for sure whether the state adopted particular measures in order to induce their bankruptcies.

On the other hand, the development policy had an unintended consequence of the high concentration of Korean economy. First of all, maybe was more efficient for the political elite and state bureaucracy to deal with a small number of entrepreneurs who proved to be receptive to state policies. We may wonder why wasn't the case that a huge number of private entrepreneurs didn't follow the official guidance as to where to invest?

By their nature, the pet projects of the government usually are designed to be of a scale impossible to match by private entrepreneurs in a competitive environment. That's because, on a free market, private entrepreneurs rely on consumers and there is always a high uncertainty regarding their behavior and the strategy of competitors. When the state backs an investment project, he is ready to forestall competition in order to reduce uncertainty and the risk aversion of the state-backed entrepreneurs. In a measure typical to XVII-th century mercantilism, the Korean government, in order to support the expansion of shipbuilding, forbade the transport of oil to Korea by non-Korean ships and the monopoly was given to one of the largest grouping, Hyundai (through Hyundai Merchant Marine Corporation).

Maintaining the economic calculations

The problems of Korea have never resided in corporate governance or liquidity shortages. The core problems of the Korean economy are the widespread misallocation of investments in the national economy. The successes of the Korean economy are less a by-product of official policies than of entrepreneurial spirit and calculation. The biggest success stories of Korean companies comes from entities that seemed to be less dependent on state – like Samsung or LG – and in sectors that were not envisaged by the state bureaucracy – like semiconductors or consumer electronics.

While deprived of some of the essential attributes of private property, private entrepreneurs still had several mechanisms that disciplined and corrected major investment errors:

- the presence on the international markets allows them to better employ economic calculation. In absence of such a presence, it is highly probable that Korean star companies would have succumbed earlier and in a deeper manner;

- the presence of certain competitive markets in the national economy, like the curb market for financial resources or the labor market, where they competed with more entrepreneurial firms;

- besides strong interventionism in the companies, entrepreneurship could still be manifested. Besides large business groups, private entrepreneurship has manifested in small and medium enterprises (SME), far away from state interventionism. As an IMF paper argued, "contrary to the popular perception, SMEs are an important part of the Korean economy"[1].

Any state regulation or political measure that is contrary to the free exercise of property rights generate different forms of arbitration by private individuals. Among them, the fundamental one is the emergence of a "black" market, a market where private agents competitively trade resources which are distracted from the "official" market (the so-called "*financial dualism*" in the case of the financial market).

The fundamental problem in such a case is the impossibility for the analysts to guess the size of such a market. In case that its size is marginal – compared to the "official" market – its role in correcting the errors of public policies is not significant and the malinvestments will soon be revealed. The pricing on such a market will be irrelevant for the real demand and supply in the society. In case that the size of the black market is significant and participants on the official market also trade on the black market, their malinvestments will be somehow lower as the pricing will keep the significance of demand and the relative cost structure.

While it is difficult by the nature of the enterprise to value the black market of credit in any country – in Korea it was named the "curb" market – there is an anecdotic evidence that reveal its significance. In 1971 – 1972 timeframe, during a liquidity crisis when the government attempted to impose a moratorium on the payments of debtors on such a market[2], "this action had the unintended effect of reducing the wealth of the many Korean householders that had lent their saving to the curb market. Households reacted by refusing to invest new funds in it. Because *many businesses were dependent on the curb market for liquid funds*, the overall result proved to be the reverse of what was sought: financial pressured on most firms were increased not reduced. When these became apparent, Park backed off his efforts to control this market. Even so, *with this misstep the popularity of the Park government*, which had been very much based on economic successes, *began to wane*"[3].

[1] *** - "Republic of Korea: Selected Issues", IMF Country Report No. 06/381, October 2006;

[2] The government attempted to regulate the black market! It is a fundamental question why the government simply didn't choose to liquidate it as it was an illegal market. It seems that the state simply couldn't ignore the preferences of the population.

[3] Graham – [2003];

The existence of a market price – even if it is formed on a black market – always help the private entrepreneurs succeed in keeping the significance of the economic calculation. Even if they access the official market, they know the opportunity costs and maintain some sort of rationality in their financial calculation.

Conclusions

Soviet Union had one of the most competitive aerospace industries in the world. While it is very difficult for a planning authority to achieve world class technological success, it is not impossible. The fundamental issue is the huge real cost incurred in a planned economy for such an achievement. As opposed to a free market, such costs are socialized. The world class success of the Korean economy was borne by its taxpayers and could be achieved only in the context of the empowerment of the private entrepreneurial elite in the 90s. Only when the state starts to withdraw from the micromanagement of the companies, the entrepreneurs may have manifested their abilities. Achieving world class profitability however is more difficult in an interventionist economy.

When claiming the success of the Korean economy in the development, a large number of authors forget its failures. Korea is, besides Mexico and Turkey, the only OECD countries in the last decades that needed an IMF package in order to avoid financial failure[1]. At its time, it was the largest IMF package in history. Besides a direct $ 57 billion loans supplied by international financial institutions, the Korean government offered a guarantee of $ 24 billion for the Korean commercial banks short-term debts. It should be noted that Korea performed more like the other developing East Asian economies and less like a more-developed Taiwan, with whom it is usually compared.

Daewoo, one of the most favored companies by political elite and state bureaucracy, has in 1999 one of the largest corporate bankruptcies in the world history: $ 73 billion dollars. Such a failure was not only of the founder of the business, Kim Woo Chung, but of the Korean state interventionism as well. In the 80s, the government forced successful entrepreneurs to diversify into strategic businesses. Kim was reluctant to invest in shipbuilding and he was right[2].

The malinvestments and failures of the last three decades were partially revealed. Besides Daewoo, several chaebols of the top 30 went bankrupt. Even Hyundai Engineering and Construction Company, the core company of the Hyundai Group, caught fire.

[1] It is interesting to note the time of the first appeal to IMF assistance by Korea: 1974. It is the moment of the energy crisis but also the moment of the HCI drive. See the Testimony of Ian Vasquez, Cato Institute before the International Financial Institution Advisory Commission, United States Congress, September 28, 1999 for the information regarding the relation between Korea and IMF;

[2] "Daewoo was to invest more than a quarter billion dollars into this shipyard without the operation ever showing a profit. It would become one of several albatrosses plaguing the Daewoo group that would eventually bring the whole chaebol down". Graham – [2003];

Concepts like "coordinated market economies"[1] are just buzzwords that ignore a clear-cut distinction. A state may accept private property rights and guarantee their free exercise or not. In the first case, it promotes development. In the second, it engages in social engineering. As Deng Xiaoping perceived, the cat may be black or white. And only one color catches the mouse.

Bibliography

1. Bastiat, Fréderic – "*Ce Qu'On Voit et Ce Qu'On Ne Voit Pas* ", Paris, 1850;
2. Borensztein, Eduardo and Jong-Wha Lee – "*Credit Allocation and Financial Crisis in Korea*", IMF working paper, Research Department, February 1999;
3. Chiber, Vivek – "*Bureaucratic Rationality and the Developmental State*", The American Journal of Sociology, January 2002, 107, 4;
4. Cho, Myeong-Chin – "*Restructuring of Korea's Defense Aerospace Industry. Challenges and Opportunities?*", Bonn International Center for Conversion, 2003, http://www.bicc.de/publications/papers/paper28/paper28.pdf;
5. Freund, Caroline and Simeon Djankov – "*Which Firms Do Foreigners Buy? Evidence from Korea*", 2000;
6. Graham, Edward – "*Reforming Korea's Industrial Conglomerates*", 2003, ISBN paper 0-88132-337-3;
7. Kand, David – „*Crony Capitalism: Corruption and Development in South Korea and Philippines*", Cambridge University Press, excerpt, „The Puzzle and the Theory", www.cambridge.org;
8. Lee, Jooha – "*Politics of Decision-Making and Implementation in Korea: The Employment Insurance Programme*", paper presented at the International conference "GDP-ism and Risk: Challenges for Social Development and Governance in East Asia", University of Bristol, July 2006
9. Levi-Faur, David – "*The Developmental State: Israel, South Korea, and Taiwan Compared*", Studies in Comparative International Development, Spring 1998, 33, 1;
10. Mises, Ludwig von – „*Human Action*", Third Revised Edition, Contemporary Books Inc., Chicago, 1963 (ediție originală, 1947);
11. Pang, Eul-Soo – "*The Financial Crisis of 1997-1998 and the End of the Asian Developmental State*". Contemporary Southeast Asia, December 2000, 22, 3;
12. Park, Chanhi – „*Daewoo's Globalization: Uz-Daewoo Auto Project*", Harvard Business School, case-study, 23 March 1988;
13. Rothbard, Murray – "*Power and Market*", Institute of Humane Studies, 1970;

14. *** - "*World Investment Report 2006*", UNCTAD;

[1] „In Korea, the important institutional environment to firm strategy is the interdependence between the state and major business groups. Such state-business alliance is conspicuous in 'group-coordinated market economies' as a variant of 'coordinated market economies' (distinguishable from 'liberal market economies') in the 'varieties of capitalism' literature". See. Lee, Jooha – "Politics of Decision-Making and Implementation in Korea: The Employment Insurance Programme", paper presented at the International conference "GDP-ism and Risk: Challenges for Social Development and Governance in East Asia", University of Bristol, July 2006;

15. *** - "*Republic of Korea: Selected Issues*", IMF Country Report No. 06/381, October 2006;
16. *** - Testimony of Ian Vasquez, Cato Institute before the International Financial Institution Advisory Commission, United States Congress, September 28, 1999;
17. *** - "*National Integrity Systems, Country Report, Korea 2006*", Transparency International.

Radu MUŞETESCU is a lecturer in the Department of International Business and Economics. He earned in 2005 a PhD with a work on Business Strategic Alliances at an International Level. He is focusing on issues like corporate governance and corporate finance as well as the relation between state and private businesses. Other significant papers on the issue are the „Global Integration of Financial Markets and the Impact on Corporate Governance of Local Firms" (Romanian Economic Journal, 2006) and the „New Economy and the Old Theory of Business Cycles" (Romanian Economic Journal, 2002).

Adina MUŞETESCU is a lecturer at the Faculty of International Business and Economics, the „Dimitrie Cantemir" Christian University. She teaches International Marketing and is interested in issues like competition policy, the relation between marketing and competition policy, the impact of cultural differences on marketing and management as well as the phenomenon of business concentrations.

Dana Rodica GÂRDU holds a bachelor's degree in International Business and Economics from the Academy of Economic Studies (AES)-Bucharest, and a Romanian-Canadian MBA (AES-Bucharest, HEC Montréal, University of Ottawa), major in Marketing. She is currently a PhD student with the AES, focusing on East Asian political economies. Her main areas of interest include development economics, foreign direct investment theory, corporate strategies, RDI and competitiveness linkages, international political economy. She co-authored *EU and European Models' Competitiveness at Stake* (with Prof. Ana Bal, PhD, et al., Nitra-Graz-Bucharest International Workshop, April 2007) and *Sliding Tectonics: the EU and the Other Power Poles in Quest for Brands of Regionalism* (with Prof. Rodica Milena Zaharia, PhD, Oradea International Scientific Conference, May 2007).