

Government Role and Industrialization in Korea 1990s – 2000s

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The Rationale of Industrial Policy

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Assessment of the Government Role in Korea

I. The Rationale of Industrial Policy

1. Theoretical Background of Industrial Policy

- ▶ **There are pros and cons regarding the long term effects of industrial intervention policy on a national economy, however, industrial intervention policy plays an important role for promoting economic growth when countries do not have plenty of natural endowments.**
- ▶ **In general, industrial intervention policy is a growth strategy where the government attempts to influence the nation's pattern of industrial development by using taxes, subsidies, or regulations.**
- ▶ **Two main approaches to industrial policy:**
 - **Typical industrial policies are to promote specific sectors.**
 - **The second approach considers market promotion policies implemented to promote the efficiency in particular markets**

I. The Rationale of Industrial Policy

2. Arguments on Industrial Policy

- ▶ **Upon rigorous arguments for industrial policy in the 1980s, one type of argument focused on the externalities associated with specific industries.**
- ▶ **The second type of argument focuses on strategic support for domestic firms in global, oligopolistic markets.**
- ▶ **The key argument against government intervention is that faulty intervention is worse than neutrality.**
- ▶ **Even correctly targeted intervention has costs.**
- ▶ **The decision to adopt an active industrial policy ultimately involves the weighing of costs and benefits.**

I. The Rationale of Industrial Policy

3. The Limits of Industrial Policies

- ▶ **The effective implementation of industrial policies requires sophisticated institutions for setting policy goals and efficient instruments.**
- ▶ **Industrial policy also requires instruments that can substantially lower input costs or increase revenues.**
- ▶ **Many of the instruments of industrial policy have been controlled or declared illegal by international agreements.**
- ▶ **Thus, the industrial policies of most advanced countries have shifted either toward greater neutrality like Germany and Japan, or toward greater reliance on credit policy, competition policy, and functional support for technology.**

I. The Rationale of Industrial Policy

4. The Efficacy of Industrial Policies

- ▶ **Many neoclassical economists allege that government does not do a good job of picking winners.**
- ▶ **Some other arguments against this critics**
- ▶ **Instead of "Picking winners" culling from a fixed pool of applicants, East Asian governments have performed an entrepreneurial role.**

II. Evolution of Korean Industry Policy

1. From Import Substitution to Export Promotion

- ▶ **The First Step to Increase Export is to Raise Local Content Ratio**
- ▶ **Active export promotion policies in Korea**
- ▶ **Selective Interventions Favoring HCI in the 1970s**
- ▶ **A New Jump in Export Structure**
- ▶ **While political uncertainty following the assassination of President Park in 1979 and the second oil crisis contributed to the downturn, the negative effects of industrial policy were also responsible.**

II. Evolution of Korean Industry Policy

2. Adjustment of Intervention Failure

- ▶ **From Industry Specific Measures to More Functional Policies**
- ▶ **Liberalizing financial sector and privatizing commercial banks**
- ▶ **Progress in reducing government intervention in the economy continued**
- ▶ **Contributions Made by GTCs(General Trading Companies) to Export Promotion and Industrial Development**
- ▶ **Nevertheless, the Korean government did not abandon ad hoc industrial interventions.**

II. Evolution of Korean Industry Policy

3. Before the Economic Crisis of 1997

- ▶ In 1993, Korean government abolished the practice of the five year economic planning, which was introduced in 1962
- ▶ Given that traditional Korean industrial policy provided an investment coordination mechanism that checked 'excessive competition', the new situation led to overinvestment.
- ▶ Industrial policy in Korea was not responsible for the overinvestment behind the financial crisis of 1997. Rather it was its abolition by the government that made such investments easier without the proper institutional checks.
- ▶ During this time, the problems in industry were closely interlinked with failure in the financial system. With easy access to credit and weak loan criteria, it was relatively simple for companies to borrow money for well- and ill-advised projects alike
- ▶ Overcapacity in key industries was a major structural weakness of the Korean economy, and the excessive private debt was a factor in rendering the economy vulnerable to the crisis.

II. Evolution of Korean Industry Policy

History of Relations between Government and Business in Korea

period	Firms' Strategy	Government Policy	Major Industries
60s- mid 70s	<ul style="list-style-type: none"> take advantage of cheap labor search for economies of scale export 	<ul style="list-style-type: none"> export-promotion pick-the-winner 	textile, footwear, clothing, electronics
mid 70s - 70s	<ul style="list-style-type: none"> diversify export 	<ul style="list-style-type: none"> incentives on HCI 	steel, automobile, shipbuilding, chemical
80s	<ul style="list-style-type: none"> diversify more attention to domestic demand 	<ul style="list-style-type: none"> adjust HCI rationalize "sunset industries" 	machinery, hi-tech parts and intermediate products
90s	<ul style="list-style-type: none"> reclaim deregulation independent from government 	<ul style="list-style-type: none"> specialize reduce chaebols' economic power 	hi-tech, R&D, software
2000s	<ul style="list-style-type: none"> streamline their own businesses 	<ul style="list-style-type: none"> implement a harsh plan of corporate restructuring 	ICT industries, software and Services

Source: Kim DoHoon (2004)

III. Crisis of 1997 and Restructuring Policy

1. Financial Crisis in 1997-1998

- ▶ Due to the economic crisis, the Korean economy has experienced a negative 5.8 percent growth in 1998. Shrinking domestic demand and credit restrictions forced a dramatic restructuring of Korean industries.
- ▶ Restructuring Initiated by Government for Conglomerates “Chaebuls”
- ▶ Easier to Build Consensus for Dramatic Restructuring
- ▶ Fortunately, Ministry of Industry Initially Conducted the Restructuring Plan instead of Financial Authorities.

III. Crisis of 1997 and Restructuring Policy

2. Dramatic Restructuring Policies

Agreements for the Restructuring of the Top Five Chaebols

	Agreements in 1999
Semiconductor	Hyundai Electronics Co., Ltd and LG Semiconductors Co.Ltd will be merged into one corporation. The core management entity will be determined by December 25, 1998 based on a consulting firm's assessment.
Petrochemical	Samsung and Hyundai Petrochemical Co. in the Daesan Petrochemical Complex will be merged into a single corporation inducing foreign investment to lower the debt/equity ratio of the newly established corporation.
Oil Refinery	Hyundai Oil Refinery Corporation will take over Hanwha Energy Corporation.
Aerospace	Samsung Aerospace Industries, Hyundai Aerospace Industries and Daewoo Heavy Industries Co.Ltd will be incorporated into a new business entity. Participants of the new company will divide ownership evenly.
Railroad Vehicles	Hyundai Precision & Industries Co.Ltd, Daewoo Heavy Industries Co.Ltd and Hanjin Heavy Industries Co.Ltd will be integrated into a new corporation.
Power Generation Facility	Hyundai, Samsung and Korea Heavy Industry will be merged into either Hyundai Heavy Industries Co.Ltd or Korea Heavy Industry.
Ship Engines	Samsung Heavy Industries Co.Ltd will transfer its assets and debt to Korea Heavy Industry.

III. Crisis of 1997 and Restructuring Policy

3. From Crisis to Recovery

▶ Progress of Restructuring Until Now

- In the semiconductor industry, Hyundai Electronics Co. took over LG Semiconductor Co. and registered it as a single company, Hynix Semiconductor in November, 1999.
- Hyundai Oil Refinery Corporation purchased Hanwha Energy Corporation in September, 1999 and got 510 million dollar investment from UAE to improve the financial situation for the new company.
- In the aerospace industry, Samsung Aerospace Industries, Hyundai Aerospace Industries and Daewoo Heavy Industries Co. were incorporated into Korea Aerospace Industries, Ltd. in October, 1999.
- In the railroad vehicles, the three companies were integrated into the new entity, Rotem Company in July, 1999.
- In regard to power generation facilities and ship engines, the transference of Samsung Heavy Industries Co. and Hyundai Heavy Industries Co. into Korea Heavy Industry were agreed in 1999 and then privatized as Doosan Heavy Industry in 2001.
- In the petrochemical industry, however, Samsung and Hyundai disagreed to merge and failed to induce foreign investment. The two companies have propelled restructuring plans separately.

III. Crisis of 1997 and Restructuring Policy

3. From Crisis to Recovery

- ▶ Dealings with Samsung Motors, Daewoo Electronics Corporation and Daewoo Motor Company also collapsed due to the bankruptcy of the Daewoo conglomerate in 1999. Renault took over Samsung Motors and the new company, Renault- Samsung Motors, came into being in September, 2000. Finally, GM company purchased Daewoo Motors in 2002.
- ▶ Accelerated Globalization and Upgrading of Industry
- ▶ Restructuring leads to Reallocation of Resources toward High Tech Sector
- ▶ Regarding long-term structural adjustments, the Korean government planned to develop a knowledge-based economy.
 - This plan focused on five key themes: developing a nationwide information infrastructure; developing a human resource system responsive to the knowledge-based economy; improving national science and technology innovation capabilities; developing new knowledge-based industries and digitalizing older industries; and addressing the digital and knowledge divide.
 - The plan also emphasized institution building for knowledge-intensive industries, such as standardization, intellectual property right protection.

III. Crisis of 1997 and Restructuring Policy

3. From Crisis to Recovery

Top 5 Export Items (%)

Rank	1970 Item (Share)	1980 Item (Share)	1990 Item (Share)	2000 Item (Share)	2010 Item (Share)	2017 Item (Share)
1	Textiles (40.8)	Garments (16.0)	Garments (11.7)	Semiconductor (15.1)	Semiconductor (10.9)	Semiconductor (17.1)
2	Plywood (11.0)	Steel Products (5.4)	Semiconductor (7.0)	Computer (8.5)	Vessel (10.5)	Vessel (7.4)
3	Wigs (10.8)	Footwear (5.2)	Footwear (6.6)	Automobile(7.7)	Automobile(7.6)	Automobile(7.3)
4	Iron ores (5.9)	Vessel (3.6)	Video Apparatus (5.6)	Petrochemical Products (5.3)	Flat display & Sensor(7.0)	Petrochemical Products(6.1)
5	Electronic Goods (3.5)	Audio Apparatus (3.4)	Vessel (4.4)	Vessel (4.9)	Petrochemical Products (6.8)	Flat display & Sensor(4.8)
Total	72.0	33.6	35.3	41.5	42.7	42.7

Source: KOTIS

IV. Assessment of the Role of Industrial Policy in Korea

1. The Neoclassical Economist View

- ▶ Those who put their faith in the market tend to downplay the role of government and industrial policy in the process of the economic development of Korea and other Asian economies.
- ▶ These arguments suggest that Korea and other Asian countries would have grown even faster but for the intervention of their governments.
- ▶ As Korea joined the OECD and became a major player in some key industries such as steel, shipbuilding, semiconductors and LCD, one hears less criticism of Korea's high-technology strategy.

2. The Revisionist View

- ▶ “The revisionist school” stresses the importance of government intervention in guiding the economy. The government can improve market outcomes and accelerate growth by deliberately distorting prices and incentives.
- ▶ In fact, without the extensive intervention during the 1960s and 1970s, Korea would not have become the economic powerhouse that it is now.

IV. Assessment of the Role of Industrial Policy in Korea

3. Conclusion

- ▶ **Given constraints of the Korean economy such as limited natural resources, a small domestic market and a lack of capital and experience, the Korean government development policy was concentrated on industrial policy and trade policy rather than open and competition policy in the beginning.**
- ▶ **Korea's fast-paced development model with government support is no longer a model to be completely emulated by the developing countries, as some of those policies are not consistent with the WTO system. But it does serve as an interesting case study of the success encountered by a small, continuously opening economy in this highly competitive world market.**

1. Development of the Korean Automobile Industry

Demand & Supply of the Korean Automotive Industry

Thousand units, percent

	1970	1980	1990	2000	2010	2017	annual growth rates ('70-'17)
Domestic Sales	21.2	104.5	954.3	1,430.5	1,556.0	1,560.0	9.6
Exports(A)	-	25.3	347.1	1,676.4	2,772.1	2,610.0	13.4
Imports	-	-	-	11.4	105.0	260.0	17.0
Production(B)	28.8	123.1	1,321.6	3,115.0	4,271.7	4,114.9	11.1
A/B	-	20.6	26.3	53.8	64.9	63.4	-

Source: Korea Automobile Manufacturers Association (KAMA)

2. Transformation of Government Policy in the Korean Automobile Industry

▶ Import-substitution Policy

▶ Export-promotion Policy

- In 1972, the low-priced 'people's car' selected to develop and export
- Technologically backward Korea could compete only on the basis of price rather than quality

▶ Rationalization Policy

- In 1981, 'The Rationalization Plan of the Automobile Industry' allowed two companies for passenger car (Hyundai, Saehan) and only one for commercial vehicle (a merger between Kia and Dong-Ah)
- The sector's rationalization policy which partially in 1985 completely lifted in 1989

▶ Liberalization Policy

- Tariff on automobile progressively reduced from 50% in 1987 to 8% in 1994
- As of the end of June 1999, the import diversification policy completely lifted, allowing small sized Japanese cars to be imported

3. Recent Restructuring of the Korean Automobile Industry

▶ Background of Recent Industrial Adjustment

- Due to economic crisis minus 5.8% GDP growth in 1998
- Because of shrank demands, credit restrictions and high interest rate, many companies bankrupted
- The capacity utilization rate dropped to 64 percent in July, 1998
- To reduce the transaction cost of inter or intra industry adjustment in the short term, government strong intervention adopted
- To solve the overcapacity and insolvent enterprises, it required a variety of restructuring efforts including M&A and strategic alliance

▶ Restructuring Process of the Korean Automobile Industry

- In mid-1998, the Korea government strongly persuaded conglomerates into propelling business restructuring
- In 1998, Hyundai Motors took over insolvent Kia Motors.
- In 2000, Renault acquired Samsung Motor.
- In 2002, GM purchased Daewoo Motors bankrupted in 2000.
- In 2004, Shanghai Motors took over Ssangyong Motors.
- In 2011, Mahindra(India) took over Ssangyong Motors.



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