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2010 Modularization of Korea's Development Experience: Private Sector Development

2011

MINISTRY OF STRATEGY AND FINANCE

KDI Korea Development Institute

2010 Modularization of Korea's Development Experience:
Private Sector Development

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Preface

In the 21st century, knowledge is one of the key determinants of a country's socio-economic development. In recognition of this fact, the Ministry of Strategy and Finance (MOSF) and the Korea Development Institute (KDI) launched Knowledge Sharing Program (KSP) in 2004. The KSP aims to share Korea's development experience and knowledge to assist socio-economic development of partner countries.

The KSP is comprised of three parts: 1) the systemization and modularization of Korea's development experiences into case studies, 2) policy consultation through knowledge sharing with partner countries, and 3) joint consulting with international organizations. The systemization and modularization of Korea's development experience researches and documents Korea's successful policy experiences, such as the 'Five-Year Economic Development Plan' and 'Saemaul Undong (New Village Movement).' The policy topics are 'systemized' in terms of the background, implementation and outcome, and then, presented as case studies in order to achieve a complete understanding of the actual policies. These systemized policy case studies are further 'modularized' by sector so they can be utilized as concrete examples by partner countries to meet their interests in specific institutions, organizations or projects. For example, Korea's 'Export Promotion Policy' has been prepared as a systemized case study while 'the Establishment of the Export-Import Bank' has been modularized to provide a specific example of Korea's export promotion experience in export financing. The modularization of Korea's development experience traces back to a policy's inception and recapitulates the rationale for its introduction; its main content; and its implementation mechanism. The case studies also evaluate a policy's outcome and draw insights with a global comparative perspective. These case studies include literature reviews, surveys and in-depth interviews with the policy practitioners and experts who participated in the implementation process.

The systemization of Korea's development experience was initiated in 2007 and finished in 2009. Under the new Modularization Project, launched in 2010, the plan has been set out to modularize 100 case studies by sectors and topics in three years.

I would like to take this opportunity to express my sincere gratitude to Project Manager, Dr. Wonhyuk Lim, and all the Korean experts for their immense efforts in successfully completing the '2010 Modularization of Korea's Development Experience.' I am also grateful to Managing Director, Dr. Kwang-Eon Sul, and Program Officer, Ms. Ja-Kyung Hong, the members of the Center for International Development, KDI, for their hard work and dedication to this Program.

I earnestly hope that the final research results will be fully utilized in assisting the development partner countries in the near future.

Oh-Seok Hyun
President
Korea Development Institute

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Chapter 01

Financial and Tax Support for Promoting Businesses

Chapter 01

Financial and Tax Support for Promoting Businesses

GyeongLyeob Cho, Taekyu Lee (KERI)

<Summary>

In Korea, full-fledged industrialization policies began in 1961 when President Park Chung-hee took office. During the course of industrialization, the most frequently utilized policies for corporate support included the finance and tax measures over which the government had a strong control. The financial support policies under the Park Administration included the export finance of the 1960s and the financial support for the heavy and chemical industries(HCIs) of the 1970s. For export finance, the automatic loan approval system played an important role. Additionally, export financing by the banks was supported by re-discount of the Bank of Korea. For the promotion of HCIs, policy loans were concentrated on the HCI sector, while the National Investment Fund(NIF) was established to utilize domestic savings for HCI investment. During the early stages of development, the financial supports were provided to the exporting companies, and the HCIs played a critical role in advancing industrialization of Korea in a short period. These policies also had served as a substitute for the underdeveloped financial market of the time. However, the Korean economy had to suffer from chronic inflation caused by monetary expansion as it developed. In addition, the government's financial control also brought a harmful side effect that undermined the development of the financial industry.

In the 1960s - the early stages of the industrialization - tax policy was focused on the increasing of tax revenues to secure the financial resources required for the economic development. While the corporate tax rate was maintained at high to increase tax revenues, various tax reduction schemes were also in places as incentives to boost exports. Entering 1970s when the government embarked on the policy to foster HCIs, the focus of tax policy shifted from direct taxes to indirect ones so that capital accumulation in the corporate sector could be

accelerated. Especially, lowering the corporate tax rate was highly regarded as a significant contributor to the formation and the rapid growth of the private capital. In addition, the introduction of the value-added tax simplified consumption taxes and enhanced efficiency to a great extent, by improving the taxation neutrality among industries. On the other hand, the tax reduction and exemption system executed to nurture HCIs and to support exports has often been criticized to have caused an over-investment in HCIs via an inefficient allocation of resources among industries.

At the turn of the 1980s, after the Park administration, the government policy began to prioritize the stability over the growth. With the change in the policy direction from growth to stability, the taarge of the policies to promote businesses was changed from large enterprises to the small-and-medium-ones, and is applicable until today. In terms of financial support to small-and-medium-sized enterprises(SMEs), some policies rely on market intervention like the regulation of mandatory lending by commercial banks to SMEs. But government support to SMEs is mostly provided through the policy loans. In order to promote SMEs, corporate tax benefits and support are also provided. The SME support system greatly contributed to the start-ups and the promotion of the SMEs, but came under criticism for emphasizing equity rather than efficiency resulting in another kind of inefficient resource allocation.

Since the late 1990s, the government has focused its support on the venture businesses based on IT, the national strategic industry. In fostering the venture businesses, the policies also promoted equity financing through KOSDAQ. This approach was taken in order to spur risk sharing in the capital market and to expand the long-term fund for the venture business. Although the number of venture businesses increased exponentially, following these friendly measures, many of them went to bankruptcy due to the over-investment. As the result, the investors faced great financial losses at the consequent collapse of KOSDAQ market. Since then, the financial support system for venture businesses has relied less on direct support and has put greater emphasis on raising capital through “Fund of Funds(FOF)”.

One of the remarkable policy changes since the 1980s is that the industry supportive policies shifted from the target-based, selective one to the function-based, general one. For industries that meet performance standards in terms of productivity improvement, energy strategy and etc., they were eligible for the same support. Therefore, policy support was not determined by the government but by the market, which resulted in substantially higher efficiency of the resource allocation. Furthermore, revolutionary tax support for venture businesses was introduced after the 1997 Asian Financial Crisis, which resulted in the growth of IT industries, venture capital, and the equity market(KOSDAQ). Meanwhile, even though various tax support measures were introduced temporarily with sunset provisions to promote venture businesses, the types of policy support continued to increase as time went on. Even after achieving the intended goals, a certain categories remained in the system. This implies that the venture businesses support system was not focused or selective, but rather impartial. Therefore, it resulted in the increased complexity in the tax system and the decreased tax base.

1. Introduction

Korea has a unique experience of rapid industrialization over a short period of time, during which the government's aggressive intervention in the market played an important role in achieving policy goals. Since growth of the business sector is a prerequisite for achieving economic growth through industrialization, the Korean government has given support to companies by implementing various policies. In particular, the most frequently utilized measures in the corporate sector were the finance and the tax policies, over which the government holds the strongest control. This research examines the policies employed to provide financial and tax support in promoting businesses since the period of high economic growth until today. The paper also evaluates the results of the policy efforts. A support policy, in this paper, is defined as one that seeks to create a business-friendly environment, such as the economic policies that benefit corporate activities (interest rate, fiscal, exchange rate policies). This also includes direct support to companies and other policies that indirectly assists businesses, namely the infrastructure building policies.

Korea's government-driven industrialization policies began at a full-scale after the inarguration of President Park Chung-hee in 1961. The Park administration has set mid-term growth goals with the Five-year Economic Plans and employed necessary policy measures to achieve them. These economic policies were successful in terms of economic development as reflected in accomplished average annual growth rate of real GDP that exceeded 9% during his term of office(1961~79). The distinguishable characteristics of the business support at this period to other times is that the scope of support was extended to a full mobilization of national resources. In other words, the government concentrated all national resources to business support with its powerful control over the entire economy instead of adopting the usual business supportive package.

After the Park administration at turn of the 1980s, the government adopted the stability prioritizing policies over growth. Such change in the policy direction was due to a number of problems associated with the government-driven, growth-oriented polices including the over-investment in certain sectors and chronic inflation. As the policy direction changed from growth to stability, the target of the policies for business promotion changed from large enterprises to small-and-medium-ones. Moreover, large corporations became subject to regulations and restructuring. The business promotion policies since the 1980s are for the small-and-medium-sized business, in effect, and such trend is maintained until today. The policy adopted to foster venture companies that began in the mid-1990s were also limited to smaller-sized venture enterprises in principle.

While the policies to promote enterprises during the Park administration have produced considerable results, it is difficult to say the same for the policies to support small-and-medium enterprises as of today, in terms of growth. In reality, the cases of small-to-medium-sized enterprises growing into large corporations are very rare, and the industries that are responsible for the national economic development are still driven mainly by the traditional large corporation. This paper constitutes of four chapters, which represent each stage of four major business supportive policies in Korea since the 1960s until today: the export industries, the heavy and chemical industries, the small-and-medium-sized businesses, and the venture companies. The chapters of this paper are chronologically arranged and, at the same time, deal with the major business promotive policy of the period. Each chapter analyzes the characteristics and the effects of the finance and tax policies of the subject period, and the overall evaluation on Korea's business supportive policy as a whole presented in the last chapter.

2. Supporting Export-led Growth Strategy

2.1. Background

In 1961, when the Park Chung-Hee administration was established, the Korean economy was characterized by an economic structure dependent heavily on foreign aid. Due to weak domestic production capacity, a considerable amount of goods had to be imported. Then, exports only covered 14.4 % of the imports (annual amount of $4,100 million) and the trade deficit was covered by foreign aid. Furthermore, domestic savings were too insufficient to finance investments. Under these circumstances, President Park Chung-Hee came to office through a military coup d'état causing economic downturn with the shock. Therefore, the government had no choice but to deploy an expansionary policy to normalize economic activities, even though inflation was getting out of control following various post-war reconstruction efforts. In addition, it became evident that foreign aid was on a gradual decline demanding for new sources of foreign currency. On the other hand, however, the cheap yet skilled labor force in Korea was internationally competitive. In combination, the government came to adopt a growth strategy centering on the export of the labor-intensive light-industry goods. The core of this growth strategy was to sell price-competitive goods in foreign markets, rather than domestic market, with no buying power, and to finance the demand for imports and investment with the earned dollars.

The Park's administration aggressively pushed ahead with the growth strategy driven by exports during the first and the second rounds of the 'Five-year Economic Development Plan'. In this scheme, a comprehensive set of financial and tax support polices were established for the exporting sector. The "Comprehensive Policy Measures to Promote Export" was announced in 1964. It contained export finance incentives, tariff exemptions for importing raw materials to be used in the production of exports and corporate and income tax benefits on income earned from exports. In addition, the government monthly monitored on the progresses, and further encouraged export by eliminating difficulties through "Monthly Export Promotion Meetings" that was chaired by the President, since 1965. In these meetings, all the details regarding export were examined and considered. Given the enormously wide range of export products from the diverse sectors of the economy, the meetings *de facto* dealt with all the issues related to the Korean economy.

Besides, because Korean economy at the time was at the starting point of economic development, many of the required systems for an efficient policy execution were missing. Therefore, the Park administration implemented government-controlled policies to promote businesses and, at the same time, it embarked on the building of the economic infrastructure such as organizations and systems required for policy implementation. These efforts to institutionalize are considered as policies that sought to promote businesses in a wide perspective, and will be introduced in the following section.

2.2. Financial Policies for Export Promotion

2.2.1. Building Government-controlled Financial System

The new government that was established through the militany coup d'état in 1961 implemented various government-driven economic development plans. So as to ensure the successful completion of the plans, a strengthened government control over the mobilization and distribution of resources was required. In this regard, the government began to build financial systems that could support its development policies. First, the government nationalized commercial banks by subordinating the majority of the stock to the government in 1961. These nationalized banks became *de facto* development banks. Even though the banks were nationalization, domestic savings were insufficient to support investment. Accordingly, the government needed more control over the Bank of Korea(BOK), the central bank, to support development projects with the monetary expansion. In April 1962, the first amendment to the 'Bank of Korea Act' was made, which essentially reinforced the control of the Ministry of Finance(MOF) over the BOK. This amendment empowered the President to appoint the governor of BOK upon recommendation from the MOF. Furthermore, the amendment gave the MOF the authority to ask for reconsideration on the decisions made by the Monetary Board, the highest decision-making body of the bank. The amendment further gave the Cabinet final decision-making authority in the event of rejection of this reconsideration request by the Monetary Board. It also gave the MOF an authority to supervise the BOK, and increased the number of government-appointed members resulting the Monetary Board member to be nine instead of original seven. Moreover, the foreign exchange policy part was transferred to the MOF among the policy authority that the BOK held in the field of monetary, credit and foreign exchange.

The government also established new specialized banks as well as reorganizing existing ones. The 'Korea Development Bank(KDB) Act', revised in 1961, increased the capital of the Bank and extended the scope of business to reinforce the lending capacity for the long-term facility investment. In 1967, the Korea Exchange Bank was found as an exclusive financial institution dedicated to the foreign exchange transactions. The Korea Development Finance Corporation was also established as a privately funded institution authorized to offer medium- and long-term loans and equity investments to the enterprises. In 1969, the 'Export-Import Bank of Korea Act' was legislated to financially support medium- and long-term activities including the export of capital goods, overseas investments and development of resources abroad.[1] Other specialized banks were established to handle the financial needs of SME and consumers exclusively; to name a few, there were the Industrial Bank of Korea(1961), the Citizens

Table 1-1 | Specialized Banks Established in 1960s

Specialized Banks	Established Year	Main Business
The Small and Medium Industry Bank	1961	Finance for small-and-medium-enterprises
The National Agricultural Cooperatives Federation	1962	Support economic activities of farmers.
The National Federation of Fisheries Cooperatives	1962	Support economic activities of fishers.
The Citizens National Bank	1963	Consumer finance
The Korea Housing Bank	1967	Housing finance
The Korea Exchange Bank	1967	Foreign exchange
Korea Development Finance Corporation	1967	Medium & long term investment & financing
The Korea Trust Bank	1968	Trust and Banking
The Export-Import Bank of Korea	1969	Finance for export-import and overseas investment

1. Although the Act was enacted in 1969, the operations were managed by the Korea Exchange Bank until the actual establishment of the Export-Import Bank of Korea in 1976.

National Bank(1963), the National Agricultural Cooperative Foundation(1962), the National Federation of Fisheries Cooperatives(1962), the Korea Housing Bank(1967), and the Korea Trust Bank(1968). Furthermore, starting with the launch of Dae-gu Bank in 1967, ten local banks were established to support the development of local economies and the mobilization of domestic savings.

2.2.2. Adjustment of exchange rates and interest rates

In 1964, on top of several export support policies, the government reformed the foreign exchange rate system to create an export-friendly environment. In 1964, the Korean Won(KRW) was devalued by almost 100% from 130 KRW to 255 KRW, per American dollar(USD). Additionally, the exchange rate system was changed to an unified floating exchange system, moving away from the previous multiple fixed exchange rate system that applied different exchnage rates for each product. Even after the adoption of the floating exchange rate system, the government made timely interventions in the market to keep the actual exchange rate stable.

In 1965, the government carried out measures to raise interest rates with the goal of mobilizing domestic savings necessary for economic development. It increased the annual interest rate on deposits with a maturity of one year by 100% from 15% to 30%, and raised the individual interest rate for other deposits in accordance with the types. This measure was intended to funnel savings into the regulated financial market from the unregulated informal one. As the result, both the saving deposit and the total deposit in the banks increased by 129.1% and 54.1% from the previous year, respectively. From 1966 to 1970, the annual growth rate of saving deposits averaged at 83.1%, while the demand deposits and the total deposits recorded 36% and 59.8%, respectively.

Table 1-2 | Deposits in Deposit Money Bank

(Unit: 1 billion KRW, %)

Years	Total Deposits	Demand Deposits	Saving Deposits
1964	43.1 (-10.2)	28.6 (9.2)	14.5 (-33.5)
1965	78.5 (82.1)	47.9 (67.5)	30.6 (111.0)
1966	121.0 (54.1)	50.9 (6.3)	70.1 (129.1)
1967	205.9 (70.2)	77.0 (51.3)	128.9 (83.9)
1968	373.0 (81.2)	117.5 (52.6)	255.5 (98.2)
1969	619.1 (66.0)	167.6 (42.6)	451.5 (76.7)
1970	789.7 (27.6)	213.4 (27.3)	576.3 (27.6)

Note: Numbers in parentheses are the growth rate.
Source: Bank of Korea.

2.2.3. Payment Guarantee on Foreign Loans

Despite of the numerous efforts to mobilize domestic savings, namely increase in interest rates and creation of special or local banks, the raised financial resources were insufficient to finance the economic development. So, the government embarked on utilizing more foreign loans in a full swing. The amendment of the 'Foreign Capital Inducement Act' in 1966 allowed the government-owned banks to guarantee the payment of foreign commercial loans acquired by the private companies. Such payment guarautee was required because the Korean companies relability was too low to secure foreign loans in the 1960s. As government approval was required for every inflow of foreign loans, the government was very selective and utilized the foreign capital as means of financial policy.

2.2.4. Financial policies for export promotion

Beginning in 1961, the government fully implemented the Export Credit Program to boost export volume. The newly established Park Chung Hee government considered exports as the key growth engine and, thereby, executed various institutional policies aimed for the maximization of the exports. For one, the government began to subsidize exports in 1961. As Korea prepared for the joining of the General Agreement of Tariffs and Trade(GATT), however, the government was pressed to abide by the rules of GATT, including the regulation on direct support on the exported goods. The government consequently adopted the indirect approaches like the financial and tax measures. The government's new financial export support policies can be categorized into two types: quantitative and price support. The automatic loan approval system was an especially important form of quantitative support. This system automatically approved bank loans for exports when a letter of credit or any proof of an export order was presented. Such funding for exports was also applied to the raw materials importation for exports as well as production of the export goods. Meanwhile, the focus that was mainly placed on pre-shipment goods at the initial extension of export funding soon included the post-shipment goods. Consequently, the expansion in export funding included goods export through D/P, D/A, consignment basis and Bonded Warehouse Transaction(BWT). On top of the financial support given to export companies, SMEs were provided with other financial support to meet domestic demand and to nurture them into export companies from the mid-1960s. The SMEs that either produced products with great potential to become exports goods or successfully addressed domestic demand, the government supported their conversion into export companies by facilitating the expansion and the renovation.

While other funds like the "Export Promotion Fund" and "Fund to Convert SMEs into Export Companies" were empolyed to financially support the export, the majority came from the aforementioned bank loans on the basis of the Automatic Loan Approval System. Additionally, the export financial support from the banks was backed up by the re-discount system at Bank of Korea. As a matter of fact, the automatic loan approval policy to support exports had its basis on the central bank's money issuing power. The ratio of export finance upon the re-discount from Bank of Korea to that from the deposit money banks exceeded 65% on average from 1966 to mid-1980s, which indicates the substantial role Bank of Korea played in supporting the export finance.

The price support for the export finance adopted lower interest rates than the market rate. The financial support related to export enjoyed dramatically low interest rates of one-digit number, when the normal market rate marked two-digit due to the excessive demand at the time. As

Table 1-3 | Export Financing by Deposit Money Banks

(Unit: %)

	1961~65	1966~72	1973~81	1982~86	1987~91
Export finance from deposit banks / Total loans from deposit banks	4.5	7.6	13.3	10.2	3.1
Re-discount at Bank of Korea/ Export finance from the deposit banks	N.A.	66.3	73.0	64.5	45.3
Interest rate for export finance(A)	9.3	6.1	9.7	10.0	10~11.0
Interest rate for other loans(B)	18.2	23.2	17.3	10~11.5	10~11.5
B-A	8.9	17.1	7.6	0~1.5	0~0.5

Source: Cho and Kim (1995).

Table 1-4 | Various Interest Rates

Year	Inflation(CPI)	One-year Time Deposit	Bank Loan		Curb Market
			Market Average	Export	
1964	-	15.0	16.9	8.0	61.8
1965	-	30.0	26.0	6.5	58.9
1966	11.2	30.0	26.0	6.0	58.7
1967	10.9	30.0	26.0	6.0	56.7
1968	10.8	26.0	25.8	6.0	56.0
1969	12.3	24.0	24.5	6.0	51.4
1970	15.9	22.8	24.0	6.0	50.2
1971	13.5	22.0	23.0	6.0	46.4
1972	11.7	15.0	17.5	6.0	39.0
1973	3.1	12.6	15.5	7.0	33.2
1974	24.3	15.0	15.5	9.0	40.6
1975	25.3	15.0	15.5	9.0	47.9

Source: Cho (1989).

illustrated in Table 1-4, the export finance enjoyed up to 20%p price support in comparison to the typical market interest rates.

2.3. Tax Policy

2.3.1. Underlying Principle

As is often the case in developing countries, Korea also was short of capital and had excess of low-cost labor force. Consequently, the market called for the light industries that can absorb the labor force and create inter-industrial effects. In addition, to overcome the constraint of the small domestic market size, a rapid industrialization was pursued by supporting the export industries to enable the production expansion targeting the worldwide markets. The export-driven industrialization, however, required the building of the social infrastructures, such as the electric power system, public transport, and communications network, as well as the development of other key industries like refinery, fertilizer and machinery. For their large scale and long gestation period, the private sector was not expected to invest in these fields. Hence, the government implemented expansionary fiscal and financial policies to build the required social infrastructure and promote key industries. The most urgent task, naturally, became the mobilization of the financial resources.

In 1961, Korea's domestic savings accounted for only 2.8% at current prices due to the low level of income. Foreign aid at the time was focused on providing the essential consumer goods, and even that was on the declination. As the risk of depending on the foreign aids as the major source of investment increased, the government seeked for a new source of capital: taxation on the domestic savings. To this end, the government reformed the tax system to launch the National Tax Service in 1966. The new tax policy aimed for indirect support by providing enlarged fiscal capacity, rather than the direct supports to the enterprises. Likewise, the underlying principle of the new tax policy was to increase the tax revenue, while simultaneously implementing various tax supportive measures to promote industrial development and investments.

2.3.2. Reforming the Tax System to Increase Tax Revenues

In order to finance the economic development, the tax system was reformed in the end of 1961, which was followed by minor revisions in each year from 1962 to 1965. Given the very low national income, indirect taxes like consumption tax greatly contributed to tax revenues. In 1961, government policy interventions to secure tax revenues included the reorganization of the general tax system, and the high taxation of the luxurious items and the recreational activities as indirect taxes. In 1962, income taxes were based on a more progressive structure by increasing the number of income tax levels from three to four, and by raising the corporate tax rate to meet the fiscal needs. The addition of 24 items including jewelry, and precious metals as taxable commodities expanded the tax base. The introduction of the 'Regulation of Tax Reduction and Exemption Act' in 1965 helped to consolidate government tax regulations on exemptions into a single law, and made it impossible to reduce or exempt taxes unless in accordance to a tax treaty.

However, a series of reforms to the tax system failed to bring the expected increase in tax revenues. Table 1-5 illustrates that the increase rates tax revenues in 1963 and 1964 were less than the economic growth rates. Moreover, the tax burden ratio was maintained at below 10.0 until 1965. The major reasons for the decrease in or low growth rates of tax revenues are as follows. Firstly, the indirect taxes that were mainly in the form of unit tax at the time, so high levels of inflation inevitably decreased tax revenues in real terms. Secondly, the measures that decreased tax were implemental for the political reasons. Lastly, as exchange rates were unrealistically undervalued, the devaluation of the Korean won undervalued imported goods, which led to a decline in revenues from tariffs. The continuing unsatisfactory level of tax revenues eventually brought about the extensive reform of the tax system in 1967.

Against this backdrop, the National Tax Service was found in 1966 and a large-scale restructuring of tax system was carried out in 1967. The general public lost trust in tax administration, which suffered corruption at the hands of tax officials. High rates of tax evasion kept the collection of taxes at an extremely low level. In order to enhance specialty and transparency of tax administration and efficiency of tax collection as much as possible, the National Tax Service was established.

The 1967 tax reform basically sought to support economic development, to increase tax revenues and equity in taxation, to secure a tax base and to rationalize tax administration on

Table 1-5 | Changes in Tax Revenues (1961~71)

	GNP		Total Tax		Tax Burden Ratio
	Billion KRW	Growth Rate(%)	Billion KRW	Growth Rate(%)	
1962	355.50	20.84	37.66	32.47	10.59
1963	502.90	41.46	43.26	14.87	8.60
1964	716.30	42.43	50.68	17.15	7.08
1965	805.70	12.48	69.47	37.08	8.62
1966	1,037.00	28.71	111.09	59.91	10.71
1967	1,281.20	23.55	153.03	37.75	11.94
1968	1,652.90	29.01	229.99	50.29	13.91
1969	2,155.30	30.40	313.66	36.38	14.55
1970	2,776.90	28.84	398.06	26.91	14.33
1971	3,406.90	22.69	492.87	23.82	14.47

businesses. While the reform in 1961 focused on converting national taxes into local ones, the 1967 reform sought to accomplish the following major objectives: 1) promoting the public listing of corporations, 2) increasing savings while suppressing consumption, 3) fostering the strategic industries, 4) facilitating the rationalization of corporate management, 5) curbing speculative investment and stabilizing prices, 6) encouraging investment and developing science and technology, and 7) reforming the rules on depreciation of capital investments.

So as to encourage the public listing of corporations, the unlisted corporations were subject to the higher tax rates of 24~45%, up from the previous 20~35%, depending on their status. The tax rates on interest gains from the private loans increased from 10% to 20%, in order to attract capital into the formal financial sector. To discourage consumption of luxuries goods and to increase savings, the number of items subject to commodity taxes was increased from 46 to 81, and a luxury tax on liquor was levied at higher tax rates of up to five times for luxury goods.

To encourage investment, research facilities were made subject to special depreciation rates and all R&D expenditures were treated as deductible expenses. The shortening of the duration for the fixed assets in industries by 10~30% promoted corporate investment and more equity capital. In addition, incentives for investment were granted by allowing capital investments in machinery bought by small-and-medium-sized companies to be subject to a 30% special depreciation rate.

To increase tax revenues and enhance equity in taxation, taxes on inheritance and gifts were reinforced and a global income tax was introduced. The rates on inheritance and gift taxes were raised from 5~35% to 5%~70%. The newly introduced tax system was characterized by application of progressive tax rates of 15%~55% to total income exceeding 5 million KRW.

The system of elastic tariff rates was introduced to protect domestic industries. An emergency tariff was imposed on specific imported goods that had an important domestic impact on related industries. The taxation of subsidized imported goods offset the tariffs. In promoting import-substitution industries and supporting strategic industries for exports, tariff policies were actively utilized. Primarily, raw materials used for exports were exempted from taxation in advance and other measures were; tariff refunds, substitution, tax exemption, establishment of free export zones and expansion of licensed bonded areas. Differential tariff rates by processing stage formed the backbone of the tariff policy. Protective tariffs with high rates of around 40% were adopted to foster import-substitution industries.

Following the establishment of the National Tax Office, the 1967 tax reform made a great contribution to the increase in tax revenues. The total tax grew by 60%, 38%, and 50% in the three consecutive years since 1966. The tax burden ratio exceeded 10% in 1966 and reached 14.5% in 1971.

2.3.3. Tax Policies to Support Enterprises

A. Tax Support

While the taxation policy trend was maintained in securing the required liquidity to facilitate investment and loans to companies, a system of tax support for corporates was also widely adopted to promote the export-oriented industrialization. In the 1950s, corporations comprised only a small portion of the economy, but the rapid growth achieved in the 1960s led to a sudden increase in the share of the manufacturing industry in the economy. This was accompanied by a sharp rise in tax revenues from corporates. The amount of corporate tax benefits, either reduced or exempted corporate taxes, reached 100 million KRW, accounting for 6.5% of corporate tax revenues in 1961. The percentage continued to increase, representing 23% in 1966. The reduction in corporate taxes continued and reached 12.1 billion KRW in 1971, accounting for approximately 25% of total tax reductions.

Table 1-6 | Trend of Corporate Tax Cuts (1961~71)

(Unit: 100 million KRW, %)

	Corporate Tax (A)	Corporate Tax Cuts (B)	Total Tax Cuts and Exemptions (C)	B/A	B/C
1961	17.07	1.10	N/A	6.44	N/A
1965	56.95	14.12	N/A	24.79	N/A
1966	108.82	25.10	86.47	23.07	29.03
1967	159.48	32.50	116.13	20.38	27.99
1971	566.99	121.69	491.16	21.46	24.78

Source: Korea Development Institute, "40 Years History of Korean Public Finance," 1991.

In the 1960s, the main development policy was to increase exports, so activities to acquire foreign currency were given tax incentives. In the 1960s, these activities benefited from a 50% reduction in corporate taxes. Starting from 1963, Special Depreciation System was introduced to allow special depreciation rate that was 30% higher than the normal rate on the machinery and equipments directly used in earning foreign currency.

In 1965, the 'Tax Reduction and Exemption Act' was enacted to unify fragmented related legal regulations The tax reduction and exemption were strictly executed in accordance to the internal tax laws on income and corporate tax and laws on customs, tonnage dues, local taxes, inflow of foreign capital, and tax treaties. Additionally, tax reductions and exemptions were applicable only on the items stipulated on the 'Tax Reduction and Exemption Act'. The scope of tax exemption expanded to corporate tax, business tax, registration tax, acquisition tax and liquor tax from the original idea that ceutered on property tax on fields with high public interest and income tax. This Act, in effect, was adopted as the economy supportive policy tool.

The ‘Tax Reduction and Exemption Act’ introduced in 1965 was amended in 1967 to support the steel and petrochemical industries as well as local industries. The steel manufacturers with certain facilities were entitled to full exemption from the business tax and 50% deduction on the income tax or the corporate tax. Firms that moved into local industrial complexes received a full deduction on the income or the corporate tax for five years, and further 50% reduction in the subsequent three years.

The lower corporate tax rate in 1971, achieved by easing the tax burden for firms, was expected to increase the internal savings, and thus, to stimulate investment and growth. Besides the lower tax rates, the application of ‘deductions on investment’ was extended further. Under the previous deductible system, an allowance of 6% of investments in equipment and facilities were deductible from corporate income tax. The subject to the tax deduction program was expanded to include the facility investment for the pollution prevention and the industrial relocation from large cities to local provinces. In addition, the application of accelerated depreciation rate was expanded to help companies recover invested capital more promptly, along with support for replenishing the capital base. In other words, newly acquired equipment and facilities with new technologies could be subject to a special depreciation rate. Also, the equipment and facilities used in the mining industry were subject to special depreciation. The application of special depreciation that had targeted only the equipment operated for more than an annual average of 16 hours per month was allowed for a minimum of 12 hours.

In order to stimulate internal savings and investment by companies, the liability reserves aimed at facility expansion were exempted from paper dividend tax within 50% of retained earnings. Furthermore, the corporate capital replenishment was expected from the shortened asset re-evaluation period, from five to two years, and the extended term of the carried deficit, from two to three years.

To help companies expand overseas and to prevent double taxation, the taxes paid abroad became deductible from the domestic taxes. With the goal of reducing production costs and enhancing the international competitiveness of the large corporates, the industrial mergers recommended by the government were exempted from the registration tax for the company acquisition. The merged corporation was exempted from taxes on income from liquidation of assets, while shareholders were exempted from taxes on dividends paid by the acquiring corporation.

B. Differential Taxation on Corporate Tax to Stimulate Initial Public Offerings (IPO)

In order to promote healthy growth of the companies and to maximize domestic financial resources, the government actively implemented measures to induce companies to go public. When the tax system was reformed in 1967 and 1968, the listed companies were taxed at a lower rate to promote IPOs. The Korean stock market at the time did not have a well-functioning primary issuance market while speculation was rampant in the secondary market. In short, the Korean stock market was an insufficient instrument to finance investments. Consequently, Korea's economic development relied heavily on the foreign capital and the tax revenues to finance the economic measures. One of the fundamental reasons for inefficient development of the stock market was that the shares of listed companies were in the hands of a small group of investors, not fully utilizing its normal distribution structure. Therefore, the government embarked on revising the corporate income tax law to nurture the stock market.

At the time, most enterprises were closed, private corporations exclusively owned by families. These companies preferred to retain corporate profits as internal reserves rather than to distribute them as dividends in order to evade personal income tax. A three stage progressive tax rate (25%, 35% and 45%) was applies to private companies while public companies were subject to differential taxes at lower rates of 15% and 20%. The listed companies with incomes over 5 million KRW were subject to a tax rate of 27.5% as opposed to a tax rate of 49.5% applied to the private companies. Furthermore, the dividend payouts of private companies were subject to a tax of 25% in contrast to 5% rate levied on the public companies. In case of private companies, the retained earnings were subject to a 5% taxation.

These different tax rates applied on the listed and private enterprise, however, were analyzed to have had incited a 'fake' listing of the companies. The number of listed companies grew from 34 in 1968 to 50 in 1971. Likewise, as these efforts were considered not to have helped the development of Korea's capital market, the 'Public Corporation Inducement Law' was enacted to progressively induce listing of the compaines: Listing order made to the target companies.

3. Promoting Heavy & Chemical Industries

3.1. Background

As the first two "Five-year Economic Development Plans" of the 1960s brought success, the export of the light industry goods increased dramatically, and consequently, Korea achieved a high level of economic growth. However, there were several inherent problems in the economic development program mainly relying on light industries. To begin with, the difficulties of securing intermediate goods like raw materials were exacerbated. Since the structure of light industry comprises of a low-wage and labor-intensive production mechanism, a stable growth geared by technology developments was a difficult goal to achieve. A development of industry that will create enough job to absorb excessive labor force and produce high value-added, technology-intensive goods was required to foster further economic growth. Additionally, Korea seeked for an industry that could provide for self-funding mechanism. In this light, the “Third Economic Development Plan” sought to promote the heavy and chemical industries (HCIs), as the basis for a stable and long-run economic growth. Yet the business environments in home country and abroad were not favorable at the time. The world economy suffered from a long recession caused by the first Oil Shock: a period of stagflation. The economic slowdown in the advanced nations negatively affected the export-driven Korean economy. The new international monetary system based on flexible exchange rates resulted in extremely unstable exchange rates among major countries. Consequently, due to the drastic reduction in international trade and capital flow worldwide, Korea had difficulty in securing the fund.

Domestically, in the aftermath of excessive development policies in the 1960s, numerous side effects emerged in the Korean economy: a weak corporate financial structure, the vicious cycle of high inflation, a high exchange rate, the widening income gap between urban and rural areas, and the real estate speculation. The issue of national security was re-raised as the communists occupied Vietnam and frequent provocations continued from North Korea. Indeed, national security considerations played a role in promoting HCIs. So, the primary national agenda to improve these conditions included rural development, higher degree of industrialization centered on HCIs, export growth, price stability, self-funding, and self-reliant national defense. Tax, fiscal, and monetary policies during this period focused on dealing with these tasks Korea was up against. Fiscal policies wer focused on supporting promotion of HCI, rural development, and strengthening national security. The system of tax reductions for exports and industrial support was completely overhauled, along with the reorganization of the tax system including the introduction of general income tax and value-added tax. The objectives of these reforms were to secure financial resources for investment and to modernize tax system. To tackle the worsening financial structure of companies caused by the aggressive investments and the lack of development in the financial system, the government aggressively implemented interventions in the market. Faced with mounting difficulties at home and abroad, the government had to overcome numerous obstacles to achieve industrialization centered on HCI, as companies were weighed down by enormous debt. So the government took powerful intervention measures to improve the corporate financial structure. Meanwhile, the government was active in overhauling the financial system so that the capital necessary for investing in the promotion of HCIs could be financed internally by channeling domestic savings into the financial market.

3.2. Financial Policies for Promotion of Heavy & Chemical Industries

3.2.1. Economic Emergency Decree on August 3rd

As Korea's growth rate increased greatly owing to the aggressive export promotion policies of the 1960s, the corporate sector expanded investments considerably. The investment was mainly funded by bank loans and foreign loans, resulting in a rapid increase in the debt ratio. It goes without saying that the government guarantee was instrumental in obtaining international commercial loans. International commercial loans had multiplied since the mid-1960s. Korea began to repay the loans in 1970. The frequent devaluation of KRW to promote exports placed a heavier burden for the repayment on Korean enterprises. Moreover, the international economic recession of the early 1970s put many enterprises in financial difficulties and the others into the bankruptcy. Chronic excess demand for funds had already made financing through the curb market rampant. So the worsening financial situation caused a vicious cycle of making enterprises more dependent on the curb market. The extremely high annual interest rate of over 40% on curb loans undermined the financial soundness of the companies, making it difficult for companies to engage in the normal business activities.

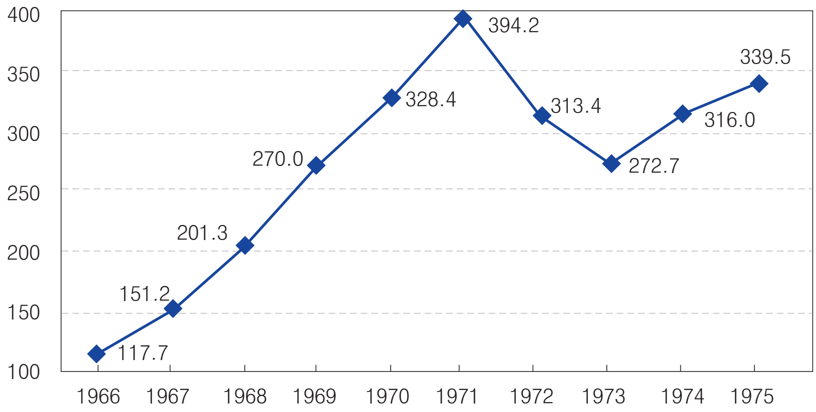
To overcome the economic crisis by improving the financial soundness of enterprises, the government announced the '8 · 3 Economic Emergency Decree' in 1972.[2] It was an extraordinary measure. This decree required every curb loan to be registered, and spitulated a fixed interest rate at 16.2%. The repayment terms of these registered curb loans were also changed: installments to be over five years with three years of grace period, and the payment to be made evenly every six months. Furthermore, short-term bank loans were changed into long-term loans with more favorable terms and conditions, namely lower interest rates. Credit guarantees were expanded for small-and-medium-sized businesses. Combined with these measures, interest rates of financial institutions were lowered by decreasing interest rates on time deposits to 12.6% from 17.4% and on general lending to 15.5% from 19.0% annually.

After the implementation of the decree was implemented, a total of 345.6 billion KRW of curb loans was reported, which was as much as 90% of the money supply(M1) at the time. This radical measure suceeded despite of its anti-market principle characteristics to record a high real GDP growth rate of 14.8% a low producer inflation rate of 6.9% and 3.2% consumer inflation rate in the following year. The level of debt in the Korean manufacturing sector had also declined significantly from 313.4% in 1972 to 272.7% in 1973. However, these effects short-lived due to the oil shock and, instead, led to moral hazard among the enterprises and the financial institutions in long-term.

2. Formal name of this decree is "Emergency Decree Concerning Economic Stability and Growth."

Figure 1-1 | Debt Ratio in the Manufacturing Sector

(Unit : %)



Source: Bank of Korea.

3.2.2. Reorganization of the Financial Market

With the 8·3 Economic Emergency Decree, the government implemented various institutional reforms to transform the financial market towards a regulated one. At first, it allowed the establishment of non-bank financial institutions such as investment and financial companies, mutual savings companies, merchant banking corporations, credit unions, and mutual credits. The government gave more freedom to these non-bank financial institutions by allowing them to provide higher interest rates on loans than the banks. The government intended the growth of these non-bank financial institutions in a formal financial market to absorb the capital demand in the curb loan market.

The 'Public Corporation Inducement Act' was legislated in December 1972 to facilitate corporate financing through the stock market and to discourage debt financing. Under this Act, the government may recommend the companies that receive public financial support beyond certain amount to list. In the case of rejection, the company could face financial disadvantages. Since then, the government has consistently sought to improve Korea's capital markets, as shown by the establishment of the Securities Supervisory Agency and the Securities and Exchange Commission in 1977.

3.2.3. National Investment Fund: NIF

Despite of the short-lived effects of the measure, the emergency decree helped to overcome the economic crisis and to reform the financial market. This allowed the government to pursue a new growth policy of promoting the heavy and chemical industries (HCIs). In the Third and the Fourth Five-year Economic Development Plans, the promotion of the HCIs was proposed as an important goal. The policies to promote the HCIs were first implemented in 1973.

Yet, Korea at the time was in financial difficulties. The capital market was underdeveloped and could not adequately facilitate long term financing for companies. On top of that, capital investments in HCIs have a long gestation period with high risk. For these reasons, domestic savings preferred the light industry or consumer goods industry where both demand elasticity and marginal productivity are high. Hence, the mobilization of an adequate fund to develop the HICs emerged as the major issue. In December 1973, the government enacted the 'National Investment Fund Act,' and mobilized both public and private funds worth of 68.9 billion KRW to launch the "National Investment Fund(NIF)."

The NIF was basically funded by issuing NIF bonds and using the government funds. Most of the funds came from financial institutions under government control, which purchased NIF bonds or funded the NIF directly. Banks were forced to invest domestic savings in HCIs by mandatorating either the purchase of NIF bonds or the institutional financing within the boundary of 20% of the deposit increase. In essence, this system mobilized private funds in the form of public funds to finance the development of the HICs. The NIF was managed in the format of BOK (the managing institutution) lending the fund to other financial institutions. Due to the long gestation period of HCI investments, long-term loans of up to 10 years with interest rates lower than the general loans were designed. In 1974, soon after the launch of the NIF, the interest rate on NIF loans was 6.5%p lower than the bank loans, but this difference was reduced gradually. The NIF funds accounted for 22% of total financial loans made to HCIs development. This figure surpassed 60% soon after, and was maintained until the early 1980s. The NIF played a crucial role in making investments in HCIs.

Table 1-7 | Changes in the Interest Rates of NIF Loan

(Unit : %)

	Jan. 1974	Feb. 1977	Jun. 1978	Jan. 1980	Jun. 1982	Dec. 1988
NIF1)	9.0	14.0	16.0	22.0	10.0	10.0 ~ 11.5
Bank Loan2)	15.5	18.5	21.0	26.0	10.0	10.0 ~ 12.0
Difference	6.5	4.5	5.0	4.0	0.0	0.0 ~ 0.5

Note: 1) Interest rate of loan for HCIs over three years.
2) Interest rate of loan for general enterprises over three years.
Source: Overview of National Investment Fund (1989).

Table 1-8 | Share of NIF Loans to HCIs

(Unit: 100 million KRW, %)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
NIF (A)	331	828	1,797	3,019	5,299	7,820	9,583	11,582	14,304	16,693	17,052	17,717
Entire Financial Institutions (B)	1,473	2,132	3,362	5,084	7,880	11,695	14,640	17,818	21,323	23,442	25,419	31,820
A / B	22.5	33.8	53.5	59.4	67.2	66.9	65.5	65.0	67.1	71.2	67.1	55.7

Source: Bank of Korea, "Overview of National Investment Fund," 1989.

3.2.4. Concentration of Loans on HCIs

In the beginning of 1970s when the investment was aggressively made in HCIs, the Korean economy suffered from rapid inflation from the Oil Shock. Thus, the government had to suppress aggregate demand to pursue a stable growth. Since the early 1974, the government sought to curb bank loans to businesses not considered a policy priority so as to channel funds to sectors considered more productive. To this end, the government established and implemented a set of rules financial institutions had to follow in providing selective loans. Under the rules, the HCIs were designated as a priority for support. Thus, financial resources were focused on this sector. This led to a rapid growth of loans from deposit taking banks. In 1974, the growth rate of bank loans to the overall manufacturing sector was higher than to HCIs. However, bank loans to HCIs grew faster than those to the manufacturing industry as a whole beginning in 1975. This trend persisted for quite a long time. Additionally, the share of loans from deposit taking banks to HCIs accounted for a greater portion. In 1975, the share of loans to HCIs passed 40% for the first time. It was maintained around 50% towards the end of the 1970s. HCIs began to account for more than 20% of total loans made by deposit taking banks in 1975. This figure has been maintained at around 25% ever since.

Table 1-9 | Breakdown of Bank Loans by Industry

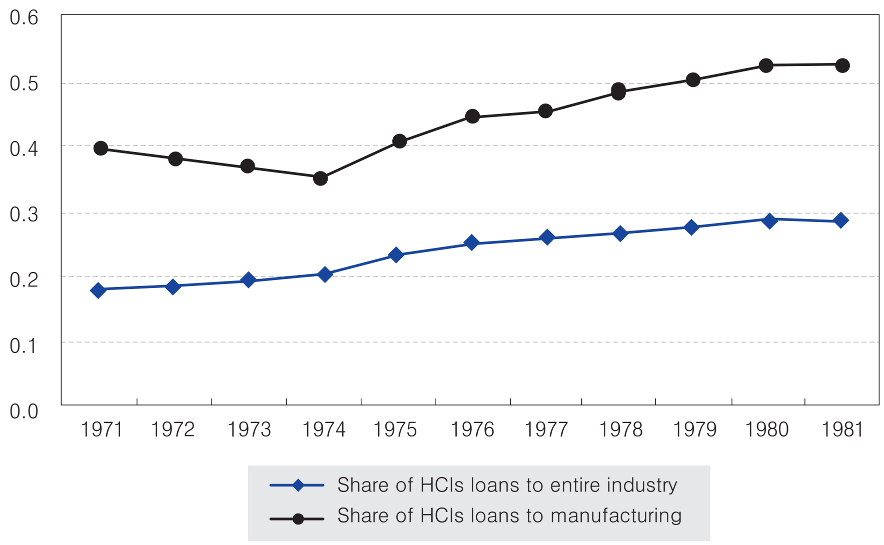
(Unit: %)

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Entire industry	27.3	30.3	32.5	52.9	19.7	28.2	26.4	40.3	35.8	35.9
Manufacturing	32.1	37.7	44.0	65.1	18.4	28.5	27.1	34.3	35.4	35.3
HCIs[1)]	15.3	34.0	37.9	58.8	37.6	39.1	30.9	43.2	41.1	39.5

Note: 1) HCIs include the following industries: chemical, petroleum, coal, rubber, plastic, nonmetallic mineral, metal, and machinery & equipment.

Source: Bank of Korea's Economic Statistics Year Book.

Figure 1-2 | Share of Loans to HCIs



Source: Bank of Korea's Economic Statistics Year Book.

Meanwhile, the strong system of targeted financial support also applied to policy loans provided by Bank of Korea, Korea Development Bank(KDB), and other banks, reinforcing the policy loans to HCIs. Firstly, the total volume of policy loans considerably increased. Since the beginning of 1970, policy loans increased while total loans from financial institutions grew slower than in the 1960s. From 1963 to 1969, total loans rose at an annual average increase of 41.5% while policy loans grew at 33.6%. But from 1970 to 1979, the average annual growth rate for policy loans was 40.2% and 34.3% for total loans. The increase in policy loans were focused on the HCIs. The pattern of loans provided by KDB based on industry type clearly showed that policy loans were concentrated in the HCIs during the 1970s. From 1972 to 1979, the amount of loans to the HCIs provided by KDB grew at an annual average rate of 41.5%. However, the loan growth rate was only 12.5% between 1980 and 1989. In the 1970s, the amount of loans provided to HCIs accounted for as much as half of the total loans provided by KDB.

To support the promotion of the HCIs, institutional arrangements were reorganized. In 1976, the government established the Export-Import Bank to support the HCIs' export promotion based on mid-to-long-term deferred payment of exports. As demand for mid-and-long-term funds increased, Korea Development Finance Corporation, found in 1967, was reorganized into Korea Long-Term Credit Bank in June, 1980.

Table 1-10 | Growth of Policy Loans

(Unit: 100 million KRW, %)

	1963~69 Average	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1970~79 Average
Policy Loans	33.6	48.5	45.6	22.4	41.6	40.1	33.9	31.6	40.2	58.6	39.4	40.2
Total Loans	41.5	35.5	30.6	25.9	32.3	47.9	27.0	26.2	30.3	46.9	40.2	34.3

Source: Kim (1986).

Table 1-11 | KDB Loans by Industry

(Unit: one million KRW)

	1962~71 Average Growth Rate	1972	1974	1976	1978	1979	1972~79 Average Growth Rate	1980~89 Average Growth Rate
Mining Industry	19.8	12,416	9,767	5,072	13,045	22,440	8.8	3.3
Manufacturing Industry	26.5	25,958	54,975	124,759	263,138	535,751	39.2	12.5
(Light Industry)	(17)	(12,349)	(10,883)	(11,639)	(21,598)	(73,751)	(29.1)	(12.8)
(HCIs)	(32.2)	(40,609)	(44,092)	(113,120)	(241,540)	(462,000)	(41.5)	(12.5)
Electricity & Water Service	31.2	69,062	31,573	52,582	148,458	174,890	14.2	3.2
Construction	11.9	1,582	11,345	7,197	25,510	27,251	50.2	17.2
Transportation & Communication	36.1	6,407	18,846	29,547	84,880	142,024	55.7	8.0
Others	24.0	3,052	9,310	8,675	40,930	24,532	34.7	32.5
Total	21.7	145,477	135,816	227,832	575,961	926,888	30.3	11.9

Source: Korea Development Bank, "40-year History of the Korea Development Bank," 1994.

Table 1-12 | Percentage of Capital at KDB by Industry

(Unit: %)

	1972	1974	1976	1978	1979
Mining Industry	8.53	7.19	2.23	2.26	2.42
Manufacturing Industry	17.84	40.48	54.76	45.69	57.80
(Light Industry)	(8.49)	(8.01)	(5.11)	(3.75)	(7.96)
(HCIs)	(27.91)	(32.46)	(49.65)	(41.94)	(49.84)
Electricity & Water Service	47.47	23.25	23.08	25.78	18.87
Construction	1.09	8.35	3.16	4.43	2.94
Transportation & Communication	4.40	13.88	12.97	14.74	15.32
Others	2.10	6.85	3.81	7.11	2.65
Total	100	100	100	100	100

Source: Korea Development Bank, "40-year History of the Korea Development Bank," 1994.

3.3. Tax Policy

3.3.1. Underlying Principle

The policy efforts to increase tax revenues in the 1960s were crucial in funding the economic development plans. The tax reforms of 1971 served as a starting point for lower taxes in order to accumulate capital in the private sector and to support exports. The expansion of the tax revenue base thanks to the rapid economic growth achieved in the late 1960s, and the successful reforms in the tax system and administration led to a significant increase in tax revenues. This, in turn, led to greater government savings and considerably enhanced fiscal autonomy.[3]

Naturally, the increase in tax revenues resulting from Korea's high growth was used to support capital accumulation by expanding reductions and exemption almost every year. As such, tax cuts were focused on corporate and income tax. There were frequent increases in the amount of exemptions for income tax. Moreover, income tax rates were also increasingly raised. Corporate taxes were given several reductions in tax rates. Tax cuts previously applied to corporate and income taxes were extended to other types of taxes several times. To offset the decline in tax revenues, consumption-based taxes were reinforced. Korea's system of indirect taxes can be traced back to the 1970s.

The tax policy of the 1970s can be characterized as the income tax system being changed to meet international standards and indirect taxes being changed to value-added tax. In addition, the basic direction of tax policy during this period was lower corporate tax rates to ease the tax burden and stimulate investment. As a result, a tax system was created in the 1970s that was mainly centered on indirect taxes in contrast to the reorganization of direct taxes to spur capital accumulation.

3.3.2. Policy of Tax Reduction & Exemption for Fostering Heavy and Chemical Industry

In the 1970s, less support was given to exporting industries while various tax incentives were introduced to promote the industrialization of the HCIs. In 1973, the 50% cut in corporate taxes for projects that earned foreign currency was replaced with indirect support measures such

3. The fiscal self-reliance is estimated as the share of financial resources raised domestically to the total revenues of the general government. It was greatly improved from 65.8% in 1965 to 95.2% in 1971. As the growth rate of tax revenues surpassed that of expenditure, the balance of public finance turned positive from 1964 and government savings increased. It stood at 3.3 billion KRW in 1964 and rose to 178.3 billion KRW in 1971.

as allowances for entering overseas markets or losses from exports. As a result, there was a severe reduction in support for export industries. Instead, stronger tax incentives were introduced to encourage investment in HCIs like shipbuilding, machinery, basic metals and petrochemical industries.

The reform of the tax system in 1974 consolidated the incentive measures for promoting investment in major industries. Previously, the measures were implemented under various corporate tax codes and presidential emergency orders through the 'Regulation of Tax Reduction and Exemption Act.' Companies that were in sectors designated as major industries were given the alternative of being subject to tax benefits for a specific period, investment tax credits, or special depreciation.

A full exemption from corporate taxes was allowed for three years and a tax rate of 50% for the next two years. Investment tax credits were limited to facility investments in machinery where a tax credit of 8% (10% for domestically produced machinery) was provided. A special measure accelerated the depreciation rate on capital investments by a 100% increase in the depreciation amount calculated according to the qualitative legal period of duration. This had the effects of shortening the depreciation period with the advantage of postponing the payment of taxes. These tax benefits were given to almost all HCIs including the petrochemical, shipbuilding, steel, refining, electricity generating and chemical fertilizer industries. Later on, the defense industry was included in 1976 and the aviation industry in 1978. Since 1972, a special depreciation of 40~80% was permitted to other lines of industries under the presidential emergency orders and the corporate tax law.

From 1972, corporate income tax rates also fell as the tax policy direction changed. For private corporations, tax rates were lowered by 5% for each income bracket. By contrast, tax rates for public corporations were raised slightly, narrowing the gap in tax rates between public and private corporations.

The increase in the corporate tax cuts led to increased corporate tax revenue reduction from approximately 12.2 billion KRW in 1971 and surged to 14.6 billion KRW in 1974. This increasing trend continued, growing to 20.7 billion KRW in 1975, 115.5 billion KRW in 1977, and eventually 229.0 billion KRW in 1979. The share of corporate tax cuts from corporate tax revenues declined in 1974 and 1975, but grew to 35% in 1976 and 46% in 1979.

Table 1-13 | Trend of Corporate Tax Cuts (1961~71)

(Unit: 100 million KRW, %)

	Corporate Tax (A)	Corporate Tax Cuts (B)	Net of Tax Reductions and Exemptions (C)	B/A	B/C
1971	566.99	121.69	491.16	21.46	24.78
1974	1,102.90	146.05	1,550.07	13.24	9.42
1975	1,304.80	207.68	2,409.17	15.92	8.62
1976	1,711.72	602.07	3,938.35	35.17	15.29
1977	2,349.80	1,155.63	9,523.85	49.18	12.13
1978	3,587.20	749.71	2,121.64	20.90	35.34
1979	4,932.10	2,290.11	4,148.58	46.43	55.20

Source: Korea Development Institute, "40-years History of Korean Public Finance," 1991.

3.3.3. Tariff Support Measures to Promote HCIs

One of the main obstacles to promoting the HCIs was the tariff burden on the capital goods imported from abroad. Indeed, importing foreign capital goods on a large scale to invest in the HCIs was inevitable. The burden of high tariffs hindered investment. Therefore, the government supported industrial facility investments by lowering tariffs. But lower tariffs on foreign capital goods could be a double-edged sword by exposing domestically produced goods to foreign competition. So, the government sought to set tariff rates on investment goods at an appropriate level so that domestically produced products could be protected from competition with foreign goods while not discouraging new investors from making investments.

Instead of indiscriminately reducing tariffs as was done so previously, the Ministry of Finance selectively reduced tariffs by industry and by goods, to prevent reckless investment in facilities and to expand investment in major strategic sectors. For instance, the nominal tariff rates for the mining industry were reduced from 8.9% to -30.9%, which meant it was virtually providing a subsidy. The HCIs was subject to a lower nominal tariff rate of 1.9%, compared to the previous rate of 15.9%. Meanwhile, tariff rates for the agricultural sector were increased from 17% to 47.1% in an effort to protect domestic agriculture. Differential tariff rates were applied based on the type of goods. The policies provided greater protection for industries producing finished products, by setting higher tariff rates on these goods compared to semi-manufactured goods whose tariff rates were also higher than raw materials. The lower tariff policies to promote the HCIs have been criticized for their role in bringing about excessive, overlapping investment in the HCIs and further distorting the allocation of resources among industries and goods.

3.3.4. Strengthening Consumption Taxes

It took about six years of preparation to introduce the value-added tax (VAT) in 1977. Before its introduction, a special excise tax accounted for the largest part of indirect taxes in Korea. In 1976, before the introduction of VAT, the business tax, which was a general excise tax, took up 34% of total revenues from consumption tax. Moreover, special excise taxes such as the commodity tax, petroleum tax, and textiles tax accounted for 66%. The commodity tax, which accounted for the biggest share in the special excise tax, was levied not only on the luxuries but also on items consumed by the general public like sugar. Even though it was difficult to distinguish between personal and corporate consumption, plate glass and plywood were also subject to taxes. In addition, intermediate goods like chemicals and plastic were taxed, posing considerable problems from the point of view of taxation equity or industrial policy. Moreover, tax rates were increased to as high as 200%. As can be seen, too many items were subject to tax, leaving little room for higher tax rates, which hindered efforts to raise tax revenues. In particular, certain taxes on individual items created distortions in personal consumption and resource allocation.

The government introduced the VATs with the aim of efficiently securing financial resources necessary to fund economic development increasing tax revenues along by modernizing the consumption tax. The VAT Refund System allowed the government to support exporting industries. Investment was stimulated as VAT had its basis on consumption, which lowers the relative price of investment goods rather than the goods for consumption. Also, VAT contributed to improving tax administration since receipts were needed to be produced for tax accounting as specified by the invoice method.

The VAT basically had a single rate of 13% and its applied rate was 10%. It was possible for

Table 1-14 | Changes in Tax Revenues (1972~79)

	GNP		Total Tax		Tax Burden Ratio (%)
	Billion KRW	Growth Rate (%)	Billion KRW	Growth Rate (%)	
1972	4,177.5	22.6	523.0	6.1	12.5
1973	5,355.5	28.2	652.6	24.8	12.2
1974	7,564.5	41.2	1,021.7	56.5	13.5
1975	10,064.6	33.1	1,549.8	51.7	15.4
1976	13,818.2	37.3	2,313.3	49.3	16.7
1977	17,728.6	28.3	2,959.3	27.9	16.7
1978	23,936.8	35.0	4,095.5	38.4	17.1
1979	30,741.1	28.4	5,360.9	30.9	17.4

Source: Korea Development Institute, "40-years History of Korean Public Finance," 1991.

the government to apply the rate with flexibility within ±3% of the basic rate without the approval of the National Assembly. This allowed the government to swiftly cope with business fluctuations.

Despite of the lower tax rates due to larger tax exemptions and special tax treatment measures, tax revenues increased faster than economic growth rates. This rapid increase in tax revenues could be attributed to the expansion of the tax base driven by rapid economic growth and a series of tax reforms that introduced consumption tax. The sharp increase in tax revenues in turn affected the tax burden ratio, which was more than 17% in 1978.

4. Promoting Small & Medium-sized Enterprises

4.1. Background

Entering the late 1970s, over-investment in the HCIs led to an increase in the number of insolvent enterprises. In addition, chronic inflation persisted since monetary expansion was utilized as a means to finance investment. As of 1980, the machine and metal industries operated at 53% of their full capacity, indicating resource inefficiencies caused by over-investment. As a result, the annual inflation rate (based on the consumer prices) reached 28.7%. The growing perception that the economy became very inefficient under the government's prolonged intervention initiated a change in policy direction. Thus, policy priority shifted to stability from growth during the 1980s.

From the 1980s, the aggressive policies to foster enterprises were gradually pulled back. Instead, policy efforts aimed at obtaining and allocating resources were more market-based. As part of the stabilization policy, the government imposed financial and fiscal austerity measures, reduced export support, and sought to reduce or redirect investment in the HCIs. In particular, the main policy concern was restructuring insolvent companies in HCIs due to over-investment rather than promoting enterprises. So, the government induced mergers and reorganizations to adjust investments in the HCIs. To activate market functions, market-based measures were pursued including the privatization of commercial banks from 1980 to 1983, as well as the reduction of financial support by setting the policy rate at an artificially low level. Despite of the attempt to make the financial sector more autonomous, corporate restructuring through banks was still led by the government, so instituting an autonomous financial sector had a long way to go.

The government enacted the 'Fair Trade Act' to create an economic environment conducive to competition and imposed stricter regulations on large enterprises. In addition, the regulation of credit sought to ease the concentration of available money to large enterprises. On the other hand, the policy focus on achieving a balanced growth translated into stronger support for smaller companies. To put it in a nutshell, the government-led policies to promote enterprises underwent a change. It went from supporting large companies, which played a pivotal role in promoting economic growth, to the protection and fostering of smaller companies. Therefore, it is not too much to say that the government's policy to promote businesses after the 1980s targeted only SMEs in fact. The preferred export funding offered by the government also excluded large enterprises (1988), suggesting that the SMEs were the only beneficiaries of the government's export finance program.

There had been numerous attempts to foster and protect SMEs through policies, but they did not lead to the kind of success seen in the policies implemented to foster exporters or heavy and chemical industries. Such lack of tangible resulted generated demand for another policy change, complicating the situation related to SME support. It has been reported that there are more than 700 laws that govern SMEs directly or indirectly (Cho, 2008). This suggests that the SME support system encompasses a broad array of financial, tax, geographical, and human resource related measures. Given that it would be very challenging to fully explain the SME support system, this chapter aims to introduce the basics and essentials of the system from the standpoint of finance and tax.

4.2. Financial Policies for Small-and-Medium-sized Enterprises

4.2.1. SMEs-oriented Financial Support

Entering the 1980s, there was a change in the government's policy focus from growth to stability. Accordingly, a tight fiscal policy was implemented across the whole economy. In pursuing the aggregate demand management policy, the money supply and fiscal spending was restrained to stabilize prices. In an attempt to liberalize interest rates and currency exchange, there was a significant reduction in support for various policy loans including export financing and the conversion of the exchange rate into a floating exchange rate system. In the process, financial support for SMEs was maintained or expanded even in the 1980s while preferential financial support for enterprises introduced in the 1960s and 1970s was reduced or abolished. From the mid 1980s, a different loan unit price per dollar was applied to large enterprises and SMEs when trade financing was offered, increasing financial support for SMEs relatively. In 1988, loans for trade financing to large enterprises was repealed. Moreover, central bank support through rediscounting continued to expand starting from 1983 in order to induce deposit money banks to provide financial support to SMEs. Deposit money banks were given rediscount support from the Bank of Korea (BOK) at a lower rate, when the banks provided loans to SMEs that used the loans to fund R&D, pollution control, restructuring, and operation of material and parts enterprises. Also, loans used to purchase products of SMEs (consumer credit) could also receive the BOK's rediscount support. On the contrary, the benefits of rediscounting on loans made to large enterprises gradually decreased, before the program was eventually eliminated in 1989.

Table 1-15 | Change in Average Loan Unit Price of Trade Financing

(Unit: won per dollar)

	1985. 7	1986. 7	1987. 2	1987. 6	1987. 10	1987. 12	1988. 2	1989. 10	1989. 12
SMEs (A)	740	720	680	630	580	520	450	500	550
Large Enterprise (B)	740	720	645	475	275	175	-	-	-
A-B	0	0	35	155	305	345	450	500	550

Source: Bank of Korea, "60-years History of Bank of Korea, " 2010.

4.2.2. Portfolio Requirement for SMEs Loans

Policies governing SMEs were legally specified by the enactment of the '1966 Framework Act on Small and Medium Enterprises.' Since then, this Act has served as the statutory basis for basic SMEs policies. Despite changes in the SMEs laws from the 1960s, support for SMEs took a backseat to other industrial policies. With the policy shift to balanced development at the turn of the 1980s, policy priority was given to promoting SMEs. Also, amendments to the constitution in 1980 included a new provision that the nation had an obligation to protect and nurture SMEs, a constitutional duty to protect and nurture SMEs.[4]

Introduced in April, 1965, the Portfolio Requirement for SMEs Loans was the main policy tool for supporting SMEs. The Bank of Korea's "Credit Management of Financial Institution" required that a certain percentage of loans be provided to SMEs. When first introduced, the mandatory percentage was uniformly set at 30% for every bank. In 1976, the same 30% was applied to commercial banks while regional banks were subject to a higher percentage of 40%. Entering 1980, the loan requirement ratio was increased to 35% for commercial banks and 55% for regional banks on the back of stronger policies to support SMEs. After several changes, the ratio has been maintained at 45% for commercial banks, 60% for regional banks, and 35% for foreign bank branches.

4. A provision on SMEs was first stipulated in the Constitution during the 1962 amendment. At that time, the clause said, "The nation should grow self-help cooperatives of SME presidents, and guarantee its political neutrality." This does not imply that the government should support SMEs but that problems in SMEs should be solved by cooperation of themselves (Cho, 2008).

This mandatory loan ratio is related to the Aggregate Credit Ceiling System introduced in March, 1994. The system enabled banks to borrow from the Bank of Korea at low interest rates within their individual aggregate credit limits. Credit limits for each bank is determined based on several factors, one of which is the track record of loans to SMEs. When banks failed to meet the required ratio, the Bank of Korea imposed a lower aggregate credit limit on non-compliant banks. When banks lent more than the required ratio, their credit limits were raised. Driven by political support for SMEs, the share of loans to SMEs relative to total loans provided by commercial banks increasingly grew, recording 37.7% in 1979 and over 50% in the 1990s.

Table 1-16 | Portfolio Requirement for Loans to SMEs

(Unit: %)

Category	1965. 4	1976. 12	1980. 1	1985. 3	1986. 4	1986. 8	1992. 2	1994. 5	1997. 7
Commercial Banks	30	30	35	35	35	35	45	45	45
Regional Banks	30	40	55	55	80	80	80	70	60
Foreign Bank Branches	-	-	-	25	25	35(25[1])	35(25)	35(25)	35(25)

Note: 1) In the case of not receiving the loan under the Aggregate Credit Ceiling System.
Source: Bank of Korea Homepage.

Table 1-17 | Share of SMEs Loans in Total Credit Extended by Commercial Bank(1979~95)

(Unit: 100 million KRW)

	1979	1985	1988	1989	1990	1991	1992	1993	1994	1995.6
Total Loans	71.7	257.9	356.2	462	540.2	649	74.5	834.1	992.9	1,054.4
Loans to SMEs	27	111	171.3	231.3	300.0	368.5	419.7	494.2	583.4	632.2
SME Share (%)	37.7	43.1	48.1	50.1	55.5	56.3	56.3	59.3	58.8	60.0

Source: Federation of SMEs Cooperation Annual Report on Regional Economy, "Annual Report on SMEs"; Nugent and Yhee (2001).

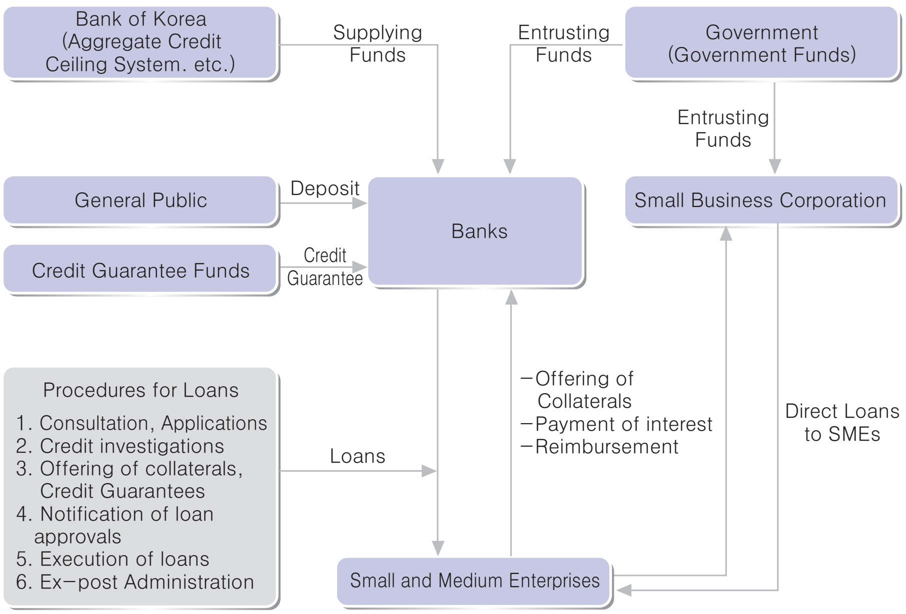
4.2.3. Structure of Financial Support for SMEs

Financial support for SMEs consisted of various policy loans, credit guarantees, and measures implemented by the Bank of Korea. The best example of the third type is the Portfolio Requirement for SMEs Loans. The primary source of policy loans to SMEs are various public funds including government funds. These policy loans are given to SMEs through governmental agencies and various financial institutions. The Small and Medium Business Corporation (SMBC) was established under the 'Small and Medium Business Promotion Act' enacted in 1978, and became the main governmental agency for supporting SMEs. It was given to the role of managing and operating the Small and Medium Business Promotion Fund.

The government and municipalities control policy loans under a separate system for the allocation and management of loans. Among organizations under the umbrella of the government departments, the consigned ones supply policy loans through direct lending or on-lending. The most representative organizations include the Small and Medium Business Corporation(SBC), Small and Medium Business Bank, and Central Committee of SMEs. The SBC is responsible of two independent tasks: the core business to both promote SMEs and manage the guidance, and the assisting role for the policy loans including the SMEs Administration, issue of SMEs bonds, and direct lending.

Credit guarantees are a key tool of supporting SMEs. About 20% of lending to SMEs in Korea is based on credit guarantee. The credit guarantee institutions include the Korea Credit Guarantee Fund, Korea Technology Finance Corporation and Regional Credit Guarantee Foundations. The Korea Credit Guarantee Fund was established in 1976 to provide guarantees for SMEs with potential to grow but suffer from lack of collateral. The Korea Technology Finance Corporation was found in 1989 to mainly provide credit guarantees to new high-tech

Figure 1-3 | Basic SMEs Supporting System



Source: Bank of Korea Homepage.

SMEs and enterprises. Under the 'Regional Credit Guarantee Act,' a total of 16 regional credit guarantee foundations were launched all across the country by the 1996. They mainly provide credit guarantee for SMEs and small merchants. The financial support system for SME is shown in Figure 1-3.

4.3. Tax Policy

4.3.1. Underlying Principle

In the 1970s, the Korean economy achieved rapid economic growth thanks to aggressive expansionary policies including the development of the HCIs. But reckless fiscal management resulted in high inflation at the end of the 1970s. Indeed, consumer prices surged 18.2% in 1979, 28.7% in 1980, and 21.6% in 1981, while the fiscal deficit as a share of GNP rose to 4~5% between 1980 and 1982. Amid the growing need to address structural inflation and target the economy's growth potential, stabilization policies were adopted as a new way of operating the economy. Instituting more autonomy in the private sector based on stability became the new mantra of economic policy.

As economic policy focused on securing stability and a market friendly economy based on autonomy in the private sector in the 1980s, industrial policy support through tax benefits was put on the back burner and more emphasis was placed on ensuring tax neutrality and income redistribution. The tax policy in the 1980s kept the Korean tax system as it was formed in the 1970s while partial reform efforts were pursued mainly to make the economy more globally competitive and to secure the economy's growth potential. Major efforts to revamp the tax system in relation to business included lower corporate tax rates and drastic decrease in tax reductions and exemptions. However, tax support for liquidating insolvent enterprises and relatively weak sectors like small and medium enterprises and farming and fishing, continued to be reinforced.

The new democratic government which took over after the collapse of the military government carried out reforms such as implementing the real-name financial transaction system and the real-name property ownership system, aiming for greater transparency in society. In the course of carrying out such measures, tax policy played a key role. The government believed that the previous system of tax administration to be seriously detrimental to the equity and neutrality of taxation; in that taxation on property income was insufficient, the tax base was inadequate, and tax reductions and exemptions were too broad. To correct them, reforming the tax system was oriented toward improving the equity of tax burden, minimizing the tax-induced distortions of resource allocation, and boosting employee morale and entrepreneurship by improving income distribution. In line with this, international taxes were introduced on financial incomes and the systems were strengthened for global land tax, property tax, and transfer income tax. All of these measures aimed at enhancing the tax equity, while lowering tax rates on corporate income and reforming tax administration. This led to easing of the tax burden and restructuring of the corporate financial structure.

4.3.2. Lowering Rates of Corporation Tax and Adjusting Standard Taxable Income Assessment

Entering the 1980s, amendments of the corporate tax laws intended to improve tax equity among corporations of different types. It also eased the burden on enterprises that suffered from reduced tax exemptions. To encourage more companies to go public, higher tax rates were still applied on private corporations, but the tax rate for general corporations declined more sharply in a move to promote small-and-medium-sized enterprises.

Table 1-18 | Changes in the Corporate Tax Rate

	Regular (Small and Medium-sized)	Publicly Listed	Non-profit (Educational)
1980	Below KRW 50 mil. 25% Above KRW 50 mil. 40%	Below KRW 50 mil. 25% Above KRW 50 mil. 33%	Below KRW 50 mil. 20% Above KRW 50 mil. 27%
1981	Below KRW 50 mil. 22% Above KRW 50 mil. 38%	Below KRW 50 mil. 22% Above KRW 50 mil. 33%	Below KRW 50 mil. 20% Above KRW 50 mil. 27% Public corporation 5%
1982	Below KRW 50 mil. 20% Above KRW 50 mil. 30(33)%	Below KRW 50 mil. 20% Above KRW 50 mil. 27%	Below KRW 50 mil. 20% Above KRW 50 mil. 27% Public corporation 5%
1988	Below KRW 80 mil. 20% Above KRW 80 mil. 30(33)%	Below KRW 80 mil. 20% Above KRW 80 mil. 27%	Below KRW 300 mil. 10% Above KRW 300 mil. 15%
1990	Below KRW 100 mil. 20% Above KRW 100 mil. 34%		Below KRW 300 mil. 17% Above KRW 300 mil. 25%
1993	Below KRW 100 mil. 18% Above KRW 100 mil. 32%		Below KRW 300 mil. 18% Above KRW 300 mil. 25%
1994	Below KRW 100 mil. 16% Above KRW 100 mil. 30%		Below KRW 300 mil. 18% Above KRW 300 mil. 25%
1995	Below KRW 100 mil. 16% Above KRW 100 mil. 28%		Below KRW 300 mil. 16% Above KRW 300 mil. 25%

Note: The numbers in parentheses refer to the tax rates applied to the corporations of which majority stockholders comprise more than 35%.
Source: Korea Institute of Public Finance, "Tax Source Book," 1997.

Table 1-18 shows that the cap on standard tax assessment increased and tax rates decreased in order to ease the tax burden of SMEs. The standard taxable amount rose to 50 million KRWwhich had been 1 million KRW and 5 million KRW before 1980. The tax rate structure was also changed to include categories of 25% and 40%, which used to have three categories of 20%, 30% and 40%. In 1981, small-and-medium-sized general private corporations were subject to a lower minimum tax rate of 22% (down from 25%) when the standard taxable amount was below 50 million KRW. The maximum tax rate for the standard amount exceeding 50 million KRW was also decreased to 38% from 40%. On the other hand, the minimum tax rate for public corporations was lowered to 22% while the same maximum rate of 44% was still applied when the standard taxable amount exceeded more than 50 million KRW.

In 1982, tax rates for general (small-and-medium-sized) enterprises were sharply reduced. The lowest tax rate decreased from 22% to 20% while the highest rates were decreased from 38% to 30%. When majority stockholders held more than 35% of the total ownership share of general SMEs, the maximum tax rate of 33% was applied. Public corporations also benefited from lower tax rates overall with a minimum tax rate of 20% and a maximum tax rate of 27%, which decreased from 33%. These tax rates were maintained until the maximum tax rate was increased to 34% at the end of 1990 when a decrease in tax revenues due to the elimination of the defense tax had to be offset.

Starting from 1991, the corporate tax structure was simplified, which used to be divided between regular corporations, unlisted large corporations, publicly listed corporations, and non-profit corporations so as to enhance tax neutrality. At the same time, the standard taxable amount was increased to 100 million KRW while a reduction in the tax rate was phased in. This led to a decrease in the highest tax rate (32%) and in the lowest tax rate (18%). As corporate tax rates were decreased by 2%p in 1994, the minimum tax rate was 18%, and the maximum rate was 30%. In 1995, corporate tax rates were decreased again by 2%, becoming 16% and 28%, respectively.

4.3.3. Reform of Tax Policy

The characteristics of the Korean tax support system for SMEs are summarized in Table 1-19. First, the system seeks to promote SMEs start ups by giving various tax benefits. To this end, newly established SMEs are given a 50% reduction in corporate income tax, income tax, and aggregate land tax. They are also exempted from paying taxes on acquisitions and registrations. Second, tax incentives are given to investment and developments for research and human resources to enhance productivity of SMEs. To encourage investment, numerous tax credits are allowed while investments in research and human resource development are given tax credits along with a 3~5% reserve for deductibles on expenses related to R&D and human recourse development. To attract foreign workers, skilled foreign workers are exempted from income taxes for five years. Third, an allowance for business losses are allowed to be included as deductible expenses so long as it does not exceed 30% of the money to facilitate the restructuring of SMEs. On top of this, taxes on transferred assets between SMEs, the conversion of private enterprises into corporation, and contribution in kind can be carried forward, along with being exempt from acquisition and registration taxes. Fourth, investments in the areas outside of the metropolitan area are exempt from acquisition and registration taxes and subject to a lower of 50% corporate tax by 50%. Fifth, tax breaks were also implemented to promote more stable management such as the coupon system in purchasing management consulting services, special tax reductions and exemptions for small-and-medium-sized manufacturing businesses, appropriation for irrecoverable debt, preferential limit in entertainment expenses, and retroactive deduction of deficits. On top of all this, SMEs which seek to continue the family business are given additional tax benefits.

Table 1-19 | Description of Tax Support System for SMEs

Type	Target	Details
New Small-and Medium-sized or Venture Companies	• SME start-ups	• Lower taxes on corporate · property · aggregate land taxes by 50%, and exemption from acquisition and registration taxes
	• Tax benefits for investments for start-ups	• Non-taxation of gains on transfer of stocks and transfer income tax, separate taxation of dividend income, exercised gains annually less than 30 million KRW subject to non taxation, inclusion of reserves for loss from investment and loan in deductible expenses
	• Operators of facilities to support start-up ventures	• Exemption from acquisition and registration tax, and 50% reduction of property · aggregate land taxes
	• Upgrade to bill system	• 0.3% deduction of the related tax amount
Investment in SMEs	• Investment reserves	• Inclusion of 20% of assets value in deductible expenses
	• Temporary tax credit for investment	• Deducting 7% of the invested amount from corporate and income taxes
	• Tax credit for investment	• Deducting 3% of the invested amount from corporate and income taxes
	• Investment in equipment to increase productivity	• Deducting 7% of the invested amount from corporate and income taxes

[continued from Table 1-19]

Type	Target	Details
Investment in SMEs	• Specified plants and equipment	• Deducting 3 % of the invested amount from corporate and income taxes
	• Energy saving facilities	• Deducting 10% of the invested amount from corporate and income taxes
	• Facilities to promote the welfare of workers	• Deducting 7% of the invested amount from corporate and income taxes
	• Projects to support information-oriented system	• Inclusion of subsidy on facility investment in deductible expenses
	• Plant and equipment investment for safer environment	• Deducting 3% of the invested amount from corporate and income taxes
	• Inclusion of depreciation cost in deductible expenses	• Fixed assets acquired as of June, 2004 are eligible for inclusion in deductible expense regardless of appropriation for loss in depreciation cost
	• Support for plant and equipment investment	• Deducting 3% of invested amount from the money to be paid as tax
Promotion of R&D and Human Resource Development	• Reserves for research staff development • Tax credit on research staff development expense • Tax credit on plant and equipment investment • Income from technology transfer • Real estate for enterprise institutes • Foreign technicians • expense associated with foreign dispatch	• Inclusion in deductible expenses for technology-intensive ones: 5%, for others: 3% • Choice between 50% of the amount incurred in excess of annual average and 15% of costs • Deducting 7% of the invested amount • Deducting 7% of the money spent in technology acquisition from corporate and income taxes • Exemption from paying registration · acquisition · property · aggregate land taxes • Exemption from paying income tax for five years • Deducting 7% of the cost concerned from income and corporate taxes
Restructuring	• Inclusion of reserve fund for business loss in deductible expenses • Contribution between SMEs • Conversion of private enterprises into corporation • Contribution in kind • Acquirer of real estate subject to restructuring • Employees' takeover of bankrupt SMEs	• Inclusion of income up to 30% in deductible expenses • Taxation carried forward for transferred assets, exemption from paying registration · acquisition taxes and special tax for rural areas • Taxation carried forward for transferred assets, exemption from paying registration · acquisition taxes and special tax for rural areas • Deferred taxation for transferred assets, exemption from paying registration · acquisition · securities transaction taxes • 50% cut in transfer income tax • Exemption from paying securities transaction tax

[continued from Table 1-19]

Type	Target	Details
Relocation	• Relocating head offices of corporations into areas other than the metropolitan area (excluding large cities), moving into agro-industrial complex, excluding the investment made in the metropolitan overpopulation control area from the amount subject to reduction or exemption	• Exclusion from gross income, exemption from paying taxes of registration · acquisition (cutting corporate income tax by 100% for five years, by 50% for two years) exemption from paying taxes for the registration and the acquisition of the acquired real estate, 50% cut in the amount of corporate, registration taxes for four years
Stable Management	• Purchase of the coupons for management consulting service • Special reduction and exemption of tax amount for small-and-medium-sized manufacturing businesses • Funds appropriated for irrecoverable debt and retirement benefits • Base amount for entertainment expense • Deficits	• 7% of the money spent in this service is deductible in taxation. • 5~30% reduction by region and lines of business • Calculating them as necessary expenses or including them in deductible expenses • Preferential treatment of entertainment expense limit compared to large enterprises • Deficits deductible retroactively
Other Tax Benefits	• Preferential minimum tax • Deduction carried forward • Reduction of local tax	• Application of 10% minimum tax • Deduction carried forward for the tax amount omitted in the previous period

Source: Joo Sung Jun et al. (2006),

5. Promotion of Venture Companies

5.1. Background

Amid the ongoing financial liberalization in Korea since the 1980s and its membership into the OECD in the mid-1990s, Korea opened its capital market. The resulting increase in foreign borrowings enabled companies and financial institutions to expand their businesses. However, their financial soundness also became vulnerable to rapid and sudden capital flows. Meanwhile, the financial supervisory authorities were not adequately aware of the risks of financial liberalization and the opening of the capital market. Moreover, moral hazard was rampant as the government offered implicit guarantees for financial institutions. Amid the accumulation of risks in the corporate and financial sector, the Asian Financial Crisis at the end of 1997 delivered a heavy blow to the Korean economy. The economic policies after the crisis were mostly focused on restructuring of corporate and financial institutions. As such, economic growth was put on the back burner. In the process of tackling the foreign exchange crisis and corporate restructuring, SMEs still continued to receive support to a greater extent to help them overcome the credit crunch.

As the financial crisis brought down large enterprises, which were the driving force behind Korea's economic growth, the need to drastically transform the industrial structure by lessening the dependence on large firms and centering on small-and-medium-sized enterprises was raised. This would put the economy on a high growth path and result in higher value-added products. In other words, it was believed that the transition toward a knowledge-based economy was necessary where high-tech industries like IT and communications, software, and biotechnology formed the core. Thus, shedding the existing growth pattern largely centered on smokestack industries. The growing perception that it was necessary to replace large enterprises and to promote venture capitalism as the main growth engine came to be manifested in policies. The KOSDAQ (Korea Securities Dealers Automated Quotations) market was launched in 1996, to play the same role as America's NASDAQ (National Association of Securities Dealers Automated Quotation). In December 1997, the 'Act on Special Measures for the Promotion of Venture Businesses' was enacted in order to lay the legal groundwork for nurturing venture businesses. According to the act, companies which meet particular requirements were designated as venture enterprises and could benefit from the government's direct support in terms of funds, manpower, tax, location, and technology, when they listed on the KOSDAQ.

The government's measures to provide support for venture companies were basically an extension of the policies to promote SMEs. But they also resemble the policies used to promote the heavy and chemical industries in the 1970s. Just as the heavy and chemical industries were selected as strategic industries for government support, venture businesses were at the focal point of government support in terms of funds, technology, and human resources. As a result, the number of venture companies registered in the Small & Medium Business Administration in 2001 exceeded 10,000 and an estimated one million people were newly employed. But reckless support of venture companies led to speculation in the KOSDAQ market and the negative side effects associated with financial bubbles. As a consequence of the so-called "IT bubble," the number of venture companies decreased from 2002 and reached a low of 7,700 in 2003. Afterwards once the market stabilized, the number of venture companies bounced back to almost 18,900 as of 2009.

5.2. Financial Policies for Fostering Venture Business

5.2.1. Supporting SMEs by Easing the Aggregate Credit Ceiling System

Despite the overall restructuring of the economy after the foreign exchange crisis, the system to support SMEs was maintained. SMEs suffering from the credit crunch during the restructuring were also given more funding. The Bank of Korea gradually increased the aggregate credit ceiling from December 1997, which reached 7.6 trillion KRW in September 1998. Even after tackling the Asian Financial Crisis, the aggregate credit ceiling continued to increase gradually, going as high as 11.6 trillion KRW in 2001 before it began to fall again. The rates applied to the aggregate credit ceiling decreased to an annual rate of 3.0% from 5.0%. Since then, interest rates have continued to fall, decreasing to 2.0% at the end of 2004.

Table 1-20 | Change in the Aggregate Credit Ceiling and Interest Rates

(Unit: 100 million KRW, %)

	1997. 12	1998. 3	1998. 9	2001. 1	2001. 9	2002. 10	2004. 8	2004. 11	2006. 2
Ceiling	46,000	56,000	76,000	96,000	116,000	96,000	96,000	96,000	96,000
Interest rates	5.0	5.0	3.0	3.0	2.5	2.5	2.25	2.0	2.25

Source: Bank of Korea, "60-year History of Bank of Korea", 2010.

5.2.2. Statutory Framework for Fostering Venture Business

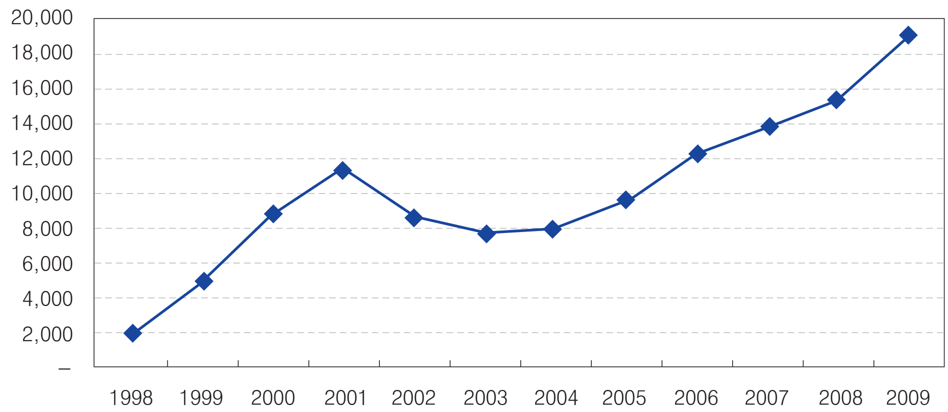
In the process of maintaining the business support system with greater focus on SMEs, the government realized the role SMEs could play as new growth engines instead of being protected. Moreover, the global "IT boom" after the mid-1990s provided great momentum in pursuing the policy goal of promoting high growth, high value-added venture businesses. The institutional framework to promote venture businesses was laid out in the 'Act on Special Measures for the Promotion of Venture Businesses (hereafter, "Special Act")'. To qualify for government support, venture companies had to meet one of the requirements defined below as well as the requirements for SMEs specified in the 'Framework Act on Small-and-Medium Enterprises':

- The enterprises that has acquired investment inflow from various venture capitals designated in the Special Act over the amount prescribed by the Presidential Decree
- The enterprises of which contribution to R&D against the total annual R&D expenses and total sales exceed the amount prescribed by the Presidential Decree
- The enterprises to which Korea Technology Finance Corporation(KOTEC) provides guarantees or the institutions prescribed by the Presidential Decree grant a loan without

collateral for promoting technology commercialization or start-ups, highly recognized ones in terms of technology with the abovementioned guarantee or loans exceeding the level prescribed by the Presidential Decree respectively.

The number of venture firms that satisfied these requirements totaled 18,893 as of the end of 2009, and has continued to increase since 2003.

Figure 1-4 | Number of Venture Firms



Source: Korea Venture Business Association.

Under the Special Act, financial support for venture businesses is centered on diverse public funds and deregulation of several restrictions which venture firms face in raising funds. To begin with, public funds and insurance companies are allowed to invest in venture enterprises or finance venture capitalists or venture capital funds. In particular, funding from the government for venture capital funds has continued to increase since 1998 and accounted for 34.1% of the committed capital in 2005, indicating the government's significant role in the venture capital market.

To facilitate financing for venture firms, deregulatory measures were pursued. Insurance companies are no longer subject regulations on asset portfolios defined in the 'Insurance Business Act.' They are allowed to invest in venture enterprises or venture capital funds within the range set by the Financial Service Commission. When foreigners buy shares of venture firms, they are exempted from the restrictions in the 'Financial Investment Services and Capital Market Act,' which impose restrictions on stock trading by foreign investors. While the total share of stocks the Korea Development Bank and the Industrial Bank of Korea can acquire is limited to 15% of a firm's total shares, the investment in venture firms or venture capital funds

Table 1-21 | Investment Funds Financed by the Government and by the Private Sector

(Unit : hundred million KRW, %)

		1998	1999	2000	2001	2002	2003	2004	2005	Total
Total		1,055	4,885	14,341	7,910	5,222	4,550	5,274	5,740	49,477
Joint Contribution	Government	135 (12.8)	718 (14.7)	2,409 (16.8)	2,406 (30.4)	1,520 (29.1)	1,379 (30.3)	1,641 (31.1)	1,958 (34.1)	11,766 (23.8)
	Private	138 (13.1)	1,392 (28.5)	5,214 (36.4)	4,532 (57.3)	2,623 (50.2)	2,325 (51.1)	1,675 (31.8)	1,474 (25.7)	19,673 (39.8)
	Subtotal	273 (25.9)	2,110 (43.2)	7,623 (53.2)	6,938 (87.7)	4,143 (79.3)	3,704 (81.4)	3,316 (62.9)	3,431 (59.8)	32,038 (64.8)
Private only		782 (74.1)	2,775 (56.8)	6,718 (46.8)	972 (12.3)	1,079 (20.7)	846 (18.6)	1,958 (37.1)	2,309 (40.2)	17,428 (35.2)

Note: Percentage in parentheses.
Source: Korea Small Business Institute.

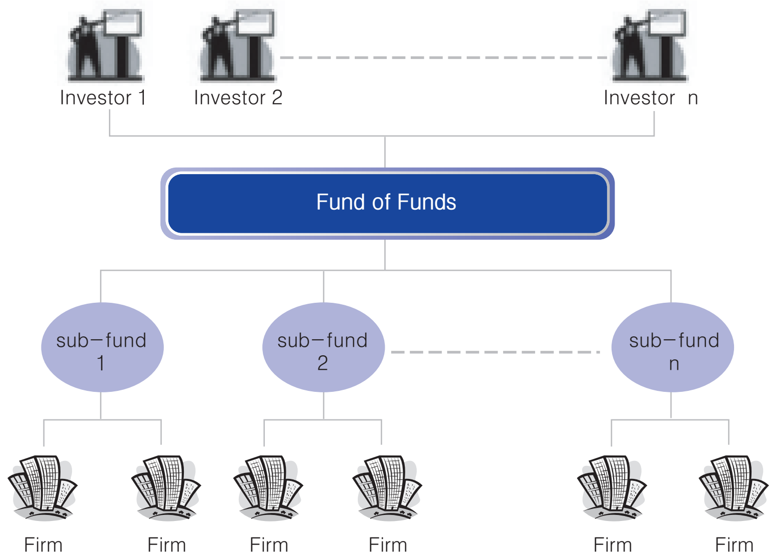
is exempted from this rule. KOTEC is supposed to offer a preferential guarantee for venture businesses. Unlike general corporations, the minimum capital requirement for venture businesses is 20 million KRW, and credit extended to venture entrepreneurs without a business record is made based on an assessment of the technology or guarantee system.

5.2.3. Supporting Venture Businesses through FOF

In an attempt to provide a long-term and stable institutional framework for financing investments in venture businesses, the Korean government established a financial support system with emphasis on "Fund of Funds(FOF)" starting from 2005. The previous approach was to determine the amount to be funded by annual budgeting, which was heavily influenced by changes in the government's budget. Moreover, as long as the retrieved amount after funding investment funds is again incorporated into government funds, there is no guarantee that the amount will be reinvested. This failed to create a long-term and stable source of capital for venture start-ups. To overcome these shortcomings, a "Revolving System" was set up by launching FOF whereby the collected money after investing in its underlying funds is reinvested.[5]

5. "Fund of funds(FOF)" is a fund which invest in other funds (investment funds), rather than directly in stocks of firms, to reduce the risk from direct investment while making profits. The total contributed capital forms a fund (main-fund) through which investment is made into investment funds (sub-fund) launched by fund management companies.

Figure 1-5 | The "Fund of Funds" System



In December 2004, the amendment of the 'Act on Special Measures for the Promotion of Venture Businesses' paved the way for creating and operating FOF. Since 2005, the Korea Venture Investment Corp. has been in charge of managing FOF as a designated professional investment management organization. As of the end of June 2009, a total of 1,075 billion KRW was set up in the fund by pooling 735 billion KRW from the Small-and-Medium Business Administration(SMBA), 170 billion KRW from the Korean Intellectual Property Office(KIPO), and 170 billion KRW from the Ministry of Culture, Sports and Tourism(MCST). The fund is scheduled to run for 30 years.

In adopting a system centered on FOF for supporting venture businesses, the government expects the following effects. Firstly, the approach of FOF can help to reduce dependence on the government budget and to manage investment resources with a long term horizon through reinvestment, which can lead to promoting a more stable and advanced venture capital market.

Secondly, countercyclical steps can be taken by adjusting its investment in subsidiary funds. For example, scaling down investments in an economic boom and scaling up during a business slump.

Thirdly, the management of the Fund is entrusted to professional organizations with expertise, so that profitability and efficiency of the Fund can be maximized.

Finally, the approach of Fund of Funds is highly effective in hedging risks and accordingly lowering the likelihood of losses, because it basically invests into several funds, rather than directly into individual firms.

Table 1-22 | Status of FOF's Funding

(Unit: hundred million KRW)

From	2005	2006	2007	2008	2009	Total
SMBA	1,701	1,100	900	800	2,850	7,351
MCST	-	500	1,000	-	200	1,700
KIPO	-	550	550	-	600	1,700
Total	1,701	2,150	2,450	800	3,650	10,751

Note: As of the end of June 2009.

5.3. Tax Policy

5.3.1. Underlying Principle

After the foreign exchange crisis at the end of 1997, the basic goals of tax policy was job creation and economic stimulus, which also allowed the structure to be reformed by this effort. Therefore, a more comprehensive and systematic framework for tax support needed to be built while preventing the concentration of favorable measures for particular enterprises at the same time. Greater emphasis was placed on income redistribution in implementing the tax policy, so more support for the middle class and the lower income class was provided coupled with higher taxes on higher income classes in response to massive loss of jobs and the widening gap between the rich and the poor. To encourage investment and to boost the economy by fostering venture businesses, there were efforts to enhance temporary investment tax credits, tax credits for investments in used facilities, and tax credits for disposal of excessive facilities, and the introduction of revolutionary measures like the exemption of acquisition tax and registration tax for four years after for new companies, income deduction (30%) for investments in venture businesses.

5.3.2. Tax Support for Newly-established SMEs and Venture Businesses

The term newly-established SMEs refers to start-ups in areas other than the capital region, and newly-established venture businesses mean those officially confirmed as venture businesses by the Small and Medium Business Administration(SMBA) within two years after the business starts up. Such companies include SMEs engaged in manufacturing, mining, telecommunications, R&D, broadcasting, engineering, information processing and operations, and the distribution industry. Any start-up and venture company falling into these categories are entitled to tax deductions (exemption or reduction) at the full or partial assessed amount and lower taxes on charges. Moreover, they benefit from lower taxes on stock options in order to ensure that they have an adequate supply of labor.

The venture businesses are entitled to the tax credit explained earlier in Table 1-19. New companies and venture companies are promoted through supportive measures to boost such activities. The companies are exempted from corporate tax, income tax, acquisition tax, and registration tax. Also, the new companies are offered a 50% reduction on income or corporate tax for the three years starting from the time the company makes a profit.

Start-ups are exempted from registration and acquisition tax, or heavy taxation. For property acquired within four years from the company's establishment, the property is exempted from registration and acquisition tax. Companies moving into the metropolitan areas are subject to a heavy registration and acquisition tax up to three times, but start-ups and new venture enterprises are not subject to such heavy taxation. In addition, these companies are given a 50% reduction on property tax and global land tax for five years from the founding of the company, along with exemptions from heavy taxes (three times higher) on property for enterprises moving into metropolitan areas. Companies are also exempt from special taxes for rural areas and stamp tax.

Besides these newly-established SMEs and small-and-medium-sized venture enterprises, business incubators that help them succeed also receive the same tax support as the abovementioned enterprises except for exemption from stamp tax.

Ordinarily, companies are subject to various charges for development gain, farmland conversion, and forest conversion as according to the requirements for establishing plants. But when newly-established SMEs and small-and-medium-sized venture enterprises set up new plants, they are exempted from the full amount of development gain and receive a 50% reduction of charges for farmland conversion and forest conversion.

The income earned from stock options for employees or outside personnel of newly-established SMEs and small-and-medium-sized venture enterprises that are exercise are not counted as income for up to 30 million KRW. As such, the amount is not taxable in transfer income tax.

5.3.3. Tax Support for Venture Capitalists

Investment companies that invest in SMEs and financing businesses that fund new technology project (hereafter, venture capital firms) stimulate the start-up of SMEs and venture businesses. As such, greater tax support for them is provided to promote and develop the venture industry. Corporate tax is not imposed on gains from transfers or dividend income which venture capital firms earn from transferring the investment securities or capital investments made to back the founders or venture businesses. To compensate for their loss from investing in or making loans to venture businesses, venture capital firms are allowed a certain amount in deductible expenses. Also, these companies are exempt from securities transaction tax and special tax for rural areas as well. The registration tax applied to companies establishing operations in metropolitan areas at three times higher is not levied on venture capitalist firms.

To attract funds from the private sector into the venture business, tax benefits are offered to investment cooperatives that invest in SME start-ups and financing businesses that fund new technology projects (hereafter: venture capital investment cooperatives). Transfer income tax is not imposed on income from transferring of stocks acquired by investing in the venture capital firms through venture capital investment cooperatives. The dividend income from investing in venture capital investment cooperatives is withheld from income tax, instead of being included in the global income. Venture capital investment cooperatives are also exempted from paying securities transaction tax and special tax for rural areas.

To stimulate inflows of funds to finance investments and to promote venture businesses, various supportive tax measures have been implemented for individual and institutional investors. Individual investors are allowed a 15% deduction on the amount invested in venture businesses for two years from the taxable amount of global income. When institutional investors acquire stocks by investing in venture businesses through venture capital firms, the gain from transferring such stocks is not subject to corporate tax.

6. Assessment

6.1. Financial Support Policies

During Korea's rapid development period, the financial support policies for exporting companies and HCIs played a huge role in advancing industrialization in a short period. Financial support acted as policies to develop particular sectors but also to promote the underdeveloped financial market. A low level of income led to low savings, so there was not sufficient capital available for industrialization. Moreover, it was difficult to mobilize savings from the private sector when the financial market was not developed. Korea had quite a huge informal financial market in the early stages of industrialization, so banks could not fully fulfill their original function as an intermediary of financial resources. Therefore, the Korean government had to tightly control the financial market so that funds could be mobilized and allocated for industrialization. Another necessary policy was to make up for the shortage of domestic capital by utilizing monetary expansion of the central bank.

Underdevelopment of the financial market has a negative effect on corporate growth in terms of risk sharing, in addition to mobilization and allocation of financial resources. Generally, companies share the risk through equity finance. In other words, the role of capitalists who make equity investments are needed, which leads to sharing the risks. However, when the equity market fails to develop, such risk sharing cannot take place normally. In this case, active investments by businesses can be hardly expected. When Korea faced a critical crossroad in its industrialization, the government assumed this role of risk sharing. In Korea, the government shared the risk, not as a shareholder but as a provider of funds shouldering the downside risk of investments (Cho, 1989). This means the government offered credit to companies through the central bank and financial institutions, and bailed out companies in financial trouble through diverse measures such as low interest rates, extension of the due date, and so on. In addition to measures to support troubled individual companies, there were presidential emergency measures which benefited the business sector as a whole.

Resource allocation by the government is supposed to be accompanied by negative side effects. In the earlier stages of industrialization with an under-developed financial market, efforts to support companies by controlling financing played a substantial role in upgrading the economy to a certain level. But the Korean economy suffered from chronic inflation caused by monetary expansion. Furthermore, intensive support for HCIs imposed an enormous burden on the economy by inducing excessive investment in the late 1970s. So the government ended up forcing HCIs to engage in restructuring.

Meanwhile, financial control by the government also brought a harmful side effect of undermining the development of the financial industry. Financial institutions extend funds to companies based on their creditability and profitability. Hence, the ability of financial institutions to assess the demand side determines the competitiveness of the industry. During the development stage, financial institutions in Korea did not have the opportunity to operate by applying their own judgment. As funds were allocated based on the government's direction, financial institutions could not enhance their ability to evaluate borrowers and so the market functions of the financial market withered, which eventually undermined the development of the financial industry. The low competitiveness of Korea's financial industry relative to manufacturing industry may be traced back to that.

In short, government intervention in the financial market can be considerably effective in promoting enterprises in light of insufficient accumulated savings and lack of players to effectively mobilize and allocate funds. But this process cannot last indefinitely, for government intervention in the market is doomed to produce adverse side effects in the long run. So, growth policies driven by the government need to be shifted into a market-friendly one at some point after passing a certain amount of time (after having grown to some extent).[6]

After the Park Chung-hee adminstration since the 1980s, a great policy emphasis was put on promoting SMEs. The policies supporting SMEs are more reflective of social policies that stress equity rather than growth. In the 1987 constitutional amendment, the introduction of the concept of “Economic Democracy” made the protection and promotion of SMEs a constitutional obligation. The policy to provide financial support for SMEs is different from the one adopted to promote exporting industries or HCIs that was characterized by tight control of the financial market aimed at fully mobilizing the total financial resources. Some policies rely on market intervention like those regulating how to operate a loan program in commercial banks exemplified by the mandatory lending requirement to SMEs. But SME support is predominantly provided through government policy loans. The need to offer financial support to SMEs is based on the rationale that the market failure of the financial market keeps funds from flowing into SMEs on a socially desirable level. So even most advanced countries with a fully developed financial market implement diverse policies to support SMEs. It is extremely difficult to measure the optimal level for policy loans to SMEs in any country. This case also applies to Korea, so it remains to be seen whether the current financial support level for SMEs is appropriate. One frequently raised criticism is that the current system is too complicated. There is too much overlap in the support measures, so a major overhaul is needed to simplify and improve its efficiency. Criticism is leveled not only at financial support but also at the overall policy to support SMEs. In practice, despite substantial support so far, the reality is that SMEs rarely grow to become large companies.

The support policies for promoting venture businesses can be seen as a part of policies to support SMEs. But they are seen as policies that seek to develop growth engines, rather than protecting SMEs. Therefore, policies to promote venture enterprises are similar to the ones in the 1970s aimed at promoting HCIs. Like the selective support to promote related industries in the HCIs, the government designated venture businesses based on IT technology as national strategic industries to concentrate support on them in the late 1990s. In fostering venture businesses, it is the promotion of more equity finance through the KOSDAQ that represents a significant departure from the promotion of HCIs. This means encouraging risk sharing in the capital market and raising more funds for venture firms’ long-term projects. When development efforts were focused on HCIs, companies were encouraged to be listed on the

6. It is difficult to pinpoint the time of transition. Conceptually it is when the growth rate slows down and government intervention in the marketplace leads to escalating negative consequences, at which point the costs from government-driven policies exceed the benefits.

stock market, only to result in little success compared to the rapid growth of the KOSDAQ market. Prompted by these policy efforts, there was an explosive increase in venture enterprises. Thanks to the dot-com craze all over the world, the KOSDAQ market remained brisk. But venture firms suffered from the aftereffects of speculation similar to the HCIs. Numerous venture enterprises went bankrupt and the collapse of the KOSDAQ market caused huge losses to investors. Since then, the financial support system for venture businesses has shifted from direct support to greater emphasis on “fund of funds (FOF).” It would be premature to evaluate the results of the FOF approach considering that it hasn’t been long since its introduction. But one thing is for sure: FOF is more market-friendly in that institutions specialized in investment are commissioned to look for an investment vehicle, instead of being directed by the government.

6.2. Tax Policy

In the 1960s, when full-scale comprehensive economic development started, tax policy continued to be centered on increasing tax revenues to secure financial resources for economic development. Given meager per capital national income and low domestic savings rate, the focus of tax policy had to be placed on increasing tax revenues in order to raise money for investment. Among numerous attempts a tax reform large and small, the 1966 tax reform is considered to have been the cornerstone to today’s tax system in Korea. The creation of the National Tax Service(NTS) contributed greatly to increasing tax revenues. It is recognized for helping to bringing transparency in determining sources of income and modernizing tax administration. While keeping the corporate tax rate high to increase tax revenues, diverse measures to cut taxes were prepared as incentives to boost exports through businesses promotion. Tax reduction had its own merit of improving the corporate financial structure, increasing corporate investment, expanding exports, and promoting the growth of companies. But the system was perceived as an easy target in achieving policy goals, which provoked the criticism that its reckless expansion was problematic. As a result, the increasing tax cuts weakened the tax revenue base, complicated the tax system, and distorted resource allocation. Despite these problems, the tax policy of the 1960s did much to raise funds for economic development and set the stage for growing small businesses in Korea into the world-class enterprises.

Table 1-23 | Major Indicators

	Growth Rate	Ratio of Import and Export to GDP	Gross Saving Rate	Gross Domestic Investment Rate	Wholesale Price Index 1985 =100
1960	1.1	16.0	9.0	10.0	4.5
1961	5.6	20.3	11.7	12.0	5.1
1962	2.2	21.7	11.0	11.8	5.6
1963	9.1	20.5	14.4	17.0	6.7
1964	9.6	19.3	14.0	13.2	9.1
1965	5.8	24.4	13.2	14.1	10.0
1966	12.7	30.3	16.6	20.4	10.9
1967	6.6	33.1	15.4	20.9	11.5
1968	11.3	37.9	18.2	24.9	12.5
1969	13.8	38.5	21.4	27.9	13.3
1970	7.6	39.0	18.0	24.3	14.5
1971	8.6	42.5	16.0	24.8	15.8
1972	5.1	46.1	17.2	21.0	18.0
1973	13.2	63.2	22.6	25.2	19.3
1974	8.1	68.2	20.3	31.8	27.4
1975	6.4	66.1	18.2	28.8	34.6
1976	13.1	65.5	24.3	26.6	38.8
1977	9.8	65.6	27.6	28.3	42.3
1978	9.8	64.7	29.7	32.6	47.3
1979	7.2	64.6	28.4	35.9	56.1
1980	-3.7	80.6	23.1	32.0	78.0

Source: Korea Development Institute, "The Fiscal History of Korea for Forty Years," Volume 4, Finance Statistics.

Entering 1970, when the government embarked on the policy to foster the HCIs, the focus of tax policy shifted from direct taxes to indirect ones to promote rapid accumulation of capital in the corporate sector. The reduced burden of direct taxes resulting from lower corporate taxes was due to the successful reform of the tax system and administration of taxes in the 1960s. The increase in tax revenues was propelled by the high level of economic growth. Lowering corporate tax rate is highly regarded as a powerful way to promote the formation of private capital and rapid growth. In particular, the introduction of the value-added tax simplified consumption taxes and enhanced efficiency to a great extent, significantly improving the neutrality of taxes among industries. A tax system based on consumption taxes is regarded as a great contributor to the accumulation of capital in the private sector and high degree of growth.

The tax reductions and exemptions and tariff systems to nurture HCIs and to support exports is criticized for having caused over investment in HCIs and inefficiencies in the allocation of resources among industries due to the differential management by industry.

Although the Korean economy achieved a high degree of growth in the 1970s, the loose management of public finances brought on high inflation. So entering the 1980s, the government's top priority was stabilizing the economy and developing a market economy driven by an autonomous private sector. In the course of implementing these stabilization policies, tax reform was carried out in piece meal fashion rather than full on. The remarkable tax policy of this period includes streamlining operations of industrial support, from the previous policy of providing selective support to certain industries to the function-oriented one. In other words, the same type of support was to be provided to any industries that accomplished the same level of rationalization and productivity improvement. Therefore, the industries to be fostered were decided not by the government but by the market, which resulted in substantially higher efficiency in the allocation of resources. To promote SMEs, the bigger picture of differential corporate tax rates and tax support was maintained. This system greatly contributed to starting and promoting SMEs, but came under criticism for creating inefficient resource allocation. The biggest problem in the SMEs tax support system was that many decisions concerning tax support were made on the basis of equity regardless of efficiency. Special tax treatment including tax deductions and special reductions and exemptions were intended to stabilize management of SMEs, but these measures were not effective in terms of achieving economic growth and job creation as did not promote higher productivity and the growth of SMEs. Table 1-24 illustrates that the ratio of large enterprises with more than 300 employees fell in 2006 compared to 1999.

Table 1-24 | Number of Manufacturing Enterprises by Number of Employees

(Unit: %)

Year / The number of employees	1999	2006
5~9	47.8	50.3
10~19	26.3	26.5
20~49	17.5	16.1
50~99	4.9	4.2
100~199	2.0	1.8
200~299	0.6	0.5
300~499	0.4	0.3
500~999	0.2	0.2
over 1,000	0.2	0.1

When Korea experienced the foreign exchange crisis in 1997, revolutionary tax support for venture businesses was introduced so that the economy could be boosted and more jobs created. Such support policies produced positive results like the success of some IT firms and industries, the growth of venture capital, and the development of the KOSDAQ. But the policy efforts also revealed several problems including over speculation driven by the venture boom, stock bubble in the venture market, and moral hazard among many venture firms. Even though diverse supportive measures were introduced temporarily with sunset provisions to promote venture businesses, support continued to increase as time went on and even the categories which already achieved the intended goals persisted. As the system was too weighted towards achieving the goal of nurturing venture businesses, the support system was not based on selection and concentration, but by imprudence. Therefore, problems of increasing complexity in the tax system and smaller tax base were caused.

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Chapter 02

Korea's Experience in Regulatory Reform and Achievements

Chapter 02

Korea's Experience in Regulatory Reform and Achievements

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<Summary>

The beginning of regulatory reform led by the Korean government can be traced back to the Chun Doo-hwan Administration. The Administration was the first to seek to change Korean economic structure to a private-driven from the government-driven one that had contributed largely in achieving remarkable economic growth since the 1960s. The shift was motivated by the possibility of the government-led economy acting as an obstacle in sustaining the economic growth and in overcoming the immediate economic crisis. In the early days of the 1980s, the Chun Doo-hwan administration embarked on de facto regulatory reform without officially branding it so. However, it was the end of 1990s when Korea's regulatory reform was institutionalized into sustainable and systematized policies for the quality enhancement of the government services and the competitiveness of the national economy.

The Kim Dae-jung administration, which succeeded the office immediately after the outbreak of the Asian Financial Crisis, carried out a full-scale regulatory reform and privatization under the critical condition of the relief loan from IMF. Fortunately, the legal and institutional framework for the reform had been arranged by the former President Kim Young-sam. During his term, the 'Framework Act on Administrative Regulation(FAAR),' which laid the foundation for the Regulatory Reform Committee(RRC), together with other gears for the regulatory reform were prepared. These measures enabled the Kim Dae-jung administration to push the regulatory reform to overcome the crisis. The Guillotine Approach, named by OECD, reduced the total number of regulations registered at the Korean government by 50% under the instruction from the President Kim. Regulatory reform was implemented in such a powerful way and made possible in practice thanks to the national consensus on the need for restructuring

and change on a full scale in the course of overcoming crisis. It resulted in a 50% cut in the level of regulations qualitatively as well as quantitatively. The Korean government also established a scientific system for regulatory quality control and regulatory management including regulatory impact analysis, prior review of new and reinforced regulations, sunset clauses, regulatory registration, and mandatory rearrangement of existing regulations imposed upon the central government agencies, and publication of annual white papers on regulatory reform, etc. through the FAAR. Since then, regulatory reform in Korea has acquired a solid place for carrying out reform policies to enhance the service quality of the government and the competitiveness of the national economy regardless of different order of priority placed by changes in the political leadership between the conservatives and the liberals. Although regulatory reform seemed to have lost some steam with the increase in the number of regulations under the Roh Moo-hyun administration, the Korean governments except for that era have continuously pursued regulatory reform and delivered great gains to Koreans through the vitality of the Korean economy and enhanced competitiveness of Korean firms.

Representative and well-known measures of Korean regulatory reform include the Guillotine Approach, prior review on new and reinforced regulations, and temporal regulatory relief etc. Through these measures, the Korean government in the era of President Kim Dae-jung achieved a real reduction in regulations whose estimated economic contribution to Korean economy was an increase of 4.4% to the GDP (of the real GDP in 1997) in the five years after 1999. The continuous reform efforts also contributed to overcoming the foreign exchange crisis in 1997 and economic crisis in 2007.

However, when we compare the performance of Korean regulatory reform with other countries in the OECD, Korea's performance has been average compared to other countries in the OECD. Of course, the Korean reform was greatly successful. But more progress is needed to enhance the competitiveness of Korea's business environment and to become a world leader. To make the business environment competitive, Korea needs more reform the entry barriers in the following sectors: service and non-manufacturing sectors, and high technology sector producing machinery and equipment. Because of the inefficiencies and low competitiveness of these sectors caused by regulatory barriers to entry and exit, Korea cannot see more vigorous and vital entrepreneurship in these important sectors and thus more job creation and economic growth nowadays.

1. Background on Regulatory Reform

1.1. Economic Conditions

The beginning of regulatory reform led by the Korean government can be traced back to the Chun Doo-hwan administration which sought to pursue an economy led by the private sector. At the time, the Korean government focused on the industrialization of the heavy and chemical industry(HCIs) with strong policy efforts. Heavy investments were made in HCIs after export growth driven by the light industry had reached a limit in the late 1960. However, economic stagflation caused by the second oil shock at the end of the 1970s put the economy in serious danger due to the overinvestment in the HCIs. Moreover, even though developed nations in Europe and the U.S. sought an economic and social system grounded on the idea of a welfare state as their top objective after the Second World War, such a system did not work any longer and many countries suffered from serious fiscal deficits and loss of economic vitality. Responding to this loss of economic vitality, which surfaced in the 1970s, conservative administrations led by Margaret Thatcher and Ronald Reagan came to power in Britain and America. To revive the national economy, these administrations placed top policy priority on privatization and regulatory reform. The aim was to reinforce the market economy on the basis of acting on one's own responsibility and competition, which went on successfully.

1.2. Policy Objectives

Against this backdrop at home and abroad, the most pressing concern for the Korean government was to overcome the economic crisis as the economy experienced negative growth for the first time since the 1960s, while high inflation posed a serious threat to economic stability in the aftermath of the overinvestment in HCIs and the global recession caused by the second oil shock. The economic policy shift towards a private-led economy originated from the belief that the government-led economic management might act as an obstacle to further growth in the future as well as to overcoming the immediate economic crisis even though it had contributed to achieving a marvelously high level of economic growth since the 1960s. In the early days of the 1980s, the Chun Doo-hwan administration embarked on de facto regulatory reform for the first time without officially branding it so.

Korea's regulatory reform was initiated in this way. It was not until the end of the 1990s when the regulatory reform and the competition policy took roots as continuous policy efforts to enhance the quality of government service and national economic competitiveness. These efforts were not temporary reforms swayed by the whim of a particular regime or political party. The launch of the WTO in the 1990s brought the full effects of globalization, and

Korea's per capita income reached ten thousand dollars in the mid-1990s when the collapse of the former Soviet Union and the East-European bloc brought an end to the cold war and mega-competition arising from globalization was becoming increasingly common. In order to cope with these drastic changes in the political and economic surroundings at home and abroad, the Kim Young-sam administration pursued the following broad set of foreign policies: adopted globalization and joined the OECD; promoted a market-based economy through liberalization and deregulation in line with developed nations. But the radical policies of open-door and deregulation led by the Kim Young-sam administration were not backed up by sufficient preparation especially in the financial sector. Also, labor reforms to achieve higher labor flexibility also lost momentum due to strong opposition from interest groups like labor unions. As such, Korea ended up having to experience the Foreign Exchange Crisis at the end of the 1990s.

Despite of the serious conditions of the IMF bailout program, the government led by President Kim Dae-jung, who took office immediately after the Foreign Exchange Crisis, carried out regulatory reform and privatization on a full scale. Fortunately, the legal and institutional framework for the reforms had already been prepared. The former administration led by President Kim Young-sam enacted the 'Framework Act on Administrative Regulation (FAAR)' which laid the foundation for launching the Regulatory Reform Committee(RRC), a permanent body with the legal and institutional basis to carry out regulatory reform. Based on this, the Kim Dae-jung administration could make a bold move to push ahead with regulatory reform to overcome the crisis. In particular, President Kim was able to instruct a 50% cut in the total number of regulations registered by government ministries. Regulatory reform was implemented in such a powerful way and made possible in practice thanks to the national consensus on the need for full scale restructuring and change in the course of overcoming crisis. Since then, regulatory reform in Korea has acquired a solid place for carrying out reform policies to enhance the service quality of the government and the competitiveness of the national economy regardless of the differences in policy priority brought on by changes in the political leadership between the conservatives and the liberals.

2. History of Korea's Regulatory Reform

Now let's look evolution of Korea's regulatory reform which started from the 1980s. Then, we can make sense of how the regulatory reform successfully served as the means to drive government innovation and to implement reform policies.

2.1. Chun Doo-hwan and Roh Tae-woo Administration (1982~92) : The Embryonic Stage of Regulatory Reform

The Chun Doo-hwan administration took office in 1980 and attempted for the first time de facto regulatory reform by trying to transform the economy to one that was led by the private sector as its main economic policy objective. The administration set up the Committee on Improving Restraints of Growth and Development, which was chaired by the Prime Minister, and comprised of ministers of relevant government agencies and representatives from business, media, bar, academia, culture and labor. This committee selected 46 major policy challenges and 760 problems to be dealt with by ministries autonomously in the process of deregulation.[1] Although an engine for regulatory reform was not in place in implementing regulatory reform, administrative regulations were eased to lessen the burden on corporations to promote economic growth.

President Roh Tae-woo took office after winning the direct presidential elections, which took place right before the Seoul Olympic Games in 1988. The Roh Tae-woo administration set the goal of strengthening Korea's national competitiveness along with pursuing deregulation as a key policy objective. In 1990, the Roh Tae-woo administration established the Committee for Deregulation of Administration made up of 21 members including ministers from relevant central government ministries with the Prime Minister acting as the chair. In 1991, the Civil Advisory Commission for Deregulation of Administration was established. The commission was composed of figures mainly from private economic associations and businesses and it sought to push for deregulation by separating general and economic administration which led to a total of 893 institutional improvements.[2] For the first time, this period saw the establishment of a deregulation system created in partnership with the government and the private sector and stronger national competitiveness as a goal set in deregulation, placing regulatory reform at major agenda of economic policies of the government.

2.2. Kim Young-sam Administration (1993~97) : Building a Foundation for Regulatory Reform on a Regular Basis

The succeeding administration was led by President Kim Young-sam and drew up the so called "100-day Plan for New Economy" in an attempt to get out of the economic recession which had lasted right before its term in office began. Under this plan, one of the important

1. Kim, Jung-soo (1992).
2. Kim, Il-joong and Seong-jong Hong (1994), p.4.

measures adopted was deregulation. The Kim Young-sam administration created the following committees: Committee for Deregulation of Economic Administration (March 1993: run by the Economic Planning Board), the Presidential Commission for Administrative Reform (May 1993: presidential advisory body), the Industrial Regulation Review Committee (September 1993: run by the Ministry of Trade, Industry and Energy), and the Joint Review Council of Administrative Regulation (May 1994: run by the Ministry of Government Administration) to put regulatory reform into practice across all ministries of the government. The striking difference between this administration and previous administrations was the competitive nature in which deregulation was implemented by several ministries in the government, instead of being carried out under a unified system.

During this period, the enactment of the ‘Act on Special Measures for the Deregulation of Corporate Activities’ and the ‘Framework Act on Administrative Regulations and Civil Petitions’ is mentioning in that it paved the way for legal and institutional reform for the first time. But the regulatory reform driven by the Kim Young-sam administration fell short of being evaluated as a success at the end of the administration’s term because its over emphasis on resolving civil petitions left much to be desired in the way of revitalizing economic growth. Another criticism of the regulatory reforms was that there were too many committees and were not binding enough from legal and institutional standpoint. Embracing this criticism, the Kim Young-sam administration consolidated four committees under the Council for the Promotion of Regulatory Reform(CPRP), an unified body, and increased the ratio of members from the private sector in the Council to strengthen its capability to drive regulatory reform and to enhance the effectiveness of the reforms in practice through greater participation from those affected by regulations.

This CPRP was a huge breakthrough for Korea’s regulatory reform; in that the Framework Act on Administrative Regulations institutionalized regulatory reform, making it legally binding for all ministries in the central government. The act stipulates the establishment of the presidential Regulatory Reform Committee as regulatory reform body. It also instituted the following: the registration and promulgation of regulations; the prior assessment of new regulations; requiring regulatory impact analysis; use of sunset clauses in newly introduced regulations; making administrative departments responsible for rearranging existing regulations and for creating comprehensive regulatory overhaul plans; and requiring relevant government agencies to cooperate in realigning the budget and organization in line with the regulatory reforms. The Kim Young-sam administration selected 4,477 areas of deregulation during its term and completed a total of 3,918 of the targeted areas (86.9%).[3]

3. For the contents in detail on the performance of Kim Young-sam administration, refer to Rhee, Zu-sun and Seon-Ok Han (1999).

2.3. Kim Dae-jung Administration (1998~2003): Launch of the Regulatory Reform Committee and 50% Cut of Registered Regulations

The office led by President Kim Dae-jung, who took office in 1998, had to overcome the Foreign Exchange Crisis that erupted at the end of 1997 when the term of the previous Kim Young-sam administration came to an end with the IMF bailout. In compliance with the FAAR enacted by its immediate predecessor, the new administration set up the RRC in April 1998, which was under direct presidential control and co-chaired by Prime Minister and a member from the private sector. This organization conducted the review and reform of existing regulations and the review of new and reinforced ones following the regulatory management system as stipulated in this Act. This enabled Korea to overcome the foreign exchange crisis on back of regulatory reforms.

In 1998, every ministry in the government had to register all the regulations they oversaw to the RRC based on the FAAR. The total number amounted to 11,125. Regarding these registered regulations, President Kim Dae-jung ordered “50% of them to be abolished” on special presidential instructions at a Cabinet meeting. So, the government established six Advisory Sub-Committees to review existing regulations in the RRC, which led to the elimination of 5,430 cases (48.8%) and to the improvement of 2,411 cases (21.7%). The regulatory reform efforts were a breakthrough in terms of easing or removing 7,841 cases, 70.5% of the total regulations. This lasted into 1999 when advisory research institutes were commissioned to examine the validity of the remaining 6,811 regulations, among which 504 cases (7.4%) were removed and 570 cases (8.4%) were improved. Entering the third year in office in 2000, the Kim Dae-jung administration continued efforts to reform existing regulations. Following the discovery of 2,533 regulations on the subordinate administrative orders and additional 1,675 based on the rules of diverse organizations under the control of the government, total modification on 2,045 cases (57.2%) were made.

2.4. Roh Moo-hyun Administration (2003~08) : Dualism in the Regulatory Reform Engine and Increase in Regulations

The Roh Moo-hyun administration that was considered as the most socialist of governments in Korea’s modern history started in 2003. In the early phase of its term, the Roh Moo-hyun administration did not claim to make regulatory reform as one of its major policy agenda. On the contrary, there was prevalent perception that regulatory reform could be used to secure the interests of the higher income class by pursuing a policy of relentless competition in the market rather than protecting the social weaks. Such inclination went up to incapacitating the functions of the RRC which is a legal institution. Despite of the global economic boom, there was not great progress on job creation. The government realized that these problems were attributable to sluggish corporate investment. This shift in perception led to the establishment of several committees in August 2004 including the Presidential Council for Promoting Regulatory Reform(PCPRR), which was chaired by the President, the Ministerial Meeting for Regulatory Reform(MMRR) led by the Prime Minister, and the Regulatory Reform Task Force(RRTF) as a temporary organization to provide administrative support.

But the establishment of this new regulatory reform bodies meant introducing dualism in the system, which deviated from the former Kim Young-sam administration's approach of a unifying to maximize efficiency. On the back of criticism regarding this dualism, the Roh Moo-hyun administration separated their functions, allocating the job of reforming key regulations to the RRTF and the review of new or reinforced regulations and rearrangement of regulations according to the FAAR to the RRC. However, the committee ceased to be the top organization in charge of reviewing and deciding on whether to introduce or maintain all the government regulations. It was relegated as a working-level consultative body under the PCPRR, and the newly established MMRR under an administrative order. Moreover, the reviewing functions of the RRC were in reality weakened since it operated around subcommittees. The regulatory reform process was also hindered because the Office of Deputy Minister for Regulatory Reform (ODMRR) in the Office for Government Policy Coordination(OPC) replaced the committee in securing the authority to actually review regulations even though the office was merely an administrative body set up to assist the RRC.

The Roh Moo-hyun administration drew up a plan to reform 54 key regulations in seven areas spearheaded by the RRTF, with 1,473 reform tasks of 48 strategic reform tasks. Such efforts resulted in the completion of 954 cases, but resolving these tasks did not lead to effective regulatory reform in terms of creating jobs and increasing competitiveness of the national economy. The reform of so called "policy regulations" were continuously avoided even though they remained serious obstacles; instead only peripheral issues in civil petition were independently resolved. As a result, the administration's declaration of regulatory reform during its term ended up becoming empty promises as the number of registered regulations rose to 7,836 at the end of 2003, 7,846 at the end of 2004, 8,015 at the end of 2005, and 8,083 at the end of 2006. This is compared to the total of 7,723 towards the end of Kim Dae-jung's administration in 2002. The number of regulations continued to grow, demonstrating the government's low appetite for reform and increasing willingness to intervene.

2.5. Lee Myung-bak Administration (2008~Present): Putting Regulatory Reform at the Top of the Policy Agenda and Key Regulatory Reform

The Lee Myung-bak administration was launched in February 2008. It put regulatory reform at the top of the policy agenda as the best means to enhance Korea's national competitiveness and to create jobs. The Presidential Council on National Competitiveness(PCNC) was established so that President Lee could push regulatory reform as a presidential task. Under the council, the regulatory reform steering group was jointly operated by the Korea Chamber of Commerce and the government. While the RRC was kept intact, its auxiliary organization in charge of handling administrative support was reorganized into the Office of Regulatory Reform (ORR), a smaller version of the previous ODMRR in the Prime Minister's Office.

The dualism in carrying out regulatory reform has continued, similar to the Roh Moo-hyun administration, as the PCNC is in charge of reforming key regulations as well as existing ones while the RRC reviews new or reinforced ones. The regulatory reform efforts of President Lee's administration are significant in the sense that it has become the most reliable policy initiative to boost Korea's national competitiveness and to create jobs. In particular, progress has been made on the president's primary concern of regulatory reform and offering signs of encouragement to push ahead with it. However, the RRC as a sub-organization for reforming regulations presents some problems even though the committee is a legal one.

Despite of these obstacles, President Lee Myung-bak identified 3,122 areas for regulatory reform, among which 1,871 were improved. The key "policy regulations" underwent extensive reforms such as regulations for governing the metropolitan area, restrictions on share ownership, separation between industrial and financial capital, and communications and broadcasting media. All of these were previously considered untouchable, so these reform efforts made remarkable progress. Progress has been made in upgrading the basis to enhance quality control and to carry out scientific and rational management of regulations by instituting regulatory reform measures such as carrying out temporary regulatory relief to overcome the economic crisis, applying sunset clauses to more regulations, registering unlisted regulations, and setting up an information system for regulations.

3. Periodical Changes in the Regulatory Reform Apparatus

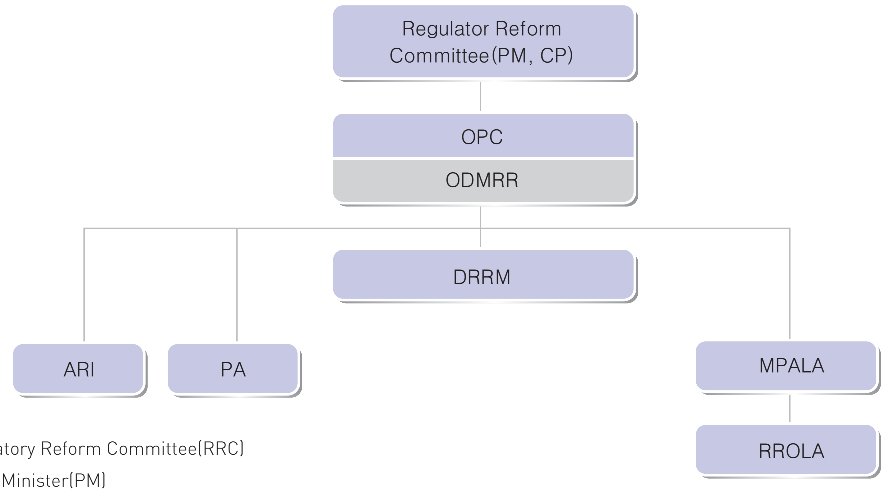
As seen in the above, the first basis for regulatory reform emerged in the Chun Doo-hwan administration. It was succeeded by more systematic form during the Roh Tae-woo and Kim

Young-sam administrations. We have already discussed the platform for regulatory reform for the Roh Tae-woo and the Kim Young-sam administration briefly. Here, we try to explain the main contents of regulatory reform apparatus in Korea. Because the Korean government established the RRC as a permanent regulatory reform engine based on the FAAR under the Kim Dae-jung administration and the engine has been working with some changes since that time, we will start the explanation from that point on.

3.1. Under President Kim Dae-jung

The Kim Dae-jung administration established the RRC as an official government organization, and launched the ODMRR in the OPC under the Prime Minister as an independent organization that would provide administrative support to the RRC. Figure 2-1 shows the regulatory reform engine under the Kim Dae-jung administration.

Figure 2-1 | **Structure of Kim Dae-jung Administration's Regulatory Reform Apparatus**



Regulatory Reform Committee(RRC)
Prime Minister(PM)
Chairman from the Private Sector(CP)
Office for Government Policy Coordination(OPC)
Office of Deputy Minister of Regulatory Reform(ODMRR)
Division for Regulatory Reform of Ministries(DRRM)
Advisory Research Institute(ARI)
Professional Advisors(PA)
Ministry of Public Administration and Local Autonomy(MPALA)
Regulatory Reform Office of Local Administration(RROLA)

Source: Regulatory Reform Committee, "Regulatory Reform White Paper," 1999, p.35.

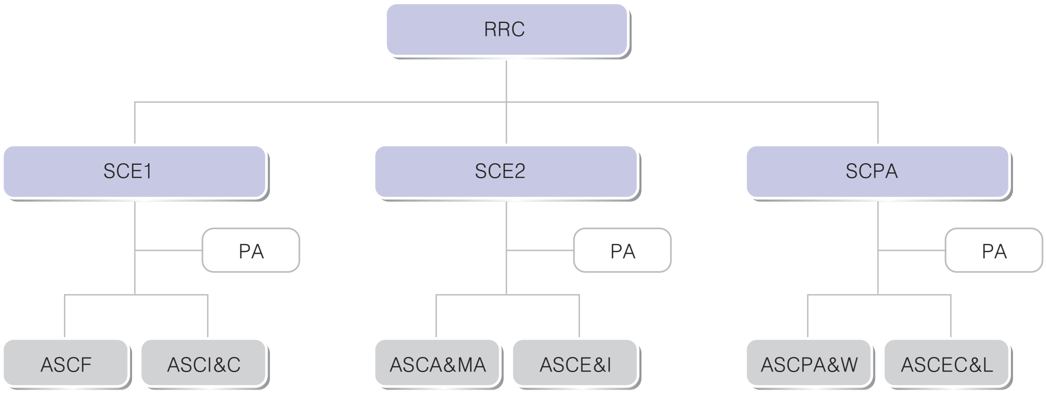
The RRC is the highest-ranking body, and is jointly chaired by the Prime Minister and a representative from the private sector. It consists of 20 members, 12 of which come from the private sector and six from the government. The belief that participation by those impacted by the regulations would significantly enhance the process led to the high number of representatives from the private sector. The ODMRR provided administrative support to the RRC. It was established as a full-time administrative organization with eleven teams under the 'Government Organization Act' that was managed by the deputy minister and three director generals. This administrative organization was characterized as the first official one within the government consisting of civil servants that exclusively dealt with regulatory reform. The presence of a dedicated official organization that was in charge of regulatory reform was an important step forward in institutionalizing the process of regulatory reform because its members were evaluated by the performance of the regulatory reforms. The RRC also designated 55 research institutes to secure the expertise necessary for implementing regulatory reform and recruited ten professional advisors with expertise in each area. This was the highlight of institutionalizing the regulatory reform engine during Kim Dae-jung administration.

In terms of the organizations that made up the regulatory reform engine, the central government had the Division for Regulatory Reform at the ministerial level. It was composed of the Assistant Minister for Planning and General Management from each ministry and the experts from the private sector. It was in charge of developing yearly plans to reorganize existing regulations and implement them. It was also in charge of reviewing new and reinforced regulations suggested by the ministry.

Local governments let deputy mayors or deputy provincial governors of administrative affairs supervise the overall management of regulatory reform. They were also allowed to have their own committee made up of 10 to 20 local government officials and representatives from the private sector. The offices of planning and coordination in the metropolitan governments were generally in charge of regulatory reform where working teams were led by planning directors that were fully responsible for the work. In local governments like cities and counties, there were similar organizations to carry out regulatory reform at that level.

The RRC operated under the structure shown in Figure 2-2, which was composed of three sub-committees including Economy 1, Economy 2, and public administration in an attempt to divide relevant duties and to run the organization efficiently. In addition, 10 experts were appointed as professional advisers to conduct researches commissioned by the RRC. In 1998, six Advisory Sub-Committees were established early in President Kim Dae-jung's term, as temporary organizations to review existing regulations of all ministries.

Figure 2-2 | Operating System of the RRC



Sub-Committee of Economy 1(SCE1)
Sub-Committee of Economy 2(SCE2)
Sub-Committee of Public Administration(SCPA)
Advisory Sub-Committee for Finance(ASCF)
Advisory Sub-Committee for Industry and Construction(ASCI&C)
Advisory Sub-Committee for Agriculture and Maritime Affairs(ASCA&MA)
Advisory Sub-Committee for Environment and Information(ASCE&I)
Advisory Sub-Committee for Public Administration and Welfare(ASCPA&W)
Advisory Sub-Committee for Education, Culture & Labor(ASCEC&L)

Source: Regulatory Reform Committee, "Regulatory Reform White Paper," 1999, p.35.

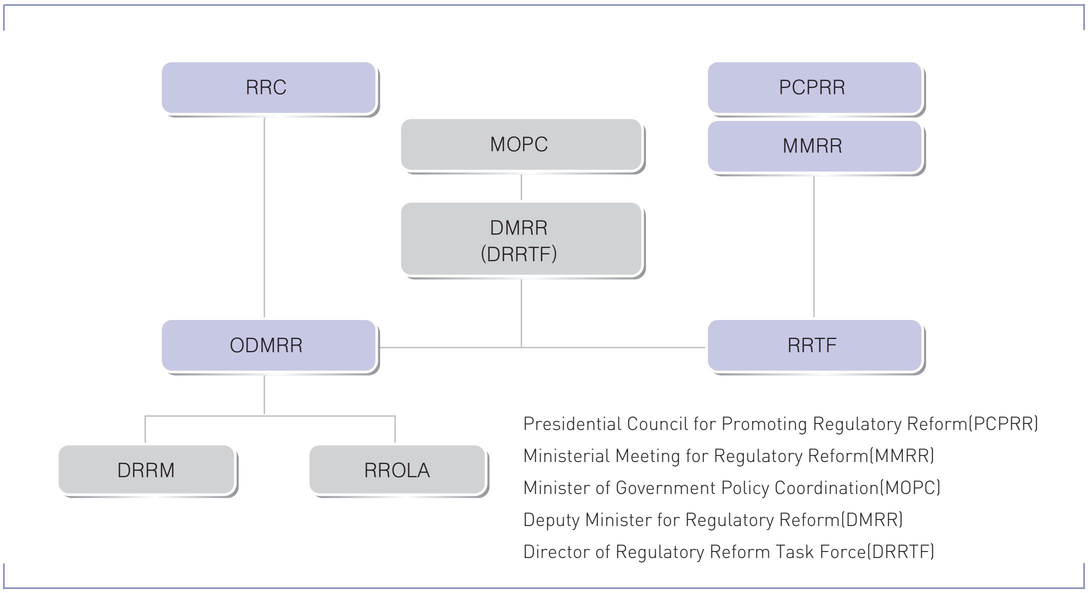
Under this system, the RRC reviewed regulatory reform plans submitted by the ministries according to the FAAR, on which opinions from related organizations, research institutes, and experts, were collected and assesses as part of the review process. The six Advisory Sub-Committees were in charge of conducting reviews by each area. When disagreements were not resolved by the Advisory Sub-Committees, another round of review was made by three Sub-committees. The issues that failed to reach an agreement were reviewed by the RRC's Plenary Session. All the items on the final regulatory reform agenda had to be deliberated and finalized by the Plenary Session.

In reviewing new or reinforced regulations, different procedures were applied to ordinary ones and urgent ones, respectively. For ordinary reviews, views from government agencies were collected and a Regulatory Impact Analysis(RIA) was conducted. Then, the regulations were subject to review by their own oversight bodies before being submitted to the RRC for review. In light of the requests for reviews from the ministries, the RRC had to review priority submissions in the Plenary Session, while less urgent submissions were subject to review by the Sub-committees. Submissions of new regulations that were considered urgent by the Sub-committees were sent to the Plenary Session after a request for review was made by the ministers so that the results of the review could be notified and resolved immediately. New regulations that were not considered urgent had to go through the normal process. When regulations submitted for review were considered urgent, they were exempted from Prospective RIA and ministry's own reviewing process, and allowed to defer the submission of the RIA report temporarily within 60 days. The ministry which had an objection to these results from deliberation and resolution over new or reinforced regulations was permitted to have them reviewed again.

3.2. Under the Roh Moo-hyun Administration

Despite of some adjustments by July 2004, the regulatory reform system of the Roh Moo-hyun administration rested on the very foundations that served the Kim Dae-jung administration. But after August 2004, several organizations were established including the Presidential Council for Promoting Regulatory Reform(PCPRR), the Ministerial Meetings for Regulatory Reform(MMRR) headed by Prime Minister, and the Regulatory Reform Task Force(RRTF) as temporary organizations to promote and expedite regulation reform, even though they were only based on executive orders. Thus, these organizations operated in parallel with the existing RRC, inviting dualism. Such dualism in the regulatory reform process is summarized in Figure 2-3.

Figure 2-3 | Regulatory Reform Engine under Roh Moo-hyun Administration

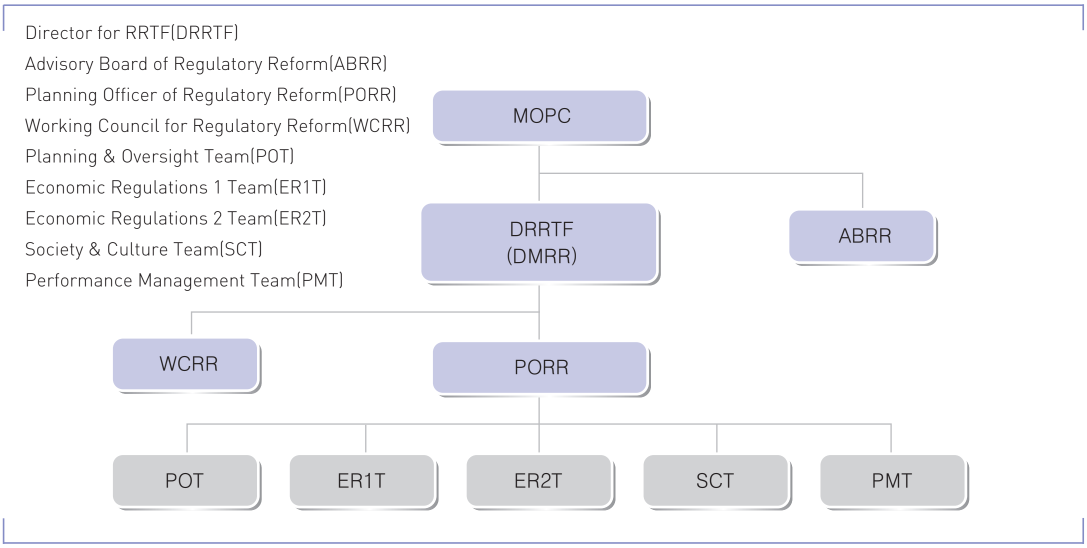


Source: Rhee(2007), p.104.

According to this system, the President led the PCPRR, which was made up of ministers and deliberated on key regulatory reform tasks. PCPRR's function was the deliveration on key task of regulatory reform and the check on each ministry's performance in carrying out ongoing regulatory reform once a month. The Prime Minister was in charge of holding the MMRR, which was comprised of the ministers of the departments related to the deliberation. In this meeting, general measures to revise regulations were discussed and deliberated. Also, It also made decisions on strategic tasks chosen and implemented by the RRTF. To avoid overlaps in the work due to dual system, the RRC was in charge of reviewing new and reinforced regulations and rearranging exiting regulations specified in the FAAR, while the RRTF, selected key regulations out of the existing ones like strategic reform tasks needing rearrangement.

The RRFF was launched in August 2004 as a temporary organization that was supposed to last for two years. Its period of activity was extended in August 2006 to end with the administration's term. From its inception to August 2006, the organization had a total of 50 people in the OPC under Prime Minister's Office: 24 from the private sector and 26 from the government. But the number of people fell to 35 (16 from the private sector and 19 government officials) after the extension. The Deputy Minister for Regulatory Reform served also as the Director of the RRTF. The RRTF also identified corporate regulations that did not make sense. It administered the Advisory Board for Regulatory Reform(ABRR) under the supervision of the Minister of the OPC and the Working Council for Regulatory Reform(WCRR) under the supervision of the Director of the RRTF for consultation. The Advisory Board and Working Council were made up of executives from trade associations and companies, heads of offices and director generals of the RRTF and ministries. The structure of the RRTF is illustrated in Figure 2-4.

Figure 2-4 | Structure of the Regulatory Reform Task Force

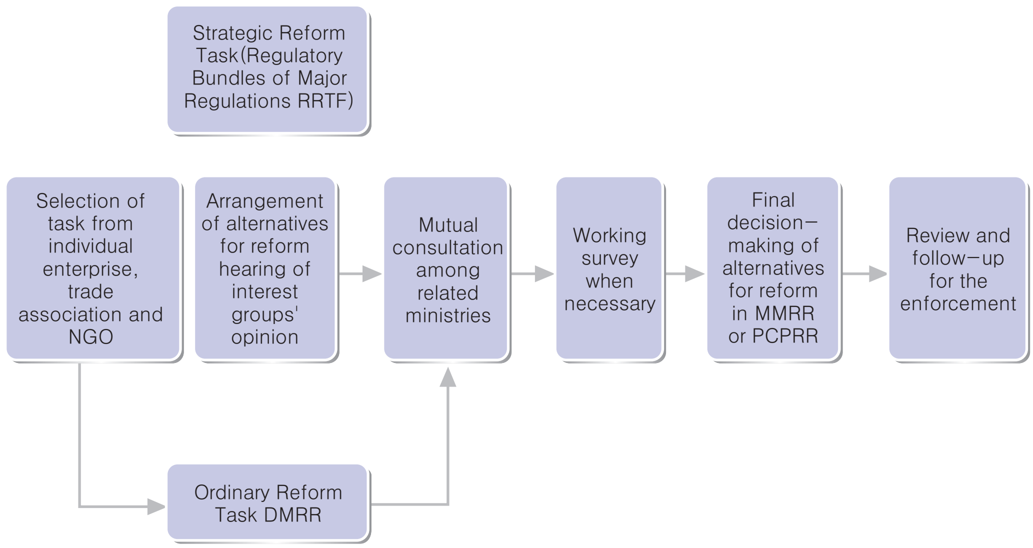


Source: Regulatory Reform Committee Hompage.

The RRTF had the following three teams: planning and oversight, Regulatory Reform Team 1, and Regulatory Reform Team 2. The planning and oversight team had three TFs for planning and oversight/education/culture, labor/health, and environment. The Regulatory Reform 1 Team had three TFs for industry/resources/agriculture and forestry, logistics/distribution/maritime, and service industries. The Regulatory Reform 2 Team had three TFs for fair competition, architecture/land, and finance. Since then, the structure was expanded resulting in five teams managed by the Planning Officer of Regulatory Reform which was under the Director of the RRTF. These teams included: Economic Regulations Team for commercial/logistics/manufacturing/construction/land sectors; Economic Regulations 2 Team for IT/financial/service sectors; Society and Culture Team for society/culture/administration /education; Performance Management Team for follow-up measures related to performance and ministerial adjustment, and department for overall control.

The RRTF selects reform tasks by collecting proposals or suggestions from the general public, companies, civic groups and trade associations, all of which are subject to regulation. The RRTF proposes the improvement measures based on discussion with various interested parties and experts in regards to key regulations encompassing several ministries. The Regulatory Reform Promotion Committees(RRPC) in the central government agencies are responsible for individual tasks which can be dealt with at the ministerial level. Such improvement measures go through consultation with impacted agencies, reflecting decisions of

Figure 2-5 | Procedure of the RRTF to Process Regulatory Reform



Source: Regulatory Reform Committee Hompage.

working-level officials like department heads. Additional deliberation and confirmation is required in the MMRR or the PCPRR. Working surveys are carried out if necessary before improvement measures are confirmed. For confirmed improvement measures, relevant statutes are enacted or amended, and implementation of regulatory reforms is followed up. The process of regulatory reform through the RRTF is shown in Figure 2-5.

The decision to introduce dualism in regulatory reform engine under the Roh Moo-hyun administration was made because achieving higher performance from regulatory reform only with the RRC and the ODMRR was assessed to be too difficult. Regulatory reforms often lead to sharp conflict of interests, requiring the President's firm support. To resolve the conflict of interests among related ministries to ensure wide cooperation, the ministers of related departments needed to make adjustments regarding issues of regulatory reform with the Prime Minister. This seems to have led to the beginning of this dual system. Moreover, the performance of regulatory reforms can be high when constraints in terms of manpower, budget and expertise under the RRC are eliminated. So the idea of setting up a separate body to implement the reforms may be regarded as an efficient way.

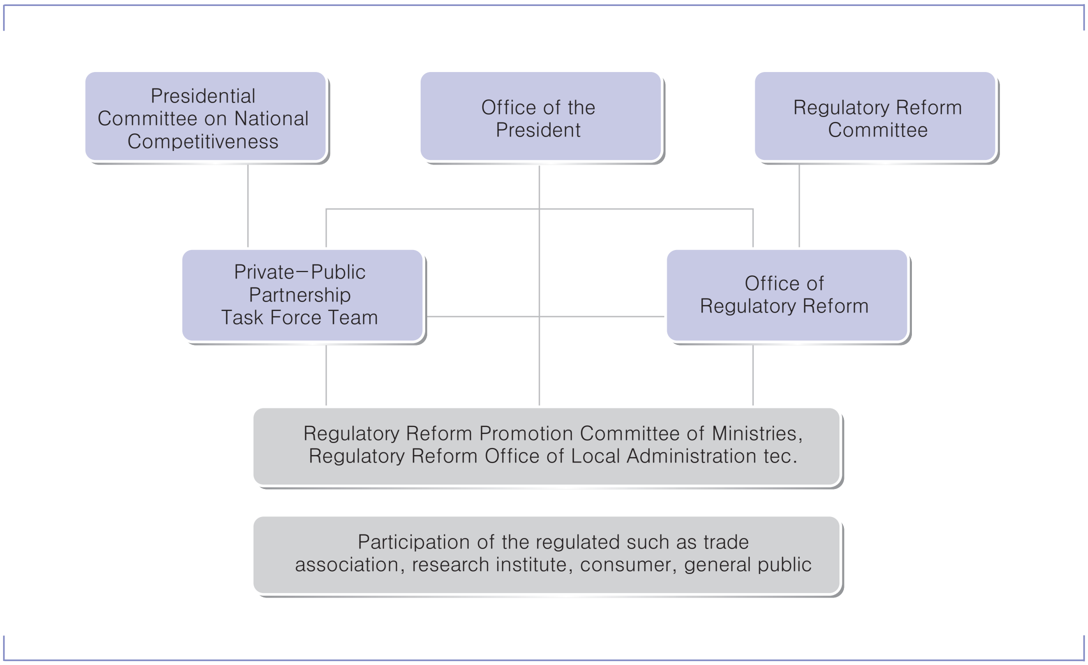
Separate from the regulatory reform engine of the administration, the National Assembly as the legislative body embarked on unprecedented regulatory reform efforts by organizing the Special Committee on Regulatory Reform as a temporary body based on bipartisan consensus. It was established in July, 2004 and went on until June, 2005. This Committee sought to drive regulatory reforms that were focused on revitalizing the economy. In the process, it sought to come up with improvement measures by considering proposals of business associations through public hearings and various meetings. Still they were not seen as reformers. But the details were supposed to have been reported to the Plenary Session of the National Assembly by this committee, which included the proposals of transforming this Committee into a permanent Committee, requiring attachment of RIA when enacting or amending law governing regulations, applying sunset provision to regulations on a default basis, and requiring the submission of regulatory work list to be handled by the RRC for greater supervision on creating and strengthening regulations. The realization of all of when can be considered progress because they prohibit the bypass of prior regulatory review by the RRC. The bypass is possible through the legislation proposed by Members of the National Assembly.

3.3. Reforms under Lee Myung-Bak Administration

The regulatory reform engine under the Lee Myung-bak administration differs slightly from its immediate predecessors from a high level, as shown in Figure 2-6.

The newly created Presidential Committee on National Competitiveness(PCNC) was in

Figure 2-6 | Regulatory Reform Engine under Lee Myung-bak Administration



Source: RRC (2009).

charge of reforming key policy regulations that had great ripple effects. It was also charged with reviewing bulk ones relevant to multiple central government agencies. As sub-organizations, the Private-Public Partnership Task Force Team(PPPTFT) was established together with the Korea Chamber of Commerce & Industry to support the PCNC. The RRC was supposed to handle everything that had to do with regulatory reform according to the FARR, including the review of new or reinforced regulations, management and assessment of regulatory reform projects of each ministry, and registration of regulations. After reorganization, the Office of Deputy Minister of Regulatory Reform, which used to be in the Prime Minister's office was reduced into the Office of Regulatory Reform(ORR) to provide administrative support to the RRC.

There were no significant changes in the regulatory reform engines of the central administrative agencies and local governments. In the central government, the Office of Legal Affairs and its own Regulatory Reform Promotion Committee(RRPC) inherited the roles played by the Office of Innovation Officer and the Division for Regulatory Reform during the previous administration. Respectively, the organizations reviewed new or reinforced regulations falling under its jurisdiction in advance and prepared and executed an annual reassessment for existing ones. Despite of the minor changes in the regulatory reform bodies of local governments, there were efforts to rearrange regulations based on ordinances and rules. The ordinances and rules that were expected to be newly established or amended in advance were to be reviewed. Also, regulatory reform training was to be provided for better governing abilities through the PCNC, the RRC and the Ministry of Public Administration and Security. The current administration added special organizations dedicated to regulatory reform, including the Ministry of Public Administration and Security, the Ministry of Government Legislation, the Anti-Corruption and Civil Rights Commission as well as the existing Regulatory Reform Working Groups of the Korea Fair Trade Commission.

4. Changes in the Regulatory Management System

The regulatory management system along with regulatory reform engine is the core measure of successful regulatory reform and regulatory quality control. The Korean regulatory management system was officially established under the Kim Young-sam administration and came into force under the Kim Dae-jung administration right after the foreign currency crisis. The system was a product of the Regulatory Research Group, a voluntarily organized public-private partnership established in 1992. The group provided the government with ideas and case studies that benchmarked OECD countries for building the system. Therefore, the paper will discuss the system starting from the pre-crisis era and finish it with the current system that has lasted since foreign exchange crisis.

4.1. Prior to the Foreign Exchange Crisis

The Kim Young-sam administration launched the Joint Commission on Reviewing Administrative Regulations(JCRAR) in May, 1995 in accordance with the 'Administrative Regulations and Civil Petition Treatment Act(ARCPTA)' enacted in January, 1994. Its goal was to establish a statutory basis for regulations and a process of reviewing them. This commission was launched on the back of calls from experts to establish preemptive measures for reviewing and assessing regulations before they were enacted given the enormous difficulty of undoing regulations already institutionalized. The point was that this commission did not target all new regulations, but focused on regulatory issues that caused disagreement among ministries or that presented problems whose rationale and economic efficiency had to be examined by conducting the RIA. Many believed that prior adjustment among ministries over new or reinforced regulations could be facilitated with the establishment of this Commission. Yet the fact that even inefficient regulations were not the subject of the preliminary examination in this Commission unless there had been opinion conflicts among the Ministries was highlighted as the system deficiency. In reality, this Commission failed to play any practical role despite of it being established in accordance with the related laws, and was dissolved in August, 1997 with the termination of the 'Civil Petition Treatment Act' that provided the basis for the 'Framework Act on Administrative Regulations.' In a nutshell, even though numerous regulatory reform committees were established before the crisis, the domestic environment of Korea at the time was difficult to install a systematic regulatory management.

4.2. Post-Crisis Era

The 'Framework Act on Administrative Regulations' was enacted in the end of 1997, right before the end of the Kim Young-sam administration. The act specifies regulatory management system as well as regulatory reform engine. This act was critical bringing about breakthroughs in the institutional improvement of Korea's regulatory management system. The defined aspects of rational regulatory management system include regulation on a statutory basis (Article 4) registration and promulgation of regulations (Article 6), the RIA (Article 7), sunset clauses of regulations (Article 8), collecting opinions (Article 9), evaluation of existing regulations (Article 19), designing (Article 20) and implementing (Article 21) of the comprehensive plan of regulatory overhaul, checking and assessing regulatory improvement efforts (Article 34), and issuing of regulatory reform white papers (Article 35).

Regulation on a statutory basis requires that every regulation be based on laws (Article 4, Provision 1) and that central administrative agencies cannot restrain the rights of the people or impose regulations that are not based on laws. (Article 4, Provision 3) It also indicates that regulations which have no legal grounds are invalid. In addition, the content of regulations should be defined in concrete and clear terms (Article 4, Provision 1).Their details should be determined by presidential decree, by ordinance of the Prime Minister, by ordinance of the ministry, or by ordinances and rules, as long as laws or higher statutes set a concrete range of delegation. As for exceptional cases involving specialized technical statutes which inevitably need a transfer of power due to minor details, regulation by subordinate administrative orders like public notification is possible when delegation provisions is made within a specific set of ranges (Article 4, Provision 2).

Systematic management and promulgation of regulatory information can be an important means of contributing to greater rationality and compliance by delivering proper information to parties impacted by regulations - planners (ministries), evaluators (regulatory reform committees), legislators (National Assembly), implementing organizations (ministries, local governments or associations), the regulated (the general public, companies and more). Therefore, in order to ensure an advanced system of managing and delivering regulatory information, the FARR requires the heads of the central administrative agencies to register the following details of regulations including titles, contents, foundations, and responsible authorities, to the RCC. The Committee should promulgate such details (Article 6, Provision 1). In line with this, when the committee discovers unregistered regulations through *ex officio* investigation, the heads of the relevant central administrative agencies are asked to register them to the Committee or to submit a proposal for rearranging the regulations through the revision of laws or decrees, etc. (Article 6, Provision 2).

The RIA plays an important role in objectively assessing whether regulations fit their purpose by clarifying the rationality of regulations and their expected costs and benefits. Its requirement at the time of applying for prior review of regulations newly introduced or reinforced can be another step forward in the regulatory management system. Upon newly introducing or reinforcing regulations including the extension of their term, ministers are obliged to fill in the RIA form considering the following factors: the purpose for creation or reinforcement; of the regulation; the possibility of realizing the regulation's intended outcome; the existence of alternatives other than regulations and the possibility of overlap with the existing ones; comparative analysis of costs and benefits of regulations from the standpoint of affected parties; inclusion of factors restraining competition; objectivity and clarity of regulatory contents; the administrative costs and burdens of new or reinforced regulations; and whether related documents and processing procedures are appropriate in the related civil petition service (Article 7, Provision 1).

Sunset clauses automatically terminate a regulation at the end of a fixed period, which is set at the time of introduction. Once a regulation is introduced, it tends to persist even after achieving its intended goals or loses its effectiveness or meaning. This puts the burden on the general public and companies which are impacted. This is an inefficient use of administrative capacity. Hence, an institutional device such as this is needed to fundamentally resolve these problems. The 'Framework Act on Administrative Regulations' requires ministers to stipulate in the relevant statutes the total duration of regulations which lack obvious reasons for their continuing existence (Article 8, Provision 1). Moreover, the period of a regulation should be the minimum necessary for serving its regulatory purposes and limited to less than five years in principle (Article 8, Provision 2). The extension of regulation's period has to be approved by the Committee. For important or urgent regulations that need to be reviewed, the RRC can be recommended to ministers to revise the lasting period of regulations (Article 8, Provision 4).

Gathering different views can be an important way to ensure the validity and compliance of regulations. The FAAR stipulates in Article 9 that "when the heads of central administrative agencies create or reinforce regulations, they should consider sufficient opinions of other related administrative agencies, private groups, interested parties, research institutes, and experts by way of public hearings and administrative prior announcement of legislation, and so on." This also includes peer reviews and consultation in addition to public hearings and prior announcements of legislation specified in the law.

So far, most regulatory management systems have focused on creating or reinforcing regulations while the provisions in the FAAR deal with the revision of existing ones so that those regulations can also be reformed through such institutional device. In accordance with the Act, regulators like central administrative agencies are responsible for reforming the existing ones. To drive this reform, the responsibility of administrative agencies including the RRC is stipulated in the law so that their regulatory reform efforts can be legally binding.

To put these provisions concretely, Article 19 asks the chiefs of central administrative agencies to revamp targeted regulations selected among those under their supervision by collecting opinions of stakeholders and experts (Provision 1), and requiring the submission of ensuing results to the RRC (Provision 2, Article 13 of Enforcement Ordinance). According to Article 20, the RRC is required to prioritize and select the sectors for regulatory reform every year. It must also identify specific regulations from existing ones so that guidance on overhauling existing ones can be given to the heads of central administrative agencies (Provision 1). As a result, these heads have to draw up regulatory rearrangement plans for their agencies and submit such plans to the RRC (Provision 2), and the RRC puts them together in preparing the governmental comprehensive plan for regulatory rearrangement, which are announced after being vetted by the cabinet and approved by the President (Provision 3). Regulatory arrangement guidelines include basic reform directions, the criteria for rearranging existing regulations, priority sectors that need to undergo regulatory reform or particular ones among existing regulations, and other items considered necessary by the RRC to ensure efficiency in rearranging existing regulations (Article 14, Provision 2 of the enforcement ordinance). All of these procedures are announced by the 31st of October every year (Article 14, Provision 1 of the enforcement ordinance). Based on this, the heads of central administrative agencies are supposed to submit a plan for regulatory rearrangement for the succeeding year to the RRC (Article 14, Provision 3 of the enforcement ordinance). Article 21 reports on the implementation of these comprehensive plans for regulatory overhaul and performances from them.

Provisions of organizational rearrangement in Article 22 can be thought of as an institutional framework to realize synerigies from regulatory reform by linking with other government-driven reforms aimed at building a smaller and more efficient government. In this case, the RRC notifies the heads of central administrative agencies in charge of governmental organization and budgets of the realized overhaul of existing ones (Article 22, Provision 1), and the heads of relevant agencies who are informed of this asr obliged to seek ways to make the governmental organization or budgets more reasonable following regulatory overhaul (Article 22, Provision 2).

Mointoring and evaluating improvements in regulations is a system of ex-post regulatory reform management. Once regulatory reform is realized, follow-up maesures whose necessity emerges afterwards and their real conditions in umplementation undergo inspection, as part of regulatory management system to have substantially improving effect on the administrative quality. The ripple and side effects brought about by regulatory refrom should be subject to monitoring to ensure that corretive actions can be taken and the changed system also functions well. In the FAAR, the RRC is responsible for ascertaining and monitoring how administrative agencies at various levels manage regulations and related improvements (Article 34, Provision 1). It also reports the results to the cabinet and President (Article 34, Provision 2). Additonally, the RCC can commission a public-opinion poll to maintain objectiveness (Article 34, Provision 3). It can also make recommendations to the President by suggesting measures to reconcile differing views when regulatory improvement is not conducted aggressively or resulting performance is not satisfactory after evaluation.

A white paper on regulatory reform is required to be prepared annually so that affected sectors of regulatory reform and the general public can be informed of the progress, which helps relieve unnecessary misunderstandings and conflicts likely to arise during regulatory reform. It also facilitates the compliance of the regulated to the revised regulations by offering up-to-date accurate information on gulatory reform.

5. Representative Measures to Conduct Regulatory Reform

5.1. Guillotine Approach: 50% Cut in Registered Regulations

In 1998, the Kim Dae-jung administration instructed that 50% of the total number of administrative regulations registered be reduced in accordance with the FAAR. Following this instruction, central administrative agencies abolished 5,430 cases (43.8%) and improved 2,411 cases (21.7%), out of the total 11,125. This regulatory reform effort was very drastic, resulting the improvement or removal of 7,841 cases, which was 70.5% of total regulations. In 1999, the administration eliminated 504 regulations and improved 570, or 7.4% and 8.4% of the total, respectively, from the remaining 6,811 cases. In 2000, the third year of the administration's term, it continued its effort to reorganize 2,045 cases (57.2%) by identifying a total of 2,533 regulations based on subordinate administrative orders, and 1,675 quasi-administrative regulations of the various rules of government-affiliated organizations. The drastic efforts in deregulation of the Kim Dae-jung administration was based on quantitative criteria, and later became known as the “Guillotine Approach” by the OECD which introduced this exemplary approach to its member countries as official measures of regulatory reform.

The guillotine approach is a powerful approach to laying groundwork for entering a more advanced stage of regulatory reform. Because unreasonable and inefficient regulations are aggressively removed in the early stages of regulatory reform, the quality control on the functions of the government at last becomes feasible. However, it is not a desirable way of continuously carrying out regulatory reform because this approach is uniform based rather than selective based on careful examination of individual regulations in a calm and orderly way. At the early stages of regulatory reform, the common approach is to remove numerous regulations all together by taking the guillotine approach as they are unreasonable but do not involve complicated interests. Of course, the existence of powerful interest groups sometimes prevents regulatory reform from affecting the relevant sector or achieving greater improvement, and regulatory reform in some sectors fails to make any significant progress or becomes impossible in fact due to a country's unique culture, tradition, customs, and ideology. Once this quantitative regulatory reform is implemented, ostensibly unreasonable or inefficient regulations are eliminated in most cases. Therefore, the remaining ones after quantitative reform needs more professional and objective review in deciding whether to let them persist. The regulatory management system aforementioned is the best tool not only to prevent regulatory control from weakening but also to make shift into more reasonable and efficient ones because regulatory reform is carried out through professional and objective review and new or strengthened regulations have to go through the same review process. The OECD classifies the regulatory reform of utilizing these regulatory management systems including the RIA into regulatory quality control and regulatory management.

5.2. Prior Review on New or Reinforced Regulations

The RRC prevents bad regulations from being introduced by reviews of newly introduced or reinforced by central administrative agencies. The existing regulations, which survived a review under the guillotine approach are likely to be inevitable ones except for a sudden change in economic and social environments. Of course, this judgment is made based on very successful deregulation thanks to the guillotine approach. Moreover, the validity of most of these remaining regulations are confirmed once again in the process of regulatory reform under the guillotine approach, indicating completion of review on their rationale and validity.

Therefore, the quality of regulations afterwards is determined by whether newly introduced or reinforced regulations can become better when they go through review. During such process, it is necessary to establish a systematic regulatory management system in diverse forms including the RIA, whose detail is explained above, that can be utilized to accomplish regulatory management in scientific and rational way. The RIA lies at the heart of this process. Offering much qualitative information also matters in providing the rationale for introducing regulations as well as quantitative analysis based on numerical figures. Adopting better regulations is possible only when experts and the committee or public officials in charge of regulatory reform conduct a review of their validity after all the information has been collected.

If the committee for regulatory review is largely comprised of experts from specific areas, then it is likely to lack the knowledge in regulatory theory. This leads to emphasis on specialized characteristics and lack of consideration on the likelihood of compliance by the regulated. In contrast, if members composed of only regulatory experts specialized in regulatory theory tend to place emphasis on raising the compliance rate or rationality of regulations, then their lack of expertise in highly technical or professional areas may result in limiting the adoption of valid regulations. Therefore, committees in charge of regulatory review should include both experts in regulations and specialists from various fields.

And it is recommended that the number of members from the private sector be greater than those from the government sector in committee dealing with regulatory review, so that the private-public cooperative partnership can effectively last. Given that the regulated belong to the private sector, their position as the main agents of regulatory review will make them more sensitive to adopting regulations with greater possibility of compliance and fewer burdens in terms of costs. In the RRC in Korea, the ratio of members from the private sector is set at around 70% to maximize the private-public partnership.

5.3. Temporary Regulatory Relief

Regulatory relief on a temporary basis allows respite from the imposition of regulations to help economic recovery for a certain period of time when an economic crisis arises and their executive force is restored in principle after the termination of relief period, as a way of regulatory reform. Regulations are subject to flexible application for a certain period of time with a view to overcome the global financial crisis early by driving private investment. The Korean government's first attempt to adopt this system was made in 2009.

The introduction of temporary regulatory relief is significant in that new means of advancing regulatory reform is added to those already implemented by the Korean government including the rearrangement of existing regulations, prior review on newly introduced regulations, and sunset clauses. In most cases, regulations are introduced due to their own policy needs and in general, numerous chains of interests are already formed as a result of such regulations. In this sense, when guillotine approach or prior review screens out most of unreasonable regulations that already exist and curbs the intorduction of new regulations, the remaining regulations subject to regulatory reform are likely to have very complicated interests as well as difficulty in making decisions of permanent relaxation or abolition. So regulatory reform to ease or remove these regulations are drawn out in this process and only cause unproductive controversy owing to several obstacles including conflict of interests. Given that boosting private investment is critical in overcoming an economic crisis, the relief of specific regulations, while the government judges it is required to overcome economic crises, can be a highly creative way of inducing private investment which has been deferred because of restraints resulting from uncertainty and regulation.

As regulatory relief is a form of regulatory reform implemented under extraordinary circumstances like economic crisis, speed is everything. In addition, key regulations that can hinder investment need to be targeted, taking the approach from the demand side point of view. Keenly aware of these problems, the Korean government allowed 280 regulations to be deferred in application after the RRC examined those proposed by local governments and central administrative agencies as well as demand-side players such as large and small-and-medium-sized enterprises (SMEs) and small self-employed workers. During this process, there was a drastic reduction in the procedural revision of statutes with a view to bringing about tangible effects from reform earlier, which resulted in sharply shortening the time required during regulatory relief.

The 2009 temporary regulatory relief set the criteria for targeted tasks as the following: resolving difficulties in start-up and investment in the private sector; relieving burden on business activities; and addressing troubles faced by SMEs and the working classes. The tasks meetings based these criteria were proposed by companies (both large companies and SMEs), the government (relevant agencies of local and central governments) and the general public, and then examined by the Office of Regulatory Reform in the prime minister's office. The tasks also went through consultation and mediation among relevant departments before they were confirmed. Some representative ones confirmed after undergoing these criteria and implementation can be listed by criteria in the following. To begin with, to resolve difficulties in start-up and investment, some regulatory relief focused on building additional facilities for existing factories and revitalizing industrial complexes where short-term investment could take place. Representative examples include raising the building-to-land ratio of existing factories within preservation areas from 20% to 40%, applying a two-year grace period for the regulation which restricts the size of development by summing up the newly developed one and the existing one in the event of adjacent development within a specific use area, and temporarily reducing various charges that companies have to pay.

Even only these two measures of relief enable the 50,000 factories or about 39% of a total of 130,000 factories which have already existed nationwide to enlarge their buildings, along with possible new investments of some 400 billion KRW in Gyeonggi Province alone and an estimated approximately 80 billion KRW reduction in the burden of companies thanks to the deferment of charges. Second, there were some moves to readjust numerous regulations to a realistic extent and to sharply scale down collective training or administrative inspections which give inconvenience to operations in an attempt to relieve companies' burdens. The measures are as follows: greater range of incidental business for medical corporations; permission of outdoor operation within a special tourism district; and replacement of annual collective training for operators of food and public health industry such as restaurants, bakery, and public bathhouse by on-line training for two years. Third, in order to save trouble for SMEs and the working class, the government temporarily applied a relaxed version of qualifications in selecting companies and individuals for support. For example, approval of research institutes as the ones affiliated with SMEs was made when they have more than three people on research staff while more than five people had been required previously. Lower rates of rental fee for state-owned property were charged on SMEs from 5% to 3% and there was a two-year extension of reduction and exemption from income tax by 2011. In addition, for the purpose of ameliorating the lives of the working class, the 10,000 students whose loan to pay their tuition was overdue could wait for two years after graduation before registration as defaulters which had previously been applied when their payment was six months behind, and another step to prolong the period of individual extension benefit for jobless people in extreme poverty was also taken, from 60 days to 90 days.

The regulations affected by such regulatory relief should be restored to the original state in principle upon the termination of relief period. However, if regulatory relief does not produce any side effect and only results in boosting investment in a positive way, some follow-up measures can be taken which eventually lead to regulatory reform of easing or removing the regulations in question. Even when there are some side effects, the system has merits of making up for the defect in rational way so that better regulations can be implemented. In other words, when the regulated may appeal some inconvenience from carrying out regulations but it is difficult to gauge the consequences of their relaxation or abolition, temporary relief of these regulations can serve as a means to be restored to the original state promptly while absence of side effects enables it to link to permanent regulatory reform.

6. Conditions of Successful Regulatory Reform

Clear objectives and directions of regulatory reform are essential for successful regulatory reform and the government also should seek these objectives and directions consistently, which calls for coherent conviction and support of the highest person in charge of state affairs, in that regulatory reform is also a “reform” which alters the status quo. Another important element is the creation of private-public partnership enabling the regulated such as companies and the general public and government officials as regulators to engage in exchanges in various forms including mutual interchange of ideas. Therefore, it is recommended that diverse types of organizations should be formed with groups of experts, interest groups, civic groups, companies and public officials participating in such organizations. Also continuing regulatory reform needs institutionalization of regulatory reform engine and regulatory management system within the government, so that such systems are firmly established as permanent quality control measures of government services unswayed in spite of regime change. Timing in reform is another requirement for successful reform. Now, let's examine the concrete conditions of successful regulatory reform.

6.1. Reform towards More Flexible Systems, Competition Promotion, Greater Openness, Decentralization and Localization

To begin with, reform should make systems more flexible. To achieve this, the government needs to make the greatest reduction in or refrain from intervening in activities of the private sector. Companies and households constitute the demand-side of services which the government provides (the regulated), so their preferences deserve a prompt response from the government whose tasks and functions call for reconsideration to reduce unnecessary tasks and functions. In addition, it is essential to reevaluate the legitimacy of the extent of authority and its exertion given to each government organization. This will lead to administrative agencies which are given rational authority in an appropriate and effective way and a clear scope of responsibility for enforcing the regulations in question. Then, the shift in a regulatory framework is also required from the present positive list system of specifying permissible activities to the negative list system of letting all the activities freely conducted except for the ones failing to win approval. Such move is expected to contribute to ensuring institutional flexibility.

Second, reform should accelerate competition in the market. When a certain field is regulated by the government on the grounds of market failure, the existence of such market failure in real life requires further examination. Even if market failure exists in fact, decision on whether to retain the regulations in question should be made according to the reevaluation on the costs incurred by market failure versus by government intervention. If the intervention produces more costs than benefits, such regulations have to be withdrawn even though market failure does exist. Thorough analysis is essential to prevent the introduction of undesirable regulations that protect the vested interests or undermine competition, particularly when the so-called social regulations are introduced or strengthened setting the cause for reinforced regulation as shown in environment, safety, food sanitation, consumer protection, and protection of small and medium enterprises. Regulation has to be carried out by looking for the possibility of using market-oriented measures that cost less in both compliance and the ensuing administrative process, accompanied by the efforts to minimize regulations and adopt the solution led by the market and the private sector in the long term.

And industrial policy is mainly characterized by protecting and nurturing specific industries or enterprises together with regulations and intervention. Industrial policy like this should be minimized while competition policy needs to be strengthened. There lies a fundamental problem in industrial policy that the government imposes constraints on or favors activities of a specific industry or enterprises based on the assumption of a desirable situation of the economy. This policy, however, weakens the functions the market plays by depriving individual companies of the opportunity to consider consumer preferences while encouraging rent seeking behavior - the main culprit behind corruption. Given that the government is not omniscient and omnipotent, most government failures are likely to be much more serious than market failure. Hence, the government has to place policy focus on punishing anti-competitive activities in the market, and lifting regulations on entry, prices, and product quantity as a way of promoting competition.

Third, regulation should be helpful in bringing greater openness towards the world. Some statutes, municipal ordinances, and municipal rules are created to artificially discriminate against foreigners, foreign companies, foreign goods and services, and foreign investment. So they are in need of prompt rearrangement. Greater openness will enable the most competitive individuals, enterprises and goods and services to be given the highest value. Additionally, consumers can be provided with the best quality goods and services at the lowest price, and enterprises will benefit from enhancing their competitiveness through competition. This will bring about laborers' demanding of rational wages and is likely to boost the market's function of resource redistribution which withdraws factors of production from marginal industries and places them again into efficient industries. Removing the bottleneck in supply which can take place in a particular area will help stabilize the economy.

Fourth, localization and decentralization need to be accelerated. When authority of the central or higher ranks is transferred to the local government or to the department in charge of community relations, the needs of the demand-side players can be promptly met. Moreover, as the competition between local governments or the departments in charge of community relations is stimulated, competition to achieve higher quality of public services is expected to be induced. Ultimately, localization and decentralization in this way has to be expanded up to the point where residents or companies are active in moving to their most preferred local community. But the regulatory reform implemented by the Korean government has left much to be desired because what has actually occurred so far is the mere transfer of regulatory power from the central government to local governments or private groups like trade associations. The localization and decentralization at this level is only shown to replicate the same pattern of regulation by local governments or private groups as the central government, indicating merely change in the main agents of regulation. In the truest sense, such transfer of regulatory power fails to construct a demand-driven supply framework of government services. Hence it would be advisable to set the purposes of localization and decentralization at achieving a federalist level.

6.2. Leadership, Settlement of the Regulatory Reform Engine, Private-Public Partnership, and Timely Implementation

First of all, then President Kim Dae-jung during the Foreign Exchange Crisis gave critical momentum to a breakthrough in successful regulatory reform by laying down a powerful guideline of "Abolish half of the existing regulations" and showing his iron will. Despite of the raging controversy on the Kim Dae-jung administration's regulatory reform and guillotine approach, the regulatory reform at that time was able to meet with considerable success compared with past administrations thanks to the key role that President's eagerness to reform played as the head in charge of state affairs. Such support from the President in charge of state affairs is crucial because there is a high likelihood that regulatory reform will lead to a bitter conflict between numerous interest groups whose interests crash with the regulations subjected to reform. After removing most unreasonable and trivial regulations through regulatory reform process, there is a sharp conflict among the remaining ones waiting for reform. President as the head in charge of state affairs is required to have a firm will to drive reform. It is indispensable for bringing advancement. Currently, representative democracy is settled down successfully, so President's determination rouses both the National Assembly and public opinion, securing the cause and driving force for reform beyond stakes of interest groups, which is essential in successfully pushing ahead with reform.

Second, the previous explanation has already shown that the Korean government has completed establishing regulatory reform engine and its management system through the 'Framework Act on Administrative Regulations.' While the regulatory reform engine had lasted as a temporary administrative committee based on directions from the President until Kim Young-sam administration, it became a formal governmental organization, indicating establishment of regulatory reform as part of the main functions which the government provides regardless of changes in administration and emergence of public officials mainly dealing with the tasks of regulatory reform. By clarifying the required procedures in regulatory reform, roles, responsibilities, and authority of the RRC, government agencies and local governments in charge of regulatory work, arbitrary orders and directions do not govern reform irregularly any longer. Instead, reform has become driven by the most objective and explicit standards and procedures, minimizing possible conflicts and uncertainty during reform and clarifying who is responsible in handling the regulatory reform among the government officials in charge.

Third, regulatory reform in Korea has unique characteristics of deciding its destination by informal organizations for regulatory research and practice groups covering experts on regulation and regulatory reform, members of the business community including companies as the regulated, and the public officials dealing with regulatory reform within the government, from the outset. The Regulatory Research Group started in 1992 with members of scholars, public officers, officer from trade associations and corporate executives, and this group's informal regulatory research has led a successful regulatory reform in Korea. It began as a voluntary study group without any support from the government or companies and since the full scale regulatory reform of the Kim Young-sam administration, it has made substantial contribution to the efforts by the government to prepare practical infrastructure necessary for reform such as the objectives, legitimacy, directions, and the criteria for regulatory reform based on the theory of regulation. The aforementioned 'Framework Act on Administrative Regulations' is a representative example of institutional regulatory reform in Korea and in fact, the fruit of arranging the research literature and debates conducted by this group. Even after the enactment of this act, the research group has continued vigorous exchanges with regulatory reform experts of the developed countries centered on OECD's regulatory reform program PUMA, seeking for better way of carrying out regulatory reform in a more rational and efficient way. The beginning of regulatory reform based on the private-public partnership is faithfully reflected in the composition of the RRC, so as of now members from the private sector like experts, NGO, and interest groups in the committee account for more than 70%. In pushing ahead with regulatory reform through this private-public partnership, adequate reflection of the opinions of those on the demand side (the regulated) makes the regulations in question more rational, leading to lower compliance costs. The existence of informal partnership between the private and the public facilitates communication between them, contributing to bringing less misunderstanding and conflicts.

Fourth, regulatory reform is also a reform to overthrow the status quo while spreading changes. So the flourishing or stable economy is not favorable to progress in regulatory reform. The time of crisis is likely to offer good opportunities to bring success in reform as shown in the Foreign Exchange Crisis in the late 1990s, which Korea went through, and the Global Financial Crisis since 2007. Of course, it is absurd to experience a crisis with a view to succeeding in regulatory reform, and no one wants to make great sacrifices as a result of crisis. However, the experience of an inevitable crisis can offer a suitable opportunity for reform. Therefore, taking advantage of such opportunity leads to a breakthrough in regulatory reform, which can achieve the aims of improving the basic structure of the national economy and ensuring the engines for growth.

7. Achievements and Tasks in Regulatory Reform

7.1. Achievements in Regulatory Reform

When the results of the Korean regulatory reform are empirically analyzed, the reforms of President Kim Dae-jung's administration have been the focus of analysis. This is because the systems of both regulatory reform and regulatory management were established as a permanent framework within the government. Also, regulatory reform took the guillotine approach on a large scale when 5,430 (48.8%) out of 11,125 registered regulations were removed and 2,411 (21.7%) were relaxed.

A study shows that the regulatory reforms based on the guillotine approach of the Kim Dae-jung administration achieved not only quantitative but also qualitative, which led to a more than 50% reduction in the level of regulation in Korea. In 1999, the Korea Economic Research Institute assessed the quality of regulatory reform. The experts engaged in regulatory reform put importance on regulatory issues and level of regulation. Then the changes in such importance and regulatory level for eased or abolished regulations were assessed by area to calculate the rate of regulatory reform and regulatory indicators, which provide a window into determining the degree of regulatory reform in terms of guality. In this study, the value of '0' is given for complete absence of regulation and 100 for the state of total regulation. According to this, in 1998 when the regulatory reform of the Kim Dae-jung administration had not yet taken place, the regulatory indicator stood at 60.6, while a lower value of 31.9 along with the rate of regulatory reform at 47.3% was given for quality after the 1998 regulatory reform. This indicates that the regulatory reform in the early days of the Kim Dae-jung administration had achieved a reduction of approximately 50% both quantitatively and qualitatively. Despite of a lot of criticism at the time, guillotine approach to regulatory reform proved to have resulted in sharp reduction of regulations in terms of both quantity and quality and greater efficiency in administration.[4]

The Korea Institute for Industrial Economics and Trade conducted a research in 1999 on the ripple effects of the drastic regulatory reductions carried out by the Kim Dae-jung administration.[5] This study covered a total of 324 regulatory reforms in 1998 whose effects on the national economy were analyzed in terms of job creation, level of regulatory burden, and

4. Please see pp.4~22 in Han *et al*.(1999) for the methods and substance of qualitative assessment of regulatory reform during the Kim Dae-jung administration in detail. Concrete evaluation on achievement of each ministry's regulatory reform is also included.
5. Please see Ha *et al*.(1999) for analysis of the effect of the regulatory reform the Kim Dae-jung administration implemented.

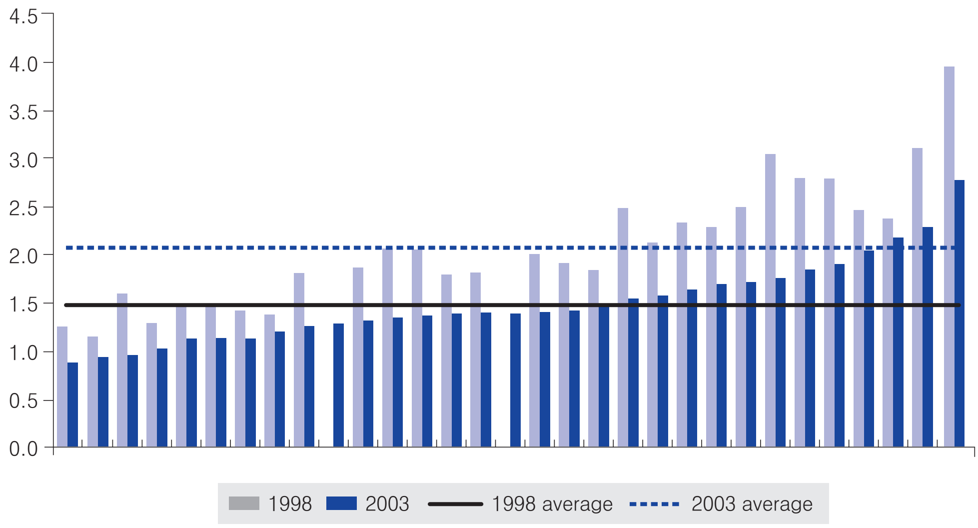
cost savings of the government. The analysis included 16 cases on attracting foreign investment, 40 cases on boosting start-ups and creating jobs, 152 cases on relieving corporate burden, 113 cases on the impact on the general public, and 3 cases on preventing corruption. These cases of regulatory reform alone were expected to create jobs of up to more than 1.06 million (4.9% of the economically active population as of 1997), while employment driven by foreign investment was estimated at 528,300, accounting for almost 50% of the predicted employment growth. The estimated reduction in costs of the private sector thanks to the regulatory reform for five years after 1999 was estimated to amount to 18.69 trillion KRW, 4.4% of the 1997 GDP. During the same period, the predicted cost savings for the government also exceeded 590 billion KRW. By industry, the regulatory reform in five major industries of electricity, construction, distribution, transportation, and telecommunications alone was projected to raise labor productivity and capital productivity to 4.4% and 4.8%, respectively. Consequently, this would have positive effects such as higher productivity, lower prices, and increased employment, leading to real GDP marking an estimated average annual increase of 0.64% for the next 10 years. These effects indicated regulatory reform in Korea had relatively higher growth potential compared with developed countries like the U.S. and Japan.

There has been more analysis on the economic effects brought by Korea's regulatory reform. To begin with, those conducted by the OECD (2005a, 2005b) showed Product Market Regulation(PMR) indicators of its member nations at two separate points of time (1998 and 2003) so that comparison of deregulation in the product market of OECD members could be made in terms of quantity as well as in changes in the level of differences over time. PMR indicators ranged from a minimum of 0 to a maximum of 6, and had an average of 1.5 in 2003 for OECD members at, lower than the 1998 average of 2.1, signifying a lower level of regulation as a whole.

As seen in Figure 2-7, Korea's indicator was higher than the OECD average in 1998 with 2.5. But the indicator fell to 1.5 in 2003, below the OECD average. Such reduction in regulation indicators means Korea achieved regulatory reform on a larger scale than other member nations. Still, as of 2003, the regulatory level in Korea ranked in the middle tier among the whole OECD members, so it wouldn't be correct to say that the business environment in Korea has improved and gained a competitive edge. In particular, the results from the analysis based on these indicators revealed that regulation undermined competition to a serious degree in the non-manufacturing business like the service industry, and for this reason, there existed greater rent seeking in this business sector. Additionally, even within the manufacturing sector, high technology sectors producing machinery and equipment saw a remarkable reduction in competition due to regulations, indicating another negative effect from regulation.[6]

6. Please refer to Ahn and Cha (2005a).

Figure 2-7 | PMR Indicators: Year 1998 and Year 2003



Source: Conway, Janod and Nicoletti (2005).

Based on the IMD's legal and regulatory indicators,[7] Ahn and Cha (2005b) calculated their elasticity. From 1999 to 2002, 1% rise in these indicators led to 0.41% economic growth. This result showed that there still remains the enormous potential for further economic growth, even though Korea has carried out regulatory reform on a large scale since 1998. If Korea had achieved legal and regulatory indicators which at least reached OECD average of 6.1 during the same period (from 1999 to 2002), there could be further growth averaged at 0.47% annually.

7. Among IMD's regulation indicators, 'legal and regulatory framework' can be accurately referred to as 'regulation indicators'. In Ahn and Cha (2005b)'s study, 'regulation indicators' include two areas of 'legal and regulatory framework' and 'transparency in the economy'. The former corresponds to the answer to the question, "The legal and regulatory framework does not act as hindrance to national competitiveness" and the latter to the question, "The government lucidly communicates the intention of its economic policy with the main agents of the economy." The indicators range from 0 to 10, meaning the most negative one (causing a serious harm) for 0 while the most positive one is represented by 10 (no hindrance at all). Observations on the indicators were able to be made from 1999 to 2002 in 42 nations, and their annual averages were 6.08 for 'legal and regulatory indicators' ranging between 3.47 and 8.26 while 'transparency in the economy' marked an average of 5.46 with the minimum of 3.35 to the maximum of 6.95. During this period, Korea had 4.7 and 3.7 respectively, as averages, let alone falling short of the medium and remaining at the lowest rank. See pp.545~551 in Ahn and Cha (2005b) for details.

7.2. Pending Tasks in Regulatory Reform

The previous part already showed that regulatory reform in Korea quite successfully achieved important policy objectives like overcoming the economic crisis, generating economic growth and jobs, and upgrading administrative quality. Like the assessment of its achievements, however, regulatory reform merely stands at an average level of other OECD members, leaving a lot to be desired in terms of improvements. The following lists the pending tasks Korea is facing at this stage.

First of all, the existing regulations need to go through continuing rearrangement annually, in order to remove or ease unnecessary, unreasonable, and untimely regulations. In this process, limiting the quantity increase in regulations is required to avoid the increase in the total amount of regulations. Considering the given manpower of public officials and budget, rational use of them is critical in providing high-quality administrative services.

Second, effective prior review is required for the newly introduced regulations because they are continuously created in order to meet the government's political and administrative needs. Therefore, the RRC should be equipped with greater expertise and enhanced effectiveness of review, calling for increasing appointment of experts in regulation and fostering regulatory experts from the organizations of government officials by establishing the Office of Regulatory Reform as an independent administrative body. The budgets related to the RRC should be increased drastically to make substantial review on important regulations.

Third, better regulations should be made to the best of policy makers' ability. As long as quite irrational or problematic regulations are filtered through guillotine approach, temporary regulatory relief and prior review, newly introduced or exiting ones should be more improved in terms of quality compared with the past ones. Therefore, for new or reinforced regulations, properly conducting RIA is required in the process of prior review. RIA provides scientific basic data to determine whether to introduce or implement regulations by accurately calculating the ensuing costs and benefits, so making decisions of regulatory introduction or implementation based on this is imperative to maintain regulatory quality.

Fourth, in establishing regulatory reform as a major vehicle to enhance administrative quality permanently, it is important to win the public support which will serve as a starting point for gaining the indispensible solid support from the supreme political leadership. To keep up the momentum for regulatory reform like this, regulatory reform should bring positive results including creating a business-friendly environment and matching the objectives of enhancing administrative quality so that the general public have less difficulty in life. Then hard work and non-stop efforts are required to carry out demand-oriented regulatory reform. Currently, the biggest obstacle in Korea's regulatory reform is the lack of proper examination through basic devices like RIA for making scientific decisions when the National Assembly reviews and vote for their introduction. If legal provisions which underlie regulations are irrational or biased by vested interest, the administration's control on regulations through the RRC will have only a limited effect.

Fifth, regulatory reform has to be compatible with other efforts to reform the government. The governmental reorganization, restructuring and realignment of public officials, budget and fiscal reform, introduction of e-government are the governmental reform which is closely connected with regulatory reform. Therefore, when regulatory reform achieves the reduced number of regulations and more rational regulatory management, the following steps are required simultaneously to generate a significant synergy effect: readjusting the placement of public officials; restructuring of excessive manpower; and the change in budget allocations along with complementing introduction of e-government. After all, these efforts to reform the government are part of the governmental innovation to sharpen its competitiveness, so integrated administrative ability and administrative organizations need to be mobilized in coordinating comprehensive governmental reform, led by the president in charge of state affairs.

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Chapter 03

Manifestation of Korean Entrepreneurship and Its Achievement

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Manifestation of Korean Entrepreneurship and Its Achievement

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<Summary>

Korea is the only country, amongst a number of other nations that declared independence during the mid-20th century, to have achieved a GDP per capita of over USD 20,000 and realized a remarkable economic development. Although an amalgamation of various factors contributed to the rapid economic development of Korea, often denoted as "The Miracle of Han River," the manifestation of entrepreneurship acted as the key to achieving such feat.

Entrepreneurship is deficient particularly in developing countries, acting as the most complex obstacle deterring economic development of a nation. Capital can be obtained through loaning or encouraging direct investments from foreign investors. Technology and resources can also be imported without much difficulty. However, realizing the talents of a competitive entrepreneur capable of combining these two factors to produce and provide products and services demanded by consumers is not an easy task. A true entrepreneur efficiently combines all the elements related to the production of his goods or services, and governs the entire business of the firm in order to maximize profit. In this process, innovation, what we refer to as an entrepreneurship, is exhibited.

The fact that government policies had a great influence on the establishment and development of Korean corporations is undeniable. However, the roles of innovative entrepreneurs, who manifested their entrepreneurship, in the rapid growth of Korean economy cannot be undermined. One would not be able to travel through Korea's astonishing economic growth over the past 60 years, having overlooked such a fact. Hence, this article intends to clarify the causes and means by which entrepreneurship contributed to Korea's economic growth.

In general, successful entrepreneurs in Korea had a very great vision of "repayment by business to the homeland." We found out that these businessmen did not simply hold onto money. Especially, any businessman obsessed with only monetary gain would have temporary success, failing to sustain his business and thus falling into decay in the long-run. Both the capability of problem solving and facing challenges without fear are important in the whole process of business because they make enterprises start, grow and thrive successfully. In this process of business, Korean entrepreneurs manifested entrepreneurship through innovation. They actively invented and introduced really new products and services. They also improved the quality of existing product and found out new production processes or methods. In addition, they pioneered new markets and achieved the secure supply of important factors of production and natural resources. And they ran new organizations to win in the market.

The performance of entrepreneur's activity and manifestation of entrepreneurship was determined by the institution and policy the government implemented and internal and external environments. That is, the performance of entrepreneurship not only depended on informal institutional factors like culture, custom, politics etc. but also was restrained by governmental policies. Although a nation establishes an ideal or just political and institutional framework, it is difficult to expect the economic development of the country without providing incentives to display entrepreneur's activities and entrepreneurship. When viewed from this perspective, it is proved by the unprecedented economic development that constitution, legal system, political decision makings and the government policies of Korea have been very effective and efficient in spite of several debates.

The Korean government have continuously been making the following efforts to boost or encourage entrepreneurship and entrepreneur activities: founding of the Republic of Korea based on liberal democracy and a capitalist market economy in the southern half of the Korean Peninsula, farmland reform and the disposal of devolving property, government-led post-war recovery process and the preparation and implementation of four rounds of the "Five-year Economic Development Plan," the choice of unbalanced growth strategy with export drive, the implementation of heavy and chemical industry promotion policy, the transformation into the private sector led economic system upon the realization of economic take-off, changing the focus of policy from the growth-oriented to balance between growth and distribution, the institutionalization of competition policy through the 'Fair Trade Act,' reinforcing laborers' rights and securing a social safety net, regulatory reform and privatization, promoting private and public partnership to develop a new and innovative growth engine for the future.

The domestic and international environments had also a positive and anegative influence on the manifestation of entrepreneurship and business activities. The representative examples of those are as follows: emancipation from the Japanese colonial rule and independence; US military rule; Korean War; aid from the West including the US for reconstruction; Viet Nam

War; serious oil shocks and the ensuing stagflation; special economic boom in the Middle East countries; the end of the cold war caused by the downfall of communist regimes in USSR and Eastern Europe; the rise of globalization and regionalism; the settlement of the WTO system in international trade and the rapid increase of bilateral FTAs; democratization; the IT revolution; foreign exchange crisis in 1997 and world economic crisis in 2007. In general, these changes posed opportunities and challenges for Korean businesses and entrepreneurs.

1. Introduction

1.1. Research Background

Korea is the only country, amongst a number of other nations that declared independence during the mid-20th century, to have achieved a GDP per capita of over USD 20,000 and realized a remarkable economic development. Although an amalgamation of various factors contributed to the rapid economic development of Korea, often denoted as "The Miracle of Han River," the manifestation of entrepreneurship pointed out by Schumpeter as the "Fundamental phenomenon of economic development" acted as the key to achieving such feat.

Entrepreneurship is deficient particularly in developing countries, acting as the most complex obstacle deterring economic development of a nation. Capital can be obtained through loans or direct investments from foreign investors. Technology and resources can also be imported without much difficulty. However, realizing the talents of a competitive entrepreneur capable of combining these two factors to produce and provide products and services demanded by the consumers is not an easy task. A true entrepreneur efficiently combines all the elements related to the production of his goods or services, and governs entire business activities of the firm in order to maximize profit. In this process, innovation, or "creative destruction" as stated by Schumpeter, is exhibited; what we refer to as an entrepreneurship.

Academic publications and analysis tend to attribute Korea's economic growth to governmental policies, rather than to contributions made by corporations and the private sector. The fact that government policies had a great influence on the establishment and development of Korean corporations is undeniable. However, the roles of innovative entrepreneurs, who manifested their entrepreneurship, in the rapid growth of Korean economy cannot be undermined. One would not be able to travel through Korea's astonishing economic growth over the past 60 years, having overlooked such a fact. Hence, this article intends to clarify the causes and means by which entrepreneurship contributed to Korea's economic growth.

1.2. Research Contents

In the following section, an explanation on the correlation of entrepreneurship and economic growth, or economic development, based on the definition of the term entrepreneurship, is presented. In order to do this, the main topics of the article centers on the definition of entrepreneurship by Schumpeter, the renowned one in economics. In Section 3, the influence of domestic-foreign economic circumstances and the nation or the government on the successful manifestation of entrepreneurship is analyzed. Analysis of this kind would eventually lead us to find out how the growth and maturation of a corporation, that play a key role in the nation's economic growth, is affected by government policies, or the economic conditions of domestic and foreign affairs. The Section 4 presents the ways in which manifestation of entrepreneurship in Korea is shown in the process of its economic growth. We will consider how the issues dealt in Sections 2 and 3 - the definition of entrepreneurship, a shift in the conditions of domestic and foreign affairs, and the roles of the government - affects the manifestation of entrepreneurship in Korea and highlight the consequences that followed. In Section 5, a summary and the applications of this study are presented.

2. Enterprise, Entrepreneur, Entrepreneurship

2.1. Enterprise and Entrepreneur

An Enterprise is a unit of people and capital doing economic activities for profit maximization, a provider of goods and service as well as a customer of factors of production, and a corporation pursuing internalization rather than market transaction in order to minimize transaction cost in the market.

According to economists, an entrepreneur is a person who conducts cooperation, arbitration, renovation, and uncertainty-bearing. Say(1821) regarded an entrepreneur as an existence of combining various resources; Kirzner(1982) - an existence of arbitrating imperfect information; Schumpeter(1934) - an innovating individual; Cantillion(1931) - a speculator; Knight(1921) - a decision maker under uncertainty; and Hawley(1893) - an owner of products and a person who submits to uncertainty of the products.

2.2. Entrepreneurship

Then, what is the entrepreneurship found in entrepreneurs? According to Schumpeter's definition, which is widely acknowledged by economists, entrepreneurship is referred to as a challenge of entrepreneurs who are conducting innovation. He considers an entrepreneur as an innovator conducting “creative destruction.” His definition of innovation has five aspects: the invention of new products and quality; the invention of new production methods; pioneering new market; the conquest of new raw materials and source of part supply; and the operation of new organization in a specific industry. He also thinks that the entrepreneurship is shown when entrepreneurs develop these five kinds of innovation activities under economic uncertainty.

3. Entrepreneurship, Internal and External Environment and the Role of Government

There are certain suitable conditions that promote entrepreneurship. In any given national economy, entrepreneurs’ activities have two kinds of restrictions. One is the variables that cannot be controlled by a country or a government such as war, natural disaster, blood and regional relations, ideology, religion, custom, tradition, culture and history. The other is the so-called “formal institutions” like the constitution, politics, laws and regulations, policy, the enforcement capability of governmental authority. These factors are external variables from the perspective of entrepreneur, but can be changed in content and incentive structures from the perspective of national economy. We call the former as the internal and external environment, and the latter as the role of country or government. We intend to look into the relationship between the variables and entrepreneurship.

In fact, entrepreneurs are those who explore how to maximize their profits under the circumstances in which the external variables are given. In general, an entrepreneur would show the maximum entrepreneurship of their own in case that the condition, in which Schumpeter’s five definitions of innovation are well activated, could be fulfilled. However, when it comes to internal and external economic environment, it is very difficult for a nation or a society to change them in reality. Nonetheless, concerning the governmental role affecting incentive structure of economic agents, official institutions have a significant effect on the manifestation of entrepreneurship. Now, let’s go over the relationship between economic environment and entrepreneurship, and what kind of effect the governmental activities could have on the entrepreneurship.

3.1. Internal and External Environment Changes and Entrepreneurship

The political, societal, and economic environments at home and abroad have serious effects on the manifestation of entrepreneurship. For instance, if a nation or a society wages a war against another one because of serious conflict, it results in mass destruction of means of production and capacity of production. Not only that, a nation being defeated in the war becomes subordinate to the winner or colonialized. In this case, the political and economic institution of the nation or the society falls down, uncertainty rises, and economic activities are seriously shrunk. However, war brings about not only these kinds of negative effects, but also breaks down the status quo in the nation or the society so that plays a role in reshaping the foundation of political, economic, societal and cultural development. In other words, war generates a new momentum for development, causing the abolition of class distinctions that suffocate economic growth, repeal of the pre-modern convention and religious blindness, introduction of a new way of production and technology and collapse of vested interests.

Also, factors called, “the informal institutions” such as an idea, religion, custom, tradition and history influence the entrepreneurs’ mind-set. The informal institutions usually undergo a change once every decades or millenniums. Therefore, the perspective of a society or a nation with regards to them becomes the foremost influential factor for the incentive structure of economic agents which constitutes the society and the national economy. For example, the communist or socialist nations or societies do not approve of the private property system. Islamic nations restrict the use of female workers and forbid cash transactions that take interests. Therefore, in general, these informal institutions directly restrict enterprises and their entrepreneurs, finally having a significant effect on the manifestation of entrepreneurship.

3.2. The Role of Government and Entrepreneurship

The political and economic institutions, so called “formal institution,” based on informal ones, have a direct effect on the manifestation of entrepreneurship. An entrepreneur is a person who always seeks a profit through the entrepreneurship. Therefore, in cases where the government’s intervention and its role in the market correspond to entrepreneurs’ incentives, the entrepreneurship is highly likely to appear. On the contrary, in cases where the government’s intervention and its role in the market run counter to their incentives, entrepreneurs are likely to concentrate on seeking their rents through opportunism. In this reason, how a nation or a society establishes and employs the formal institutions ultimately affects the manifestation of entrepreneurship. From now on, let us investigate what kind of formal institutions play an important role in displaying the entrepreneurship.

First, the most important thing in the manifestation of entrepreneurship among formal institution is whether property rights are protected and to what extent they are protected. To protect property rights thoroughly by the constitution serves as a positive factor in manifestation of the entrepreneurship, because it removes the uncertainty around property right which could occur in the relations among economic agents like individuals, corporations and government. Not only so, the enforcement capabilities of the authorities for the protection of property rights have also crucial influence on the entrepreneurship.

Second, the rule of law is very important. The governmental authority is exercised following legal processes stipulated in the constitution and laws. This is important because by doing that a nation or a society can raise the predictability and reduce uncertainty about entrepreneurs' activities. Whether the government guarantees, promotes and encourages the freedom of pursuing profits through legal system also plays a great role in the manifestation of the entrepreneurship. In addition, the principles of no regulation and taxation without formal legislation have a decisive influence upon the entrepreneurs' incentives, because those principles are the decisive factors in determining how the extent and outcome of economic activities are socially distributed.

Thirdly, the economic policy performed by the government is influential. The government exercises direct influence over enterprises and entrepreneurs' activities using a variety of policies like taxation and budget, monetary policy, trade policy, industrial policy and competition policy. Therefore, whether the government carries out economic policies to promote entrepreneurs' activities has a considerable effect on entrepreneurs' incentives. The rate of corporate tax or income tax, and allotment related to enterprises' activities are crucial factors in deciding entrepreneurs' shares. So the level of share exercises a significant influence on entrepreneurs' activities and the manifestation of entrepreneurship. Moreover, the government's development project or financial and non-financial assistances also considerably affect the manifestation of the entrepreneurship. Especially in a developing country where the procurement of factor of production and sale of merchandise in the market are not going on smoothly, the government's development plan and industrial policy focused on assistance generally play an important role in enhancing the inspiration of entrepreneurship. It is also very important for the government to provide a fair framework for making enterprises actively compete with each other. In most cases, competition becomes fierce where market transactions are vitalized, so it is important to remove the obstacles to market transaction including regulations. However, developing countries at the early stage of economic development do not have an advanced market system. For this reason, in cases where its government distinguishes between good and bad companies in accordance with a criterion similar to market competition, the nation can succeed in the economic take-off. If the criteria to distinguish a good company from a bad one are working within a national economy, the efficiency of the nation is dramatically increased. Also, this raises the possibility of success for entrepreneurs who display entrepreneurship and play a positive role in lifting the entrepreneurship.

4. Economic Development of Korea and Entrepreneurship

4.1. Influence of Internal and External Environment Changes on Korean Entrepreneurship

After the World War II, Korea was liberated from Japanese colonial rule. For 60 years of the economic growth, the circumstantial change had massive influence on Korea's economic growth by affecting various factors, such as the mind-set of entrepreneurs. The following account presents significant changes that affected Korean entrepreneurs.

First, the most significant factor on the Korean economic growth was the establishment of the Korean government based on democracy and a market economy. In 1948, the establishment of the Korean government brought forth a guarantee for the citizens' rights through the constitution and a democratic republic with general elections based on democratic procedures. These meant that the constitution guarantees the property rights and free and unfettered economic activity and market transactions. It also meant that the authority of the government is divided into legislative, executive, and judicial branches according to the principle of checks and balances.

Second, the Korean War had left a tremendous impact on the economic growth. While dealing with the post-bellum issues after the World War II, conflicts between the US and the USSR resulted in the separation of South and North Korea. By 1946, a Communist regime was established in the North with support from USSR. In 1950, the North Korea invaded the South Korea. The Korean War, which lasted for three years, resulted in bloodshed and a complete annihilation of physical infrastructures. The division of the peninsula added to the economic difficulties posed by the war. However, the Korean War broke down a social hierarchy that divided commoners from aristocrats. Also, the expansion of industrial activities and competition among the two Koreas became an unforeseen factor in establishing economic growth and democracy.

Third, the 5.16 coup d'état in 1961 helped economic growth. The 4.19 revolution brought a destruction of the Freedom Party administration that maintained the dictatorship after the end of the Korean War. However, social chaos and the incompetency of the Democracy Party Administration led to 5.16 coup d'état with the General Park Jung-hee as the leader. Through the coup d'état, General Park Jung-hee attained political power and for 18 years, he led Korea's economic development. In fact, the economic development driven by the military authorities lasted until 1988 when Roh Tae-woo administration stepped in. Although there are still many debates surrounding Park's legacy, the President Park Jung-hee's leadership was a significant factor for Korea's economic growth and the establishment of democracy. President Park was in the office for 18 years since the 5.16 coup d'état. During this period, his government had caused a number of problems such as violation of human rights and spread of military culture. However, he proved himself as an excellent leader in developing the Korean economy through success in planning and enforcing the economic development plan, the normalization of Korea-Japan diplomatic relationship, the dispatch of troops to the Vietnam War, the implementation of export-oriented growth strategy, the heavy and chemical industry drive and the so-called "Saemaeul Campaign." The successes in industrialization laid the foundation for the economic achievement since then and the political democratization in Korea.

During the 5.16 coup d'état, President Park accused and detained prominent entrepreneurs for accumulating wealth illegally under the previous administration, then released them early so that they could contribute to the nation's economic development. The Park administration also supported them by jointly establishing the Council of Korea Businessmen to promote the government's economic development plan actively. The Council changed its name to the Federations of Korean Industries(FKI) in 1968 and contributed to the economic development by aligning mutual interests among members and playing a role as the negotiator between the government and the people. The Park's presidency was when entrepreneurship was mostly manifested,[1] because the Park administration offered significant incentives to entrepreneurs by planning and executing business-oriented policies listed above and founding the FKI. So it is essential to study Korean government policy during President Park's presidency to understand the manifestation of entrepreneurship of Korea.

Fourth, another significant factor in Korean economic growth was the development of liberal democracy. Korea recovered its procedural legitimacy of political regime and revived its reputation as a democratic country in 1988. After the end of developmental dictatorship since the 5.16 coup d'état in 1961, the Constitution was revised to minimize the possibility of dictatorship and the abuse of authority by setting a presidential term limit in 1987. The amendment of the Constitution stipulated that the incumbent president could only serve a single 5-year term and could not be re-elected. In 1988 after the establishment of democratic procedures in Korea, it dramatically expanded the rights and freedom of the people including freedom of association and freedom of speech. On the other hand, the tension between people and various interests led to an increase in political, economic and social conflict, especially over labor-management issues. The representative examples of domestic and foreign economic surroundings in this period are intensive conflicts between labor and management, reinforcement of labor's three primary rights, criticism on Korean conglomerates (which is called 'Chaebol'), introduction of regulations controlling the concentration of economic power

1. Samsung Economic Research Institute(SERI) made a survey on the manifestation of Korean entrepreneurship. The Institute also created an index to measure the entrepreneurship and calculated the index each year since the 1960. According to its report, Korean entrepreneurship was the highest in the 1970 and was continually withered since then. Refer to SERI (2004) in detail.

in the 'Fair Trade Act,' establishment of diplomatic relationship with USSR and PRC, economic boom caused by lower interest rates, lower oil price, lower exchange rate (so called "Three Lows") and Seoul Olympic game in 1988. Democratization also expanded individual's rights and freedom in a great deal and reinforced rule of law. Foreign Policy toward Communist countries like USSR, PRC and Eastern Europe countries gave the momentum of pioneering new markets to sell more product and services and to procure necessary production factors. The boom caused by "Three Lows" and Seoul Olympic game also made the momentum of business activities strengthened. However, democratization raised tension among various interest groups including labor union, NGO, trade associations etc. and made the government introduce variety of policies, such as labor policy, fair trade policy, that is against enterprises and against market, banning some business activities, and this raised uncertainty of economy. Economic boom caused by "three lower" and Seoul Olympic game in 1988 produced a bubble in the Korean economy. Foreign policies toward Communist countries became magnify ideological tensions within Korea, and these raised anti-market economy and anti-business sentiment.

Fifth, other primary factors of Korean economic development and entrepreneurship are globalization and the IT revolution. Globalization was begun with the collapse of communist countries including the USSR and then the end of the cold war. The globalization brought the restructuring of international political and economic order in the 1990s. It developed with the fall of the Berlin Wall and unification of Germany, collapse of the Soviet Union and independence of CIS nations, entry to capitalist system of Eastern European countries, success of Chinese market opening and reform, settlement of Uruguay Round and establishment of WTO system, generalization of mega-competition of multinational companies with global sourcing, global locating and global marketing. Besides the IT revolution in the 1990s resulted in the brilliant technical progresses in computer, Internet and the mobile phone has evolved to the ubiquitous society with various smart information devices like WiFi, SNS and smart phones. These new developments have ensured the age of knowledge-based economy, which is based on borderless competition and innovation. Those changes in management and economic environments have eventually led the results of entrepreneurial activities to the-winner-takes-all, and switched new production system of mass-customization from mass production based on economies of scale. Also, the form of enterprises has changed. The enterprise enclosing a number of independent enterprises such as eBay, App Store and Auction etc. have appeared as a new mode of businesses while traditional firms with vertical hierarchy have been also making efforts to utilize the changes from globalization and IT revolution.

Those external and internal environmental changes allowed the Korean government to enter into the OECD in 1996 with the liberalization of import and capital transactions, and to make agreements with 44 economies on FTA including EU, the United States, India, Chile, ASEAN and Singapore in the 21st century. The changes eventually put the Korean economy on the international market. The Korean government also promoted information-communication and the knowledge-based industry as the future growth engine through various policies that responded to the challenges of knowledge based economy. Globalization and IT revolution made business activities of enterprises go beyond national boundaries, and changed competition from local to international. In addition, this phenomenon allowed enterprises to get information for free at any moment, and made the movement of enterprises and people freely so that the government has to compete with other governments as a public service provider rather than control and rule.

Sixth, the financial crisis in 1997 also affected Korean economic development and its entrepreneurship. The financial crisis took place because of the spread of other Southeast Asian nation's financial crisis, including Thai and Indonesia, government's impatient capital market open, absence of financial supervision devices, and lack of ability of crisis management. In addition to those government's problems, Korean enterprises and monetary sector also were exposed to the financial crises because of their immoderate expansion of their businesses and over-borrowing fund management without any consideration toward the risk. Rather than focusing cash flow and profit making, the business management was mainly concentrated on expansionary growth, and it have led the leading Korean enterprises to bankruptcy. During the crisis, the Korean government responded with regulatory reform, privatizing public enterprises, restructuring enterprises and financial institutes, capital market open, incentives to foreign direct investment, revitalization of policy for venture businesses, finding and supporting new growth engines, expansion and reorganization of social safety net, etc. Those responses of Korean government were considered to be effective to boost entrepreneurship and overcome the financial crisis. They finally led to affirmative effect to the economic growth.

4.2. The Korean Government's Role in the Manifestation of Entrepreneurship

The policies implemented by the Korean government promoting entrepreneurship can be divided into the periods of building industrial basis (Independence~1971), of rapid growth (1972~87), of paradigm shift (1987~97), and of overcoming crisis and take-off again (1998~2008). Such classification of periods is required due to the differences in the stages of economic development and in the way entrepreneurship manifested.

4.2.1. Major Institutions and Policies during the Period of Building Industrial Base

1) Enactment & Amendment of the Constitution, and Establishment of Free Market Economy

In 1948, the constitutional assembly enacted the constitution of the Republic of Korea which was promulgated on the July 17th. This constitution affirmed essential guarantee of property rights, and the 3rd Amendment in 1954 stipulated the system of free economy along with easing the provision of state control by requiring laws in cases of the control on the development of natural resources and overseas trade. The fifth amendment after the May 16th coup d'état stipulated the free market economy with the rule "The Republic of Korea has a basic economic order of respecting freedom and creativity in the economy." The paragraph 2 of the same article exceptionally leaves a room for government intervention if necessary for realizing social justice and achieving a balanced development of the national economy. During this period of building an industrial basis after the establishment of the government in 1948, liberal democracy, protection of property rights, and the free market economy settled down institutionally, laying the most central and fundamental basis for manifestation of entrepreneurship and economic development.

2) Farmland Reform

The efforts to reform farmland continued as shown in the special presidential instruction to implement the 'Farmland Reform Act' in July of 1949. Farmland reform was significant to increasing agricultural productivity so that the surplus could be put into productive investment by excluding the land ownership of semi-feudal landowners. According to the 'Farmland Reform Act,' ownership of farmland was limited to only farmers, there was the ceiling on the ownership of farmland by prohibiting even farmers from possessing farmland exceeding 3 hectares(= 9,000 pyeong = 9,917.4㎡), and tenant farming and management on consignment basis were banned. Farmland reform distributed land to farmers extremely exploited as they engaged in tenant farming under Japanese imperialism for the landowning class. This made enormous contribution to building and keeping a system based on liberal democracy and free market economy when the Korean peninsula was embroiled in the national divide between the south and the north, the turmoil right after regaining independence, and the confrontation with the communist forces after the Korean War. This also brought about the collapse of the landowning class, indicating the realization of laying the industrial capital basis during the process of economic development through such farmland reform.

3) Disposal of Devolving Property

Since the establishment of the U.S military government in South Korea on August 15th in 1945, the ownership of the Korean property possessed by the Japanese government and the Japanese people passed to the military government. As of the establishment of the Korean government in August of 1948, registered devolving property included 2,690 factories and mines, 3,924 movable property, 225 vessels, 2,818 warehouses, 9,096 shops, 324,404 jungbo (1 jungbo = 9,917.4㎡) of farmland, 150,827 jungbo of site, 48,456 houses, 70,039 jungbo of forest land, 1,366 cases of miscellaneous land, and 2,386 cases of orchards. The value of this devolving property is estimated to total around 80% of that of Korea's asset as a whole. Farmland belonging to devolving property accounted for approximately 14% of the total arable land in Korea, and there were 2,354 manufactures in the enterprises subject to devolvement, representing 66.3% of the total enterprises in Korea. Based on the 'Act on Disposal of Devolving Property' promulgated in December of 1949, the government placed large factories under its management while factories of small or medium scale were leased or sold off to the individuals from the private sector, resulting in the completion of disposal of devolving property by 1958. The total number of devolving property whose disposal took place by May of that year was 263,744, accounting for 90% of the total devolving property. Because those who won devolving property were offered excellent fiscal and financial benefits and hyperinflation broke out, competition for devolving property was keen. The Korean government also placed top priority on management abilities of applicants in disposal of devolving property, so most winners of devolvement were individuals with personal connections to the enterprise in question directly or indirectly, and former government officials, bankers, and businessmen. This devolvement of enterprises to collaborators under Japanese imperialism was later criticized for failing to punish the pro-Japanese Koreans. But the disposal of devolving property had implications beyond clearing away the remnants of Japanese colonialism. In addition, the private sector was chosen as the principal agent of rebuilding the national economy after the liberation and this measure contributed to ensuring the private property system and property rights, serving as a policy to generate important momentum in the development of the Korean economy.

4) Rationing of Foreign Aid (Foreign Exchange)

In the 1950s, the U.S. aid to Korea comprised most of the revenues in foreign exchange, and the government enforced a system of concentrated deposit of foreign exchange which forced the deposit of acquired foreign exchange into the account in the acquirer's own name, demanding separate accounts for each source of acquiring foreign currency in making along with differing disposal of respective account. In addition, there were different official, conventional, and market exchange rates, and the conventional exchange rate was always lower than market rate. Therefore, the foreign exchange market always had excess demand for foreign exchange. The government responded with artificial rationing of foreign exchange, which was divided into rationing of funds to purchase foreign aid and foreign currency held by the government. To begin with, foreign currency to purchase foreign aid was rationed to importers of foreign aid among which price of foreign currency to purchase goods demanded in the private sector was decided in open competitive bidding while official exchange rate was applied to the purchase of goods for end users. Prepared to confront the friction with the U.S. during the rationing of foreign aid, the government carried out consistent policies of giving preference to producers as end-users of raw materials in putting in a great deal of effort to make economic development through import substituting industrialization. And these policies had a significant impact on enterprises and entrepreneurs manifesting entrepreneurship.

5) Preparation and Implementation of 5-year Economic Development Plan

After the President Park Chung-hee took office in 1961, he drew up the first round of Five-year Economic Development Plan, spanning from 1961 to 1966, to fully embark on economic development. This Plan had basic strategy of economic development based on industrialization and export-driven imbalanced growth and paved the way to achieve the high degree of economic growth in Korea for more than 30 years. In principle, the Plan was based on economic principles of capitalism such as private property, seeking profit, and free competition, but government-led management of the economy was adopted, in effect, combining planning and market in devising development strategy. This development plan was characterized by high degree of economic growth, government-led development strategy, and export-oriented industrialization, fund raising through foreign capital inducement, and support for creating and nurturing capitalist enterprises. Remarkable achievements ensued as the plan served as the starting point for a breakthrough in economic structure, including annual average of economic growth at 8.5% during the period of this plan, per capita GNP growth at 5.6%, much greater share of industry or manufacturing business, larger share of heavy and chemical industry, annual average of investment growth at 15.1%, around 60% of funds for investment financed by foreign capital, the surge in exports, and the structural shift of imports from mainly bringing in consumer goods and raw materials to importing capital goods. In particular, the first round of Five-year Economic Development Plan concentrated national competency on economic development and generated momentum to secure economic modernization and social development. The realization of high-degree economic growth through successful implementation of the Plan imbued the public with the firm belief that ‘We can be better off and we can do it’, which helped gathering the competency of the whole nation for economic growth, leading to enormous contribution to manifest entrepreneurship.

The second round of “Five-year Economic Development Plan” lasted from 1967 to 1971, setting objectives of establishing a self-sustaining economy and modernizing industries through national prosperity through export. The objectives in this Plan included achieving higher level of industrialization with chemical, steel and machinery industries, building basis for improving international balance of payments by steeply increasing exports and promoting import substitution, self-sufficiency in food production and forestation, curbing demographic expansion by increasing employment and promoting birth control, boosting rural household incomes through agricultural diversification, and improving scientific and farming technology. This Plan brought an average annual increase of 10.5% of economic growth for the Plan’s time span, marking 1 billion and 67.6 million dollars in exports in 1971, massive expansion in infrastructure of transportation, electric power and telecommunications including the construction of the Gyeong-In[Seoul-Incheon] and the Gyeongbu[Seoul-Busan] expressway, industrialization driven by growth of export industries like synthetic fiber, petro-chemical, electronic device businesses, drastic fall in share of the agriculture, forestry and fisheries, and achieving higher degree of industrial structure centered on the manufacturing business. Also various industrial policies were set up and implemented, leading to the continued growth of companies.

4.2.2. Important Institutions and Policies during the Period of Rapid Economic Growth

1) Private Loan Freeze (August 3 Measure)

In the early 1970s when economic circumstances had deteriorated, entrepreneurs often raised money from private loan market and their weak financial structure brought about more dependence on private loan, eventually resulting in aggravated financial cost. As immoderate payment guarantees provided by the government and banks caused many insolvent foreign-affiliated companies, the government announced a Private Loan Freeze on August 3, 1972 in order to solve the problem. The measure obligated every private money broker and debtor company to report industrial debt to the competent tax office and financial institution and banned debt repayment if they fail to report. According to the measure, reported private debt must be repaid by parities every six month for five years with the interest rate of 1.35% per month (16.2% per year) after three years of the term of unredeemed. It turned out that creditors reported 210,906 cases which amounted to 357.1 billion KRW and debtor companies reported 40,677 cases which amounted to 345.6 billion KRW. The combined amount takes up for nearly 90% of the money supply(M1) at that time. August 3 Measure reduced companies' overburdened financial costs derived from private loan and pushed the industry to buoyant phase along with the economic recovery of developed countries, resulting in achieving 12.0% of economic growth rate in 1973. Although the private loan freeze was an extremely shocking remedy for the economy, the government was able to protect the economic system from further deterioration by reducing risks that could damage companies through the administrative order. It made a significant contribution to fostering entrepreneurship in the early stages of Korean economic development. As such, Korean government has implemented workout measures to ease uncertainties and share risks whenever serious industrial problems arise.

2) Designing and Implementation of the Heavy and Chemical Industry Promotion Policy

In the 1970s, the Korean government implemented the policy of promoting a government-led heavy and chemical industry. The government directly participated in promoting the industry because its export-oriented growth policy hit a bottleneck as light industry goods export hit its limit and capital goods import jumped. The purpose of heavy and chemical industry promotion policy was to reinvigorate the stalled economic growth by elevating the industrial structure.

The main subjects included steel, nonferrous metals, shipbuilding, machinery, chemicals and electronics industries. In the early 1970s, the early stages of the policy implementation, the government focused on expanding social overhead capital and strengthening support in terms of finance, banking, tax, technology and manpower areas. As major companies aggressively advanced into heavy and chemical industry, along with the economic recovery from the first oil shock in 1973, the government redirected its focus on promoting initial public offering and improving business finance structure.

The Korean government's strategy for promoting heavy and chemical industry can be summed up as follows: first, concentration is the main principle in order to raise economic feasibility and competitiveness that can match the giant scope of the global industry; second, the heavy and chemical industry should be nurtured as the strategic industry for export in order to overcome the limit in the confined domestic market; third, so-called 'one skill per person' should be fulfilled by adopting skills qualification system and masters qualification system and innovating the system for skills development and training in order to secure and develop the manpower in the area; forth, the industry's technology development is supported through establishing technology research centers for five strategic industries including shipbuilding, mechanical engineering, petrochemistry, electronic engineering and marine technology; and lastly, as the heavy and chemical industry reaches throughout various areas, requires large scale of social overhead capital and partly causes serious air pollution, the industry should be induced and developed at appropriate region according to each area's characteristics.

The heavy and chemical industry promotion policy fundamentally changed Korea's industrial structure, the share of the heavy chemical industry increasing within the manufacturing area and the structure of exporting goods changing. Moreover, the government's export drive policy presented opportunities for major companies to rapidly grow quantitatively, setting up the grounds on which the group of major companies could shape its current form. It was reflected by the facts that in 1977 the heavy and chemical industry's occupation in total manufacturing production already exceeded 50% and that it took up 42.7% of the total manufacturing export. Its rapid growth continued through the 1980s during which it occupied 47.4% of the manufacturing export.

The heavy and chemical industry promotion policy throughout the 1970s and the early 1980s was one of the most important policies on the process during which Korean entrepreneurship had fully blossomed. Through this policy, the government shared risks by providing companies with comprehensive benefits in tax, finance, credit, trade, technology adoption and manpower area in order to help them take further risks expanding their horizon. Even during the global economic recession due to the first and second oil shocks, the government continued the comprehensive support and selective support measure to sort out good or bad companies based on the competitiveness in the global market in order to reveal each company's performance. The government's comprehensive and selective support apparently made significant contribution to the manifestation of entrepreneurship during that time.

3) Investment Adjustment of Heavy and Chemical Industry

Coinciding with a global depression due to second oil shock in the late 1970s, overinvestment in the heavy and chemical industry led to some problems of investment imbalance, including lower investment efficiency, declining profitability and limited investment on the service sector. The Korean government made investment adjustments three times throughout overall heavy chemical industry including generation facilities, vehicle, heavy equipment and heavy electric machines for construction, electronic exchangers, copper refineries and diesel engines. The government-led adjustments were parts of efforts to minimize the side effect of the 1970s' heavy and chemical industry promotion policy. Despite the adjustments, however, the industry's production had been poor until the mid-1980s, and then restored momentum during the bullish period with "Three Lows" which means low oil price, low interest rate and low USD exchange rate from 1986 to 1988.

In the late 1980s, the Korean government also implemented industrial rationalization based on the 'Industrial Development Act.' The subjects included: seven industries (July, 1986) including vehicles, heavy equipment for construction, diesel engine, heavy electric machines, alloy iron, textile and dyeing and finishing machinery; fertilizer industry (December, 1987); and footwear industry (February, 1992). During the rationalization period, the government limited new businesses advancing into the said industries and provided financial support with existing companies when they changed facilities. As scheduled, the rationalization had been completed during the period of 1988 to 1990 on the seven industries except for textile manufacturing industry among the eight industries designated as the subject for rationalization before 1992.

The government-led restructuring of companies was an effort to share the risks of companies and financial institutions in order to prevent crisis that could affect the overall economy when comprehensive weakness of companies and financial sector would be visualized due to global depression and overinvestment on the heavy and chemical industry. The restructuring also included liquidating companies with poor competitiveness and providing various incentives for competitive companies to take over poor ones, which functioned as the screening process similar to that of the market that rewards successful enterprises well-demonstrating entrepreneurship and closes down insolvent ones. The restructuring played a positive role in the incentive system of enterprises and entrepreneurs.

4.2.3. Important Institutions and Policies during the Period of Paradigm Shift

1) Improving Worker's Rights and the Failure of Labor Reform

Along with Korean democracy advancing in the late 1980s, the government greatly strengthened the rights of workers and labor unions through the revision of three important labor laws including 'Labor Standards Act' and 'Labor Union Act.' According to the revision of the labor laws, senior labor union was excluded from the concept of the 'third party'; the requirements for ordering to dismiss labor union were strengthened; the limit on the labor union form was eased; the government right to dismiss labor unions and order to change the executive was scrapped; and a union shop became compulsory (Ministry of Labor, 2008).

The Korean government tried to innovate working conditions and labor-management relations as the labor laws based on the principle of strengthening the rights of workers and labor unions needed to respond to the changes of the global economic circumstances brought about the establishment of the World Trade Organization(WTO) and Korea's join in the Organization for Economic Cooperation and Development(OECD) and fundamental reform was needed to improve the high-cost and low-efficiency economic structure. The government, however, failed to accomplish the reform because of the strong opposition from labor unions. Going through many revisions, the reform was reflected in the labor laws in March 1997, with many of the difficult issues set aside. According to the 1997 labor laws, many institutions were adopted such as mid-payment of retirement pay and retirement annuity insurance; flexible working hours, optional working hours, equivalent labor and discretional labor; and substitution of paid annual and monthly leave. Layoffs were allowed with two-year grace period and multiple labor unions were allowed with conditions that senior unions were allowed instantly and independent labor unions were allowed from 2002. And substitute labor and new subcontract were not allowed during the period of dispute (Kim Jeok-gyo, 2008).

While improving the rights and interests of many workers by strengthening workers' rights in the late 1980s, Korean democracy created a rigid labor market and preserved confrontational labor-management relations, causing harmful effects which seriously limit the activities of enterprises in the long term. In fact, the past authoritarian regime protected workers' rights by setting higher working conditions comparing to other countries in exchange for illegalizing workers' rights to organize and strike. Since democratization, however, the government improved the rights to organize, strike and bargain collectively of workers and labor unions but failed to obtain flexibility in the labor market because it failed to reasonably improve strict regulations on working conditions. This problem is a serious bottleneck for entrepreneurship to blossom in the Korean economy since this period.

2) Strengthening Economic Concentration Control Policy

In 1980, the Korean government started to regulate monopolistic and anticompetitive behavior by establishing ‘Fair Trade Act.’ In the late 1986, the government fully implemented economic concentration control policy by newly including to ‘Fair Trade Act’ clauses related to designation of large-scale business group. It banned top 30 companies by asset values to make mutual investment between affiliated companies and to establish holding companies and limited the total amount of investment and their voting rights on financial and insurance company. Korean government’s economic concentration control policy was constantly strengthened: liability for guarantee between affiliated companies was limited in 1992; the limit of the total amount of investment was reduced in 1994; and the limit of liability for guarantee was reduced in 1996. In 1998, right after the foreign exchange crisis, controls over large-scale business group were further strengthened: regulations on internal transaction between affiliated companies were strengthened; liability for guarantee was banned; front affiliated companies were exposed; and initial public offering of affiliated companies was urged.

In March, 1991, the government pursued a business specialization policy by limiting large-scale business group’s diversification in un-related areas and focusing investment of limited resources on the core businesses. The policy limited the main businesses of top 30 groups by total amount of asset or by credit value, or by choosing two to three businesses among the 12 businesses, combining the first and second categorization according to the Korean standard industrial classification. The said groups also selected their main business as the businesses with 70% of full-time operation rate and 10% of sales within the said area. The government promoted the policy by providing incentives such as permitting exceptions for limited investment, excluding as many as three main businesses of each business group from the subject for credit limit control and permitting same person loan and exceptions in limit of liability for guarantee.

The purpose of the economic concentration control policy was to prevent the harmful effect caused by conglomerates’ reckless diversification and to improve economic efficiency by promoting specialization. However, this control weakened competition by intensifying concentration in the industry or market, rather than strengthening economic efficiency. It also restrained entrepreneurial activities, rather than strengthening them, through various regulation hampering autonomous decision related corporations’ finance and governance structure. Moreover, the business specialization policy pursued in the early 1990s failed to achieve tangible results and eventually was scrapped.

3) Opening-up and Restructuring of Financial Market

The Korean government started to open up the financial market as the surplus of international payments increased since the first surplus in 1986. In the late 1980s, the government permitted foreign banks to operate money trust and join in a clearing house; American life insurers to advance into the domestic market; and issuing beneficiary certificate exclusively for foreigners and overseas securities. Korea also accelerated globalization and opening of the financial market by being the 29th country to join OECD in October 1996.

In order to achieve the goal of developing financial markets including improvement of financial system and liberalization, globalization and vitalization of financial market, the government turned five companies including Seoul Investment Finance into securities company and three companies including Hanyang Investment Finance into banks in 1991; tried to ease entry limit of financial institutions and to concentrate and specialize financial institutions in 1993; turned nine investment finance companies in 1994 and 15 of them in 1996 into full-service brokers to allow them to invest in foreign securities and operate foreign exchange. The series of measures to open financial market and restructure financial industry have received criticisms as the main culprit behind the financial crisis in 1997 because they prioritized easing entry limit and regulations on operation focusing on the interests of the financial industry, putting aside financial regulation and rationalization of regulatory and auditory system. Nevertheless, the Korean government's efforts to promote the financial sector as an industry also played a positive role in that they made it possible many companies and entrepreneurs to advance into the financial industry and exposed them in the competition brought about by the opening-up of domestic market.

4) Opening of Distribution Market; Concentration and Specialization of Businesses

As a result of the Uruguay Round in the 1990s, the domestic distribution market was scheduled to be fully opened by 1993. In 1991, the government allowed foreign investments on 36 businesses among the 51 retail businesses and eased the limit on stores' extent and number. In order to strengthen the distribution industry, the government since 1991 aggressively promoted large companies to participate in the distribution industry and permitted the large companies who advanced into the industry to purchase properties and excluded them from credit control.

By opening the domestic distribution market and promoting concentration and specialization of businesses, the government's efforts improved the industry's competitiveness by achieving modernization of the industry which used to consist of mainly small stores, allowing distributor with global competitiveness and the industry to develop as a new growth momentum for the overall economy by occupying the upper position in domestic competition. Opening the distribution market and allowing large companies to advance into the area presented an important opportunity for entrepreneurship to blossom. In the process, however, the decline and collapse of small distributors have caused new social and political problems, which have led to adoption of various regulations on large distributors, hampering innovative entrepreneurship in the industry.

5) Restructuring and Liberalization of Telecom Industry

The Korean government restructured the telecom industry three times since 1990 and promoted liberalization and competition within the industry in phases since 1991 in response to the changes in circumstances surrounding the telecom market including the development of telecoms technology, diversification of telecom demand and the pressure from developed countries to open up telecoms market. During the first restructuring in 1990, the Korean government adopted market competition in the areas of international calls, mobile communications and value-added network. During the second restructuring in 1994, the government introduced competition into the area of long-distance calls, expanded competition in the area of international calls and adopted new services such as PCS, TRS, LEO and CT-2. In October 1996, the government nominated 27 new communication service providers in seven areas according to the direction of the third restructuring (the basic direction for improving competitiveness of telecoms industry) announced in July 1995.

The government's restructuring of the regulation on telecom industry and adopting market competition eliminated monopolistic practices by public enterprises, developing competitive telecoms industry based on market competition and leading to the birth of telecoms enterprises equipped with global competitiveness. The successful commercialization of CDMA and achieving global competitiveness in the mobile phone market were possible thanks to the government's efforts to adopt market competition and to ease regulations and to privatize public enterprises. Those government's efforts provided momentum with enterprises and entrepreneurship. In particular, adopting market competition, easing regulations and privatizing public enterprises run in monopoly played an important role in dramatically improving the competitiveness of national information infrastructure pivotal to information revolution. Exhibition of entrepreneurship based on such circumstances continued to play a critical role in advancing the national competitiveness in the high-tech industry such as information and telecommunications and knowledge information processing in the 21st century.

4.2.4. Important Institutions and Policies during the Period of Overcoming Crisis and Take-off again

1) Complete Opening of Capital Market

After the Foreign Exchange Crisis, Korea received a bailout from the International Monetary Fund(IMF) on the condition that Korea made various economic reforms includingthe complete opening of its capital markets.

It started with transforming the foreign exchange system into a freely fluctuating exchange rate in late 1997. Eliminating the limit on the range of exchange rates presented an opportunity to substantially ease regulations related to capital flows which was postponed at the time of joining OECD. The Korean government completely scrapped the investment limit of foreigners in the stock market (except for investment on public corporations) in May 1998. As a result, foreign investment maintained 40% of total investment by market capitalization until 2003 after the foreign exchange crisis, and then had gradually reduced to 37.3% at the end of 2006, 32.4% at the end of 2007, 28.9% at the end of 2008 and to 28.5% at the end of February 2009. The percentage increase of shareholding by foreigners brought about changes in corporate behaviors different from those before Foreign Exchange Crisis, including direct and indirect threat to management, self-tender, increase in dividends and improvement of corporate governance.

Also in the bond market, investment limits on listed bonds for foreigners was completely eliminated at the end of 1997. In the early 2003, foreign corporations could issue domestic bonds freely if they submitted the financial statements based on internationally-recognized accounting standard when foreign companies issued Won-nominated bonds in domestic market. Investment by non-residents on short-term financial products was completely opened in 1998, which allowed non-residents to invest on all short-term financial products of banks and corporations.

The revision of the 'Law concerning Foreign Investment' in 1998 completely permitted the opening of transnational M&A in order to promote foreign direct investment and accelerate corporate restructuring, which allowed hostile takeover. However, maintained limit on the total amount of investment and the voting rights on financial and insurance companies in the 'Fair Trade Act' caused reverse discrimination against domestic corporations, which led to corporations withholding investment and increasing dividends to defend their control over management. Consequentially, this asymmetric and reverse-discriminative opening resulted in significantly negative effect on the activities of enterprises and manifestation of entrepreneurship.

Nevertheless, the phased foreign exchange liberalization measures in 1999 and 2001 respectively eliminated almost all regulations on foreign exchange and capital transaction. They made the Korean capital market compatible with those of developed countries. This reform made the Korean financial industry compete in the global financial market. Moreover, the financial industry has transformed from a government-controlled industry where the government used to dole out and provide money unilaterally to an industry run by free market transactions. As a result, financial transactions have been vitalized as various kinds of marketable securities and derivatives emerged and the ground was built for entrepreneurship to develop with excellent financial specialists.

2) Corporate Restructuring Policy

Conglomerate reform was the essence of corporate restructuring policy that the Korean government implemented in order to eliminate over-borrowing of conglomerates criticized, which was one of the major factors leading to the foreign exchange crisis. Conglomerate reform had three purposes of improving corporate governance and management transparency, financial structure, and business structure.

The Korean government focused on introducing and strengthening a system that could enhance accountability and transparency of major corporate shareholders in an attempt to improve corporate governance and management transparency. Measures which formed the core of this policy included enhancing accountability of governing shareholders; adopting outside director system, lifting limitation on voting rights of institutional investors, and strengthening the authority of minority shareholders. For the purpose of enhancing management transparency, the government implemented policies to limit or sever connection between conglomerates' affiliated companies in terms of management, finance and transaction, which included obligating combined financial statements, establishing auditor nominating commission, adopting public disclosure of forward-looking information; and strengthening sanctions on violations of public announcement. These measures allowed institutional investors and minority shareholders to be important concerned parties and foreign investors to have greater influence.

In order to improve financial structure, the government banned in principle mutual guarantee between conglomerates' affiliated companies and obligated yearly settlement of existing amount of guarantee (1998) and reduction of debt ratio under 200%. As a result, the amount of top 30 conglomerates; mutual guarantee reduced from 63 trillion KRW in 1997 to 1.3 trillion KRW in 2000, leading to significantly less possibilities of chain bankruptcy of affiliated companies within conglomerates. Control on debt ratio led to reduction of the average debt ratio of the top 30 conglomerates from 516.4% in 1997 to 189.6% in 1999.

In order to improve business structure, the government focused on the reduction and restructuring of marginal companies through the revision of laws related to corporate restructuring. The government also attempted to broker a deal with conglomerates to eliminate overinvestment by unifying over-abundant investment among conglomerates and raise their competitiveness by fulfilling economies of scale. The deal included top five conglomerates in seven areas, oil refining, semiconductor, railroad cars, and aircrafts, generating facilities, vessel engines and petro chemistry in July 1998. However, the deal fell through and the government pushed ahead with a unilateral takeover. The government's actions got greatly criticized as it was a government-led business restructuring, not based on the market's choice and need, and remained as an example of the government's artificial intervention in corporate business structure and activities, which were seen as no longer effective in the Korean economy.

Especially, this policy was sharply criticized because the government made an artificial intervention in private business, infringing on private property rights and the freedom of seeking profit.

The government set up a program for top 30 conglomerates except for the top 6 and to undergo restructuring through the banks' guidance and financial support. After 1998, a total of 104 companies were designated as subjects for the program. Among them, 21 companies dropped out before the workout rolled out or merged by their parent company so that the workout program was implemented on 83 companies. Along with this, a divesture system was adopted in 1998, which separated certain business of a company along with its capital and debt, different from the usual divesting system as a way of investment. This has become a new management strategy of Korean companies as they nurture and monitor the progress of their spin-off companies. The government's various corporate policies to enhance business structure played an important role to reduce the possibility of collapse of corporate ecosystem due to the Foreign Exchange Crisis. Although there had been some negative effects, sorting out competitive companies and poor ones and quickly restoring market order by decisively liquidating incompetent companies was one of the most important factors which developed entrepreneurship and enhanced corporate competitiveness, leading to the rebound of the Korean economy after the 1990s.

The Roh Moo-hyun administration, that started in 2003, implemented conglomerate policy focusing on adopting multi-dimensional and concentrated regulation system based on the logic that conglomerates are the source of problems, rather than the growth engine of the Korean economy. Considering 'excessive' control of governing shareholders as the core problem of conglomerates, the Roh Moo-hyun administration announced and implemented at the end of 2003 'Three-year Roadmap for Market Reform' aimed at addressing the distortion brought about corporate governance structure. At first this policy focused on conglomerates' diversification of businesses and expansion of affiliation, but the focus was later redirected to addressing distortion of corporate governance structure. In order to solve the problem, Fair Trade Commission in charge of competition policy led the conglomerate policy with the limit on the total amount of investment as the core means of policy.

However, Roh Moo-hyun administration's conglomerate policy, different from Kim Dae-jung administration's corporate structural reform policy, was based on the logic that considered conglomerates, entrepreneurs and their entrepreneurial activities as an obstacle to economic development. As a result, it came up with various measures to limit entrepreneurial activities of conglomerates that already proved their competitiveness, having survived from the foreign exchange crisis. Eventually, it significantly hampered the development of entrepreneurship. The result of this anti-corporation or anti-market government-led policy was evidently reflected by the fact that corporate investment was difficult to promote and thus the economic growth of

Korea was recorded below the average level of the global economy during the Roh Moo-hyun administration.

3) Vitalization of Venture Businesses

The IT revolution, starting in the 1990s and corresponding to the rise of the vitalized venture business brought about venture boom centered on IT industry also in Korea since the foreign exchange crisis. As a result, management resources such as capital and manpower which used to be concentrated on conglomerates were turned to newly-emerging venture businesses. Therefore, venture businesses obtained an important status in the Korean economy. In early 1997, the Korean government presented the ‘Act on Special Measures for the Promotion of Venture Businesses’ and built up the foundation on which support for the selected companies could be made in the area of capital, tax, location and manpower. Although the venture promotion policy based on this Act caused debates over a speculative bubble and excessive governmental support, the policy played an important role to help venture businesses become one of the major pillars of the Korean economy. Since then, the government came up with improving measures to address the problems of existing venture promotion policy: In 2004, the government changed its support method to indirect support in the areas of infra establishment and provision of service and information and limited the target support to innovative small-and-medium-sized companies; in 2005, it announced its fostering plan for 300,000 innovative small-and-medium-sized companies and established financial support system to back this plan; and in 2007, it revised the law to extend ‘Act on Promotion of Venture Businesses’ with 10-year expiration established in 1997, making it possible to continue the policy to foster venture businesses.

The purpose of the promotion policy for venture businesses was to gain momentum under the economic circumstances in the late 1990s during which “IT Revolution” emerged. Along with the implementation of this policy, Korean economic circumstances focused on existing large companies including conglomerates found new source of momentum in new types of entrepreneurs, entrepreneurial activities and entrepreneurship. The fact that more and more workers quit their jobs at large companies to start up a venture business or start their career at venture businesses rather than large companies during the time reflected that this policy, and despite much dispute, played the role as an important momentum to enhance entrepreneurship in the Korean economy.

5. Manifestation of Entrepreneurship in Korea and Its Achievements

5.1. Entrepreneurship during the Period of Building Industrial Basis (Independence~1971)

After Korea gained independence from the Japanese rule, it was not until the embarking on the economic development in the 1960s when the Korean economy impoverished by colonial exploitation and ensuing war was able to get out of the vicious circle of poverty and to reach the stage for making a leap forward. This was when Korea laid the important institutional and social basis for achieving industrialization and democratization at the same time. The liberties and the economic prosperity enjoyed by Koreans today can be attributed to Korea's liberation from the Japanese colonial rule, the founding the Republic of Korea, and the adoption and evolution of the Republic of Korea's constitution on the basis of liberal democracy as its political system and market economy as its economic system. The policies carried out by the Korean government included farmland reform, disposal of devolving property, rationing of foreign aid, normalization of diplomatic relations between Korea and Japan, sending troops to the Vietnam war, and the first two rounds of Economic Development Plan, which offered institutional and policy framework marking an important turning point in Korea's economic development and manifestation of entrepreneurship. The Korean War that broke out in 1950, the U.S. aid and the postwar reconstruction, and the Vietnam War also affected decisive effects as environments at home and abroad.

Korea had been one of the world's poorest countries that recently gained independence, and here came the beginning of companies after the Independence from the Japan occupation with trade business of bartering goods shipped in junk vessels. The trade industry pre-existed the establishment of an official government, and soon expanded into Hong Kong, Macao, and Japan after 1946, finally spreading into the U. S. and Europe in the aftermath of the Korean War that broke out in 1950. The businessmen engaging in trade at that time showed active response to the economic development policy in the 1960s with their experience and knowledge, which led to corporate growth and development. As the Korean War stepped up the U.S. aid to Korea, companies started to participate in the modern manufacturing business during the rationing of foreign aid. Some entrepreneurs accumulated capital and gained experience in corporate management through trading business, rice-polishing business, or rice dealers, and they invested in the construction of manufacturing facilities to process the goods the U.S. offered as aid, growing into representative companies in the so-called "three white industries" of sugar, flour, and cotton textile industries. Businessmen participated in the disposal of devolving property and cultivated the companies of devolvement, paving the way for becoming large business groups.

While Korea underwent the postwar restoration in the 1950s, businessmen entered into new industries, expanded the market by trading with foreign nations, and took part in the competition over ensuring raw materials. In the fields where obtaining raw materials was stable, entrepreneurs gained management experience, created profit and accumulated capital.

Such active efforts by businessmen led to the revealed diversification of forming large business groups by some successful companies as early as the late 1950s, along with the manifestation of entrepreneurship. Representative large scale business groups formed at that time were shown in Table 3-1. Out of these representative large scale business groups in the 1950s, only Samsung, Lakhee(LG), and Hyundai have succeeded in growing into global firms, and even core companies of these large business groups failed to retain the same status in today's large scale business groups. Sambo, Gaepoong, Donga, Hwashin, Hankook-yoori, Keukdong, Panbon, Keumseung(Ssangyong) practically faced dissolution, hardly keeping themselves in existence, and Samyang, Tongyang have degenerated into medium-sized ones that do not belong to major large business groups any longer. This is solid evidence showing that corporate formation, growth, maturity and extinction can be determined according to their responses to changes in external environment.

During this period, the government played a creative role in preparing an institutional framework of policy and offering important opportunities to nurture the companies established by businessmen. This institutional framework of policy enabled entrepreneurs to start companies, expand the market, and do its best in producing new products and service, to lead economic development. On the basis of forming start-ups established with this entrepreneurship during the restoration stage, the entrepreneurs exercised in inducing foreign capital, exports to overseas market and M&A in the 1960s, which brought about growth of large-scale business groups. Then brilliant economic development took place along with diversification in industries and companies and the emergence of globally competitive companies.

Of course, not all companies succeeded in this process. Only when companies dealt with the changing corporate environment actively, took risk, and embarked on innovation, were they able to enjoy success. Those seeking to remain within the current borders or facing the change in the corporate environments with passive attitude or cynicism had the tendency of being weeding out. Such dynamism in the rise and fall of companies was remarkable, as many of the higher rank large scale business groups in the 1950s were actually weeded out during the reorganization of industries and companies in the 1960s, while enterprising businessmen developed their own companies into today's globally competitive business groups. In particular, those who formed large scale business groups with success in business in the 1960s largely continued to lead economic growth afterwards with continuous innovation and successful entrepreneurship. At that time, the main force in Korea's modernization was the companies constituting large scale business groups, and their response to the changing corporate

Table 3-1 | Affiliate of Large Scale Business Groups in the 1950

Affiliation	Representative	Number	Title
Samsung	Lee, Byung-chul	18(16)	Samsung-Mulsan, Jeil-Jedang, Jeil-Mojik, Hankook-Tire, Ankook-Hwajae, Keunyoung-Mulsan, Hangook-Gigye, Poongkook-Jujeong,Choseon-Yangjo, Cheonil-Securities, Tongyang-Bangjik, Hyoseong-Mulsan, Samgang-Euiji,Tongyang-Daeliseock, Hanil-Bank*, Choheung-Bank*, Tongyang-TV, Shinsegye-Departmentstore
Sam-ho	Jeong, Jaiho	7(6)	Samho-Trade, Samho-Bangjik, Chosun-Bangjik,Daejon-Bangjik,Samyang-Heungup, Jeil-Hwajae, Jail-Bank*
Samyang	Kim, Yeon-soo	10	Samyang-Sa, Kyoungseoung-BangJik, Jeonjoo-Bangjik, Samyang-Jedang, Kwahag-Hancheon, Kamup, Keupsok-Nangdong, Donga-Ilbo, Joongang-Hakwoon(Korea University, Joongang High School), Donga-Bangsong
Gaepoong	Lee, Jeong-lim	7	Daehan-Yangheo, Hoyang-Industry, Baea-Industry, Gaepoong-Sangsa, Daehan-Tankwang, Samhwa-Jechul, Daehan -Steel
Donga	Lee, Han-hwan	5	Donga-Sangsa, Daehan-Jeboon, Hanyoung-Bangjik, Hankook-Jedang, Kookje-Sonhaeboheum
Lakhee	Koo, In-hoi	5	Bando-Sangsa, Lakhee-Chemical, Lakhee-Euijigongup, Guemsung-Sa, Hankook-Cable
Daehan	Seul, Kyoung-dong	6	Daehan-Industry, Daehan-Bangjik, Daehan-Jeonseon, Daedong-Jedang, Daedong-Securities, Wondong-Industry
Tongyang	Lee, Yang-koo	3	Tongyang-Cement, Tongyang-Jegwa, Tongyang-Jedang
Hwashin	Park, Heung-sik	5	Hwasin-Industry,Hwashin-Departmentstore,Shinshin-Departmentstore,Heunghan-Bangjik, Heunghan
Hankook- yoori	Choi, Tae-seop	3	Donghwa-Industry, Hankook-Yoori, Yoori-Panmae
Keukdong	Namgoong, Ryun	4	Keukdong-Haeun, Keukdong-Tongsang, Hankook-Jeongyoo, Hankook-Kwan
Hyundai	Jeong, Joo-young	3	Hyundai-Geunseol, Keumgang, Hyundai-Cement
Panbon	Seo, Gap-ho	1	Taechang-Bangjik
Keumseung	Kim, Seung-gon	2	Keumseung-Bangjik, Ssangyong-Cement

Remark: * means Ascription to the National Treasury in 1961 when the persons who accumulated their wealth by illicit means were punished by the court.

Source: Cho et al. (1984), pp.48-49.

environment led to clear division between successful ones and failed ones.

Representative businessmen during this period included Lee Byung-chul, Jung Joo-young, Kim Woo-jung, and Choi Jong-hyun whose entrepreneurship is still highly respected until now. These entrepreneurs shared the characteristics of having a vision of protecting the nation with business through active participation in economic development, entry into new industries by inducing foreign capital as a sign of fully embracing the government policy, facing greater challenges and putting effort in exporting goods and services and pioneering new markets through overseas expansion, and securing growth opportunities and entering into a new area by actively engaging in M&A while underperforming companies went through breaking-up process.

At the end of the 1950, the restructuring of 13 companies such as Hankook Tire, Samchuck Cement took place by Lee Byung-chul of Samsung Group, out of its 19 subsidiaries. Instead, 11 companies of Tongyang-Bangsong, Jungang-Ilbo, Dongbang-Sangmyeung, Cheonjoo-Jeji, Samsung Electronics and so on were newly created or acquired, so that diversification and brisk entry into new industries could encourage entrepreneurship excellent in ensuring new growth engine and competitiveness. In fact, the industries selected by Samsung Group to enter into at that time were growth industries with enormous synergy effect such as press, medical, paper manufacture, electronics, real estate development, retail, culture business. So, constant business innovation and success in new markets or industries could be evaluated to play the role of locomotive for Korean economic development and to act as core competitiveness in the emergence of Samsung Group as a global firm. Even in the presence of institutional and policy supports by the government, failing to reveal such creative entrepreneurship would make it difficult to result in successful economic growth.

Another representative entrepreneur in the 1960s was Jung Joo-young of Hyndai Group who also helped bring success in economic development of Korea. In the 1950s, seizing upon providing services to the U.S. forces in Korea, he transformed a small and medium enterprise for auto repair and construction into a large construction company. With the completion of constructing the Footbridge over the Han River, Korea's biggest construction projects at that time, his construction company already grew into the best in the industry in 1957. Jung Joo-young newly established Keumgang Slate, Danyang Cement, Hyundai-Yanghang in 1958 to enter the upstream engaging in production of construction materials and architectural facilities in an attempt to seek vertical integration in the construction business. The 1965 construction of Pattani Narathiwat highway in Thailand by Hyundai Construction Co. started the overseas expansion, and sending the Korean troops to Vietnam was used as an opportunity to expand overseas in earnest, obtaining contracts for dredging project of Cam Ranh Bay and for housing construction of Bangoi in Vietnam, as way of showing entrepreneurship in pioneering new markets. The overseas expansion of Hyundai Construction led to winning the contract for a second highway in Thailand, getting recognition for Korean construction businesses, and paving the way for Korean construction businesses to meet the increased demands for construction in the Middle East starting in the 1970s. In particular, Jung Joo-young established Hyundai Motor Company at the end of 1967 on the basis of the financial resources from businesses in Vietnam, and entered into a contract with Ford to produce the Cortina for the Korean market in 1968, which became a stepping stone to advancement into securing competitiveness that enabled worldwide competition with the automobile industry as Korea's key industry. Also, Jung Joo-young played the leading role in the construction of the Gyeongbu[Seoul-Busan] Expressway which was the core policy objective of Economic Development Plan designed by the Park Jung-hee administration under the banner of comprehensive development of land, serving as the main driving force in economic development. Entrepreneurship of Jung Joo-young was shown in taking risks and overcoming the difficulties which resulted in actively participating in business that produces enormous benefits for the future. This can be considered giving impetus to Korea's emergence as the globally leading producer and exporter of automobiles, as well as establishing the foundation of becoming the most competitive nation in ship building and construction.

In addition, businessmen like Kou In-hoi, Kim Woo-jung, Choi Jong-hyun revealed entrepreneurship at that time as entry into diverse industries such as petro-chemicals, transportation, trade, and electrical and electronic industries. Their entrepreneurship helped the growth of companies, becoming the main driver of economic development.

5.2. Entrepreneurship during the Period of Rapid Economic Growth (1972~87)

The period of rapid economic growth can be divided into the 1970s, a period of pushing the heavy and chemical industry, and the 1980s, a period of restructuring. Throughout these periods, a lot of entrepreneurs, who took risks, were succeeded with government policy of promoting the heavy and chemical industry. Especially from the 1970s to the mid of 1980s, the entrepreneurship was considered to be the highest. As it is shown in Table 3-2, the time when the entrepreneurship ranked highest was the era of heavy and chemical industrialization, from 1975 to 1979.

Table 3-2 | Entrepreneurship Index by Year

(Unit: %)

Interval	Growth Rate of Number of Businesses	Growth Rate of Investment	Growth Rate of R&D	Index of Entrepreneurship
1971~74	-1.6	43.7	20.3	20.8
1975~79	6.8	42.8	87.3	45.6
1980~84	5.4	11.8	53.3	23.5
1985~89	9.2	19.0	28.2	18.8
1990~94	6.7	16.8	24.3	15.9
1995~99	0.3	6.2	6.0	4.2
2000~03	9.0	7.2	13.3	9.8

Remark: Entrepreneurship index shows entrepreneurship's upswings and slowdowns, that is the simple average of rate of increase in the number of businesses (more than 5 laborers in manufacturing and mining industry), rate of increase in investing plant and equipment and rate of increase in R&D.

Source: Korea Chamber of Commerce and Industry (2005).

In this period, the first generation of business founders entered into new industries. For example, Lee Byung-chul of Samsung ventured into semiconductor and electronics, Jung Joo-young of Hyundai was into shipbuilding and automobiles and Park Tae-jun entered into the steel industry, and they became representative entrepreneurs, stepping in each industry with the long-term business vision corresponding to government's policy of promoting the heavy and chemical industry. Achievements of these representative entrepreneurs in detail are as followed in Table 3-3.

Table 3-3 | Investment Plan by Industries and Enterprises' Achievements

Industry	Plan	Performances
Iron & Steel	Extension of POSCO Construction of the Second Steel Company Construction of Plant for Special Steel	• Extension of POSCO: 8 million 500 thousand ton • Final decision on the construction of the Second Steel Company (Kwangyang Steelmill by POSCO) • Hankook Integrated Special Steel (Sammi Special Steel) • Daehan Heavy Machinery (KIA Special Steel)
Non-Ferrous Metals	Establishment of Onsan Combinat	• Korea Zinc, Onsan Cooper Refinary (LG metal, 82) • Hyundai acquired Daehan Aluminum

[continued from Table 3-3]

Industry	Plan	Performances
Machinery	Establishment of Changwon Combinat Making Automobile Industry as Export Industry	• Hyundai, Hyundai Heavy Industry • Daewoo (Hankook Machinery → Daewoo Heavy Industry) • Hyoseong (Hanyoung Industry → Hyoseong Heavy Industry) • Samsung (Daesung Heavy Industry → Samsung Heavy Industry) • Ssangyong, (JinilIndustry → Ssangyong Heavy Industry) • KIA acquired Asia Automobile Co. • Daewoo (GM Korea → Daewoo Automobile Co.)
Shipbuilding	Establishment of Geoje-do Combinat	• Hyundai, Hyundai Shipbuilding Industry (Hyundai Heavy Industry), Hyundai-Mipo Shipbuilding • Daewoo, Daewoo Shipbuilding (Daewoo Heavy Industry) • Samsung, Samsung Shipbuilding (Samsung Heavy industry)
Electronics	Making Electronics Industry as Export Industry Extension of Kumi Industrial Complex	• Samsung, Samsung Electricity Samsung Corning (Hankook Semiconductor → Samsung Electronics) (Hankook Electronic Telecommunication → Samsung Electronics) • LG, Keumsung Electronic Machinery Keumsung Electronic Mesument Machineries (Daehan Semiconductor → LG Telecommunication) • Daewoo, Daewoo Electronics Daehan Cable acquired Consumer Electronics (1983)
Chemistry	Construction of Yeucheon Industrial Complex Construction of another Refinery	• Honam Ethilene (Privatized → Daelim Industry) Honam Petrochemicals (Privatized → Lotte Group) Keumho, Keumho Chemicals (Keumho- Shell Chemicals) • LG, LG Petrochemicals Samsung, Samsung Petrochemicals (Ulsan) Kolon, Kolon Petrochemicals (Ulsan) Namhae Chemicals (National Corporation) • Ssangyong, Ssangyong Refined Oil

Source: Kwack et al. (1995).

A unique characteristic of the entrepreneurship in this period was derived from the existing large-scale business groups, which took diversification strategies and expanded their business sizes, rather than small and medium enterprises' venturing. This means that entrepreneurship in this period was manifested qualitatively, not quantitatively. That is, there was an expansion or increase in size of the existing enterprises, not an increase in the number of new businesses. Moreover, through importing skills and technology from developed countries, highly ranked enterprises of Korea successfully entered automobile, electricity and electronics and shipbuilding industries. By learning various production skills, they accumulated technical resources. Status of large-scale business groups' unrelated diversification is described in Table 3-4.

Table 3-4 | Strategic Industries in 1970s and Diversification of Enterprises

Title	TX	RF	CM	EL	ST	NF	MC	AM	SB	CO	GT
Samsung	●		●	●			●		●	●	●
Hyundai			●		●	●	●	●	●	●	●
LG		●	●	●		●				●	●
Daewoo	●		●	●			●	●	●	●	●
Seunkyoung	●	●	●				●			●	●
Ssangyong		●		●			●			●	●
Hanhwa		●	●	●				●		●	●
Kookje					●		●			●	●
Hyoseong	●		●	●		●	●			●	●
Daelim			●				●			●	
Dongboo										●	
Donga				●			●			●	
Keumho			●							●	

Remark: TX: textile; RF: Refining; CM: Chemical; EL: Electronics; ST: Steel; NF: Non-Ferrous Metal; MC: Machinery; AM: Automobile; SB: Shipbuilding; CO: Construction; GT: General Trading.

In 1970s, mass production system was built mainly by large enterprises, and export-oriented industrialization was earnest. Industrial policy and trade policy in this period constantly drove enterprises to be competitive in international markets and showcase the entrepreneurship in Korean economic history since independence.

5.3. Entrepreneurship during the Period of Paradigm Shift (1988~97)

For a decade, from the late 1980 to the late 1990, internal and external economic environments have changed significantly. Externally, there were unification of Germany, collapse of the Soviet Union, the end of the Cold War, entry of eastern European nation to market economy, settlement of Uruguay Round and establishment of WTO system, so the age of limitless competition has come. Internal political and economic environmental changes we faced were the progress of democratization, the collapse of military regime, the political reinforcement of labor movement, the proliferation of labor-management dispute due to reorganization of economic order, the reinforcement of regulations against economic concentration to large scale business groups, "Three Lows" boom and Seoul Olympic game in 1988.

Facing these rapid internal and external environmental changes, enterprises conducted management innovation and the reorganization of business structure. In this period, entrepreneurship was presented by existing large-scale business groups' innovation capabilities, rather than by individual entrepreneurs, like Lee Byung-chul, Jung Joo-young and Choi Jong-hyun, and led to growth and development of enterprises and economic development. The current leading enterprises, such as Samsung Electronics, LG Electronics and SKT have actively stepped into high-tech industries, like semiconductor, TFT-LCD, information and communication industry in this period, and succeeded with developing technical advances and securing competitiveness in global market.

Since entering the semiconductor industry in the early 1980s, Samsung, LG, and Hyundai helped make Korea the third largest producers of semiconductor in the world in the beginning of 1990s, and in 1993 when 10 years passed from the penetration became the top producer of D-RAM by beating Japanese companies. Already established as a pioneer in the semiconductor industry, Samsung Electronics entered into this industry in 1983, and mass-produced 64K D-RAM in 1984, 256K D-RAM in 1986, 1M D-RAM in 1988, and 4M D-RAM in 1991, trailing the most competitive Japanese manufactures in the world by three, two, one, one year in terms of mass-production period. Nobody anticipated the rise of Samsung Electronics to the top spot in the world beating Japanese and American representative enterprises in this industry. Samsung Electronics has achieved full technological independence since the production of 4M D-RAM, and completed the development of the world's first prototype of 64M D-RAM in 1992, jumping to the top place. To this day, maintaining its premier position in the memory semiconductor market globally, Samsung has been successful in the cut-throat competition in the semiconductor market, because products of the next generation or even after the next generation are almost concurrently being developed in parallel with the reduction in size out of entrepreneurship in rapid and creative technological development.

Korean enterprises put massive profits accumulated during the 1995 semiconductor boom into the TFT-LCD business as concentrated investment. In this investment, Korean companies focused on 13.3 inch and 14.4 inch products, rather than the 12.1 inch products which constituted mainstream line of products at that time. There was concentrated investment in the facility for the products with larger than 13.3 inch screen, and such challenging and bold investments resulted in reaching the top place in the world market since 1998. As new growth engine following the semiconductor, Korean entrepreneurs adopted TFT-LCD business to take the greatest advantage of technological accumulation from the semiconductor, and the profit from the semiconductor business was concentrated on making a bold investment. From the start, Korean entrepreneurs decided to compete in the major market of developed nations where the confrontation with the Japanese market leaders was waiting. Such firm determination of successful decision making of entrepreneurs provided the driving force to have the highest competitiveness in the TFT-LCD market globally. This exercise of entrepreneurship in the semiconductor or TFT-LCD was possible thanks to the system of management by a largest shareholder where large scale business groups of Korea were able to make a rapid and bold decision. Especially for the industries with shorter cycle of technology or products like semiconductor or TFT-LCD, the ability to make prompt and bold management decisions is critical to ensuring competitiveness.

In the information and telecommunications industry, companies including SKT succeeded in the world's first commercialization of CDMA technology in 1996, making Korea an IT power. As a result, the number of mobile phone subscribers reached 1 million in February of 1995, and the next year saw the expansion into 2 million subscribers, opening the age of popularized use of mobile phones. In 1997, three PCS service providers of KTF, Hansol PCS, LG Telecom entered the mobile phone market escalating competition, but the subscribers to mobile phone continued to increase to 5 million in 1998 and 10 million in 1999. As mobile telecommunications became universal, every entrant experienced astonishing growth. SKT has remained the undisputed top in the domestic mobile phone market, and has established itself as market leader in the world CDMA market since 2000 with superior technological development and commercialization.

In addition, the commercialization of CDMA technology led to the world's first launching of commercially viable mobile phones by Korea's Samsung and LG even though they fell behind in the world market of handsets. Their mass production started in 1996 and a total of 1 million handsets were sold only a year later their first production, with market share of 8% in the U.S. market rising to the fourth largest seller in the market. Since then, Samsung Electronics developed PCS, GSM handsets as well and sold them to the markets internationally. By selling 4.42 million handsets in 1997 and 10 million handsets in 1998, Samsung Electronics marked a 28.5% market share in the world, rising to the top spot. After that, Korean entrepreneurs have continued to stay at the top place in the global handsets market.

In addition, enterprises made active inroads into finance and distribution businesses in responding to the opening of financial and retail markets according to globalization. Large enterprises created new financial capital products in addition to the existing industrial capital, and achieved innovation in financing by steeply lowering the share of indirect finance from banks and by directly financing through the stock market or float long-term bonds abroad. Large enterprises also entered into the distribution business with strengthened consumer satisfaction or efficiency in management. They defeated foreign competitors who entered the Korean distribution market after its opening, securing competitive edge in the domestic distribution market. Moreover, on the basis of this success, they expanded into emerging markets like China and became the main agent in accomplishing innovation of providing to customers better quality goods and services at lower price.

Entering the 1990s, the conclusion of UR Agreement and the establishment of WTO framework brought an age of limitless competition, encouraging domestic enterprises to make overseas expansion. From this period, domestic enterprises sought entry into the world stage in earnest under the banner of 'global management', mainly aiming at securing overseas production bases through M&A in mostly the U.S. and Europe. Korean enterprises acquired foreign producers facing insolvency through M&A, so that cutting-edge technologies could be obtained along with evading import regulations of the developed countries while boosting the revenues in these areas effectively.

Entrepreneurship shown by these entrepreneurs at that time seems to cover almost every characteristic Schumpeter mentioned in his definition. During this period, there were reorganization of business structure according to the sudden change in environments at home and abroad along with pioneering new markets through overseas expansion, and the entry into new businesses through diversified lines of business including finance and distribution. Despite the serious setback of the 1997 Foreign Exchange Crisis, Korean enterprises were able to establish the framework for achieving corporate and industrial competitiveness globally after such crisis.

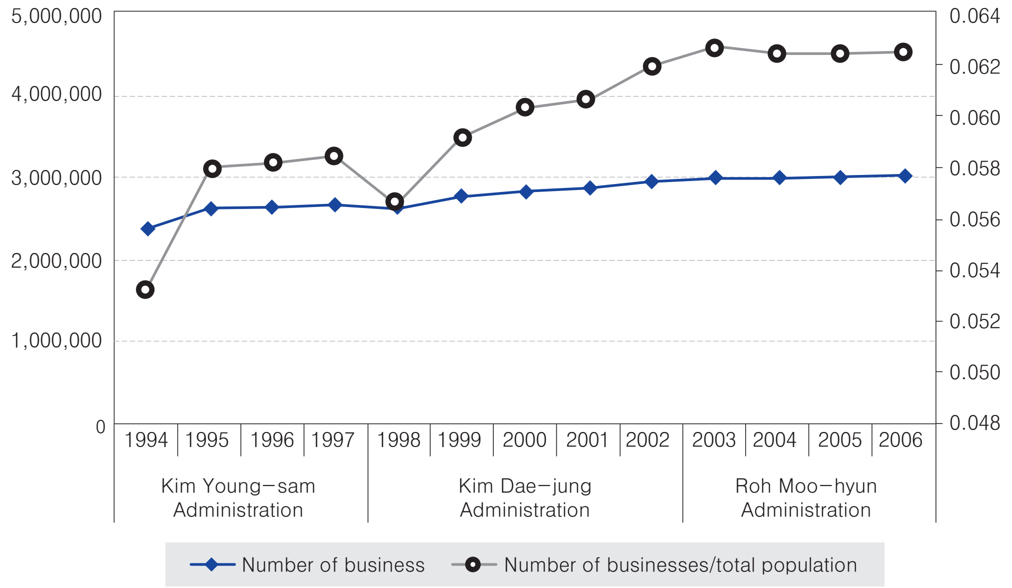
The most remarkable thing during this period could be found in the fundamental change in the relationship between the government and enterprises. Previously, it was common that the government provided enterprises with various benefits in terms of policy and institutions to raise industries and to nurture enterprises. However, after the late 1980s, the government reinforced regulations on enterprises through laws such as the 'Fair Trade Act' under the cause of curbing the concentration of economic power, and the government's economic policy came to be driven by the market. Reversing the trend established in the 1980s when companies relied on preferential treatment by the government, companies began to seek independent growth strategy, and raised funds from outside by increasing the share of direct financing from the second financial sector or from the stock market, rather than from the bank credits. As a result, the relation between the government and enterprises went through transition from vertical one in the past to the current horizontal one.

5.4. Entrepreneurship during the Period of Overcoming Crisis and Take-off again(1998~2008)

Korea rebounded from the foreign exchange crisis in this period and reached 20,000 dollars per capita GDP in 2007. It has passed 12 years since Korea already arrived at 10,000 dollars per capita GDP in 1995. This kind of successful economic growth was possible because of bold restructuring and advancement of industrial structure, speedy external opening of the domestic market and epoch-making regulatory reform. These policies enhanced economic efficiency and promoted and reinforced market competition in spite of serious environmental changes like foreign exchange crisis. These successful policy responses and the manifestation of entrepreneurship resulted in the enlargement of trade volume and huge trade surplus, increase in foreign direct investment and foreign exchange reserves and rapid increase in the number of venture businesses.

The manifestation of entrepreneurship in this period appeared in the form of increase in start-ups of venture businesses. However, this vitality of ventures has decreased since Roh Moo-hyun administration's inaugural in 2003 and the number of start-ups was stagnated since then. As we can see in Figure 3-1, while the ratio of number of businesses in the total population was rapidly increased after foreign exchange crisis, it was stagnated since 2003 as we explain in the above. This trend coincides with the fact that the total number of newly established businesses decreased in 2003 and stagnated since then.

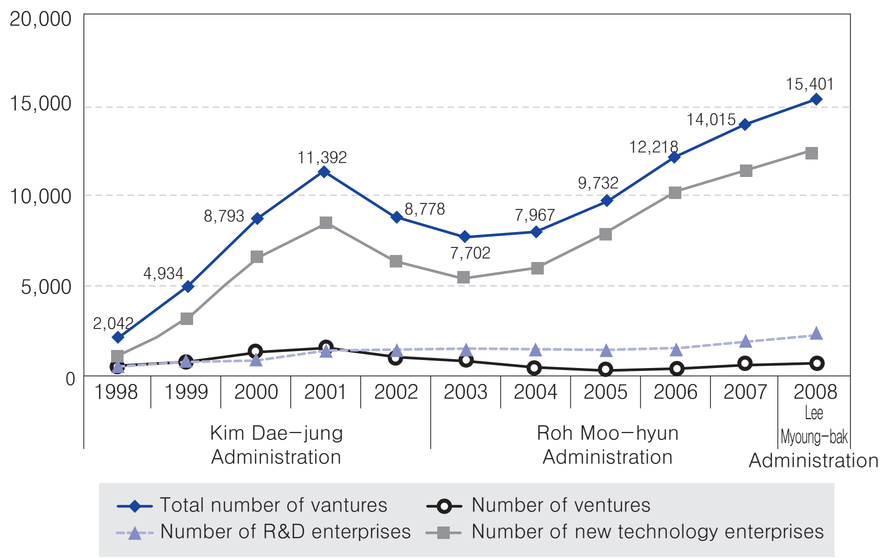
Figure 3-1 | Number of Businesses and Number of Businesses per Person



Source: Small and Medium Business Administration (http://www.smba.go.kr/).

As can be seen in Figure 3-2, the number of venture businesses rapidly increased after foreign exchange crisis and bubbles were burst. However, the number of them greatly reduced with bursting bubbles and was increasing in recent years. Despite of the recent increase, it cannot be interpreted as a positive sign of entrepreneurship because the ratio of the increase in the number of venture businesses among the total number of businesses was very low. According to this trend, while the entrepreneurship had vividly displayed after foreign exchange crisis, it rapidly lost its momentum since 2003.

Figure 3-2 | Annual Trend of the Number of Venture Businesses



Source: Small and Medium Business Administration (http://www.smba.go.kr/).

Entrepreneurship was shown in the form of the development of new products, the innovation on production process, and the entry into new markets by companies from large scale business groups in this period. It gave rise to the rank change of large scale business groups which is shown in Table 3-5.

For example, top ten large enterprises based on sales had been Samsung C&T, Hyundai Co., Samsung Electronics, LG International, KEPCO, Hyundai Motor Co., SK, POSCO, Ssangyong, KT in 1997 when Korea had faced foreign exchange crisis. It astoundingly changed in 2007. In 2007, the top ten large companies were Samsung Electronics, Hyundai Motor Co., KEPCO, LG Electronics, POSCO, GS Caltex, SK Networks, KIA Motor Co., Hyundai Heavy Industry in 2007. The characteristic of this change means there were structural change in businesses that made the above-normal profits. The main businesses of large scale business groups have been greatly changing from the businesses based on general trading companies to those based on high and complicated technology manufacturing industries such as electronics, automobile and

Table 3-5 | Rank Changes of 20 Large Enterprises according to Sales

(Unit: million USD)

1980	Sales	1988	Sales	1997	Sales	2007	Sales
SK	1.97	SCT	6.81	SCT	29.73	SSE	63.18
HCC	1.08	HDC	5.62	HDC	25.04	HMC	30.49
SCT	0.92	KEPCO	4.42	SSE	18.47	KEPCO	28.98
SKN	0.65	POSCO	3.70	LGI	15.58	LGE	23.50
KAL	0.56	HMC	3.41	KEPCO	13.12	POSCO	22.21
DIC	0.51	SSE	3.03	HMC	11.66	GS Caltex	21.47
DCC	0.49	LGI	2.71	SK	10.76	SKN	17.69
LSN	0.47	KT	2.60	POSCO	9.72	KMA	15.95
HDC	0.41	SK	2.37	Ssangyong	8.42	HHI	15.53
Ssangyong	0.40	GS Caltex	2.11	KT	7.79	S-OIL	15.22
HHI	0.38	SKN	1.74	GS Caltex	7.20	SKE	14.86
LGI	0.35	KAL	1.54	Posteel	7.05	KOGAS	14.26
CJ	0.30	Ssangyong	1.46	KMC	6.38	LGD	14.16
Hanyang	0.29	KMC	1.42	SKN	6.00	GMDA	12.51
SYC	0.29	HCC	1.37	HHI	5.89	KT	11.94
KHI	0.26	LG	1.21	HCC	5.61	SKT	11.29
Sammi	0.25	HHI	0.94	S-OIL	5.32	LGC	10.80
SSE	0.23	DCC	0.84	KAL	4.29	LTS	9.77
HMC	0.22	DIC	0.78	LG	4.11	SCT	9.73
TEW	0.20	CJ	0.69	SHI	3.95	HOB	9.46

Remark: Hyundai Construction Co.(HCC); SK Networks(SKN); Samsung C&T(SCT);Daelim Industrial Co.(DIC); Donga Construction Co.(DCC); LS Networks(LSN); Hyundai Co.(HDC): Hyundai Heavy Industry(HHI); LG International(LGI); Ssangyong Cement(SYC); Kumho Industrial(KHI); Samsung Electronics(SSE); Hyundai Mortor Co.(HMC); Taihan Electric Wire(TEW); Kia Motor Co.(KMC); Samsung Heavy Industry(SHI); LG Electronics(LGE); SK Energy(SKE); LG Display(LGD); GM Daewoo Auto &(GMDA); LG Chemicals(LGC); Lotte Shopping(LTS); Hyundai Oil Bank(HOB).

Source: Korea Investors Service, KISVALUE.

shipbuilding. This means that the manifestation of entrepreneurship played a major role to the successful structural change in industry and it resulted in the strong economic competitiveness of the enterprises in the international competition.

The key factors of entrepreneurship, like the invention of new products and innovation in the production process, may create new demand and strengthen the firm's competitiveness and enlarge their shares in the international market. Therefore, they are the proofs of the manifestation of entrepreneurship. Besides, export oriented entrepreneurial behaviors may also extend the export. After foreign exchange crisis, Korea's export increased and contributed to a significant trade surplus, allowing Korea to escape from the crisis and accumulate foreign exchange reserves that could shield Korea from market volatility and uncertainty in the future.

There were apparent changes in the composition of export items. As can be seen in Table 3-6, the rank change of top 20 export items during last 30 years shows us the change in composition towards high-tech and high value-added industry. This means that the change was not interrupted at the inter-industrial changes but progressed to high value-added items in the industry itself. There was also successful diversification of the export market. The rank of major export markets had been changed from the US, Japan and China before foreign exchange crisis to China, US, Japan in 2007. This is another evidence of the manifestation of entrepreneurship because it means that Korean firms and entrepreneurs took advantage of Chinese economic growth. In fact, the rank of top ten countries was 59.7% in 2008, while it had been 65.7% in 1997. This is also an evidence of diversification.

Table 3-6 | Rank Changes in Export Items during the Last 30 Years

(Unit: million dollars)

Rank	1982		1987		1992		1997		2002		2008	
	Item	Amount	Item	Amount	Item	Amount	Item	Amount	Item	Amount	Item	Amount
1	CS	23,508	SC	26,878	CS	40,892	MSC	153,932	MP	97,847	CS	344,618
2	OS	8,272	OS	26,128	OSIC	34,022	SC	75,236	MSC	94,796	ESI	205,388
3	IUH	7,164	OSIC	15,001	MSC	28,316	CS	64,497	CS	94,132	LCD	182,448
4	OMP	6,439	PF	12,871	PF	26,818	Gold	61,596	SC	83,209	MSC	170,262
5	PF	5,997	ORC	11,587	SS	23,519	PF	41,546	OSIC	59,568	LO	159,648
6	OSIC	4,969	LC	10,797	SC	18,304	LO	22,631	DDD	45,875	AP	139,499
7	OSH	4,416	CS	10,055	CRTT	15,286	CCRT	21,869	OCP	44,240	PC	118,204
8	MASH	4,202	VCR	9,004	LC	13,146	AP	21,170	JSC	33,121	OWCDP	113,215
9	MW	3,635	Toy	8,744	IUH	12,678	Knitting	20,008	AP	27,045	OWCD	102,392
10	LC	3,569	IUH	7,052	VCR	11,810	CRTT	15,856	Knitting	27,003	Jet oil	93,143
11	C&J	3,517	MWO	6,351	ORC	11,635	DDD	15,196	PF	22,028	CDMAP	86,708
12	OSS	3,415	MASH	6,328	C	11,174	OL	13,841	CCRT	20,768	OOEP	64,170
13	SS	3,100	Sweater	5,902	CCRT	8,773	OF	13,439	LO	20,619	LCI	54,730
14	C	2,797	MW	5,834	Sweater	8,487	OT	13,430	OWCD	19,421	OSH	54,214
15	ORC	2,616	Blouse	5,540	OCP	7,974	IUH	11,059	SW	16,865	CTVP	47,811
16	toy	2,247	CRTT	5,409	OL	7,028	OFC	10,757	OPP	13,973	LSI	46,197
17	Sweater	2,187	C&J	5,041	Knitting	6,814	UCRRS	9,301	OF	12,746	DDD	40,396
18	PS	2,177	IC	4,573	IUH	6,711	OPP	9,190	OT	11,854	OPP	35,867

[continued from Table 3-6]

Rank	1982		1987		1992		1997		2002		2008	
	Item	Amount	Item	Amount	Item	Amount	Item	Amount	Item	Amount	Item	Amount
19	BWTV	2,114	CTV	4,404	BCO	6,669	Naphtha	8,989	AC	11,585	OPCP	33,623
20	PW	2,009	C	4,290	OV	6,619	CTVP	8,962	Naphtha	11,578	OFC	33,334

Remarks 1: Cargo Ship(Cs); Other Shoes(OS); Iron, Unalloyed and Hot Rolled Steel(IUH); Other Miscellaneous Product(OMP);Polyester Fabrics(PF); Other Semiconductor Integrated Circuit(OSIC) Other Ship(OSH); Man's Shirt(MASH); Men's Wear(MW); Leather Clothing(LC); Coat &Jacket(C&J); Other Steel Structures(OSS); Sport Shoes(SS); Containers(C); Other Radio-Cassette(ORC); Plated Steel(PS); Black & White TV(BWTV); Plywood(PW); Sedan Car(SC); Memory Semiconductor(MSC); Microwave Ovens(MWO); Cathode Ray Tube Terminals(CRTT); Infant Clothing(IC); Color TV(9-15 inches)(CTV); Color Cathode Ray Tube(CCRT); Other Computer Parts(OCP); Other Leather(OL); Bunker-C Oil(BCO); Other Vehicle(OV); Light Oil(LO); Auto Parts(AP); Data Display Device(DDD); Other Fabrics(OF); Auto Truck(AT); Other Fine Chemicals (OFC): Unalloyed Color-Rolled Sheet Steel(UCRSS); Other Plastic Product(OPP); Color TV Parts(CTVP); Air Conditioner(AC); Mobile Phone(MP); Other Wireless Communication Device(OWCD); Jeep Style Car(JSC); Station Wagon(SW); Exceeding 1500 cc Spark Ignition(ESI); Process and Controller(PC); Liquid Crystal Devices(LCD); Other Wireless Communication Devices' Parts(OWCDP); CDMA phone(CDMAP); Other Optical Equipment Parts(OOEP); 2500cc or Less Compression Ignition(LCI); 1500cc or Less Spark Ignition(LSI); Other Petrochemical Products(OPCP)

Remarks 2: Export Product was classified through MTI 6 digit.

Source: KITA, KOTIS.

6. Conclusion

In general, successful entrepreneurs in Korea had a great vision of "repayment by business to the homeland." They were not the usual money hoarding profiteers. If any businessman had an obsession about the monetary gain without consideration of laborer in his company, his society and his country and he could be successful temporarily, but he could not sustain his business and thus it would decay in the long-run. Both the capability of problem-solving and the facing challenges without fear of an entrepreneur were important in the whole process of business because they make enterprises start, grow and leap successfully. In business, Korean entrepreneurs manifested entrepreneurship through innovation, which Schumpeter had defined. They actively invented and introduced new products and services. They also improved the quality of existing product and found out new production processes or methods. In addition, they pioneered new markets and achieved the secure supply of important factors of production and natural resources. And they run new organization to win in the market.

The performance of entrepreneurs' activity and manifestation of entrepreneurship was determined by the institution and policy the government implemented and internal and external economic environments. That is, the performance of entrepreneurship not only depended on informal institutional factors like culture, custom, politics etc. but also were restrained by governmental policies. Although a nation or a society establish an ideal or just political and institutional framework, it is difficult to expect the economic development of the country or the society without providing incentives to display entrepreneur's activities and entrepreneurship. When viewed from this perspective, it was proved by the unprecedented economic development that constitution, legal system, political decision makings and the government policies of Korea have been being very effective and efficient in spite of several debates.

The Korean government has continuously been encouraging entrepreneurship and entrepreneur activities. Such efforts include the founding of Republic of Korea based on liberal democracy and capitalist market economy in the south half of Korean Peninsula, farmland reform and disposal of devolving property, government-led post-war recovery process and preparation and implementation of four "Five-year Economic Development Plans," choice of unbalanced growth strategy with export drive, implementation of heavy and chemical industry promotion policy, transforming to the private sector led economic system when being visualized of economic take-off, changing the focus of policy from the growth-oriented to balance between growth and distribution, institutionalization of competition policy through the 'Fair Trade Act,' reinforcing the laborers' rights and securing social safety net, regulatory reform and privatization, private and public partnership to develop and find out new and innovative growth engine for the future.

The domestic and international environments had also positive and negative influence on the manifestation of entrepreneurship and business activities. The representative examples of those are as follows: emancipation from the Japanese colonial rule and independence; the US military rule, Korean War; aids for reconstruction from the West including the US, Viet Nam War; serious oil shocks and stagflation caused by them, special economic boom in the Middle East countries; end of cold war caused by collapse of Berlin wall and downfall of communist regimes in USSR and Eastern Europe; rise of globalization and regionalism; settlement of WTO system in the international trade and rapid increase of bilateral FTAs; democratization; Foreign Exchange Crisis in 1997 and Global Economic Crisis since 2007. In general, these changes resulted in good opportunities and challenges for Korean businesses and entrepreneurs.

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