The Spiraling of Market Power

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Abstract and Keywords
This chapter starts with a discussion of the development of the highly diversified business/industrial groups that have grown in late-industrializing countries – as exemplified by the zaibatsu in Japan, and the chaebol in South Korea. Such big businesses raise various issues, including economic performance, and their social effects, but this chapter is mainly concerned with two further issues: the magnitude and causes of concentration, of which there has been no systematic study; and the support of, and the discipline by, the government. These issues are discussed under the headings of market concentration, corporate strategy towards diversification, and the discipline of monopoly power.

Keywords: big businesses, chaebol, discipline, diversification, economic performance, government control, industrial groups, Japan, market concentration, market power, monopoly power, social effects, South Korea, zaibatsu
Monopoly, Competition, and Liberalization: An Overview

Big business as well as the state shouldered the burden of carrying Korea into basic and high-tech industry. Beginning in the 1880s, big, oligopolistic firms became a general property of industrialization. Oligopoly, or a relatively small number of firms in control of the output of a single industry, is one meaning attached to the term market power. The term has, however, another meaning. This meaning relates to the tendency of big business to diversify into more than one industry, giving rise to high aggregate concentration. According to an account of industrialization in the United States, “The large modern corporation typically is not confined to a single industry but embraces many lines of business and its operations extend to all parts of the earth. . .” (Mueller, 1982, p. 427). Thus, a general property of the industrialization beginning in the late nineteenth century is high aggregate concentration along with industry concentration, the former referring to the accountability by a relatively small number of firms for a large share of national product.

The countries that industrialized still later through learning took high aggregate economic concentration even further, in the form of the diversified business group—zaibatsu in Japan, chaebol in Korea. A volume describing the proceedings of the International Conference on Business History testifies to the generalness of this form of business in late industrialization:

In developing countries such as South Korea, Taiwan, the Philippines, Thailand, India, Brazil and Argentina . . . industrial groups which resemble Japan's former zaibatsu have sprung up since the Second World War. (Yasuoka, 1984, p. xi)\(^1\)

\(^{(p.116)}\)
### Table 5.1 Combined Sales of Top Ten Chaebol, as Percent of GNP,a 1974-1984

<table>
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<td>57.1</td>
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<td>14.7</td>
<td>16.7</td>
<td>19.3</td>
<td>25.2</td>
<td>28.9</td>
<td>31.6</td>
<td>46.0</td>
<td>53.3</td>
<td>55.1</td>
<td>59.8</td>
<td>64.8</td>
</tr>
<tr>
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<td>15.1</td>
<td>17.1</td>
<td>19.8</td>
<td>26.0</td>
<td>30.1</td>
<td>32.8</td>
<td>48.1</td>
<td>55.7</td>
<td>57.6</td>
<td>62.4</td>
<td>67.4</td>
</tr>
</tbody>
</table>

(a) (Aggregate net sales of the largest ten business groups/GNP) × 100 for each year.

The extreme degree of diversification and concentration represented by the diversified business group is notable when one compares the chaebol with, say, General Motors and General Electric before World War II. These two American giants were highly diversified, but largely in related products (however remotely related). The leading Korean chaebol, by contrast, comprise major divisions that have no relation to one another whatsoever: consumer electronics and petrochemicals in the case of the Lucky-Goldstar group; finance and heavy machinery in the case of Hyundai; consumer electronics, heavy machinery, finance, and entertainment in the case of Samsung; and so on. What is more, while prewar General Motors and General Electric were larger in absolute size than Samsung or Hyundai, they never accounted for as high a share of total gross national product. As Table 5.1 shows, in 1984 the three largest chaebol alone accounted for a staggering 36% of national product in Korea.

Big business raises two sets of issues: its economic performance and its social effects. Concerning its social effects, they appear similar whatever the mode of industrialization. In Germany, the appearance of big business was associated with the trusts, gold and iron, an imperial style in politics and economics, and the rise of centralized state power. In Japan, the modern industrial enterprise was associated with heavy industry, fascism, and war:

The whole period of military hegemony and fascism was very favorable to business. Industrial output rose from 6 billion yen (p.117) in 1930 to 30 billion yen in 1941. The relative positions of light and heavy industry were reversed. The four great zaibatsu firms, Mitsui, Mitsubishi, Sumitomo, and Yasuda, came out of the Second World War with total assets of more than 3 billion yen, compared with only 875 million in 1930. (Moore, 1966, pp. 301–2)

In Korea, too, the rise of the diversified business group has been inseparable from the thunderous social change accompanying the decline of agrarian society, ushered in by the army and the state, with which it is associated.

Concerning economic performance, the supposed benefits of bigness have inspired a fair amount of skepticism. The major economic rationale for bigness is economies of scale. Yet the case for economies of scale applies to plant size, not firm size.
The major economic rationale for big diversified firms is economies of scope. That is, given fixed inputs, it can be demonstrated theoretically that producing a greater rather than a smaller variety of products may be cheaper under certain circumstances. Yet the case for economies of scope has also come under attack. Writing about the world's beleaguered hegemonic power, the United States, Adams and Brock argued,

The case for large firm size . . . rests upon alleged efficiencies of management rather than technology. Efficiency, it is said, is enhanced by spreading administrative expenses over multiplant operations; by eliminating duplication of officials, services, and record systems; by providing sophisticated statistical, research, and other staff services that would be ruinously expensive for smaller firms; by hiring more competent executives, more talented legal departments, and more effective lobbyists; by obtaining credit on more advantageous terms; and so forth. Some of these economies . . . reflect advantages of bargaining power; however profitable they may be to the particular firm they do not benefit the community at large. (1986, pp. 33–4)

Moreover, it is argued that the diseconomies of scope tend to overwhelm the economies. Adams and Brock quote a professor at Harvard Business School, Steven C. Wheelwright, as saying, “Companies always thought, ‘Our people can manage their way out of the problems [that] size and complexity create.’ But the evidence is that they can’t” (1986, p. 153). The authors came to a related conclusion: (p.118)

By most objective standards, America's corporate giants have not performed very well over the last fifteen years. They have lost markets to the Japanese and the newly industrializing countries. They have lagged in innovation. The quality of their products has often been inferior and unreliable. And, taken together, America's five hundred largest industrial corporations have failed to generate a single new job since 1970. (1986, p. xi)

These arguments about bigness miss the point. America’s corporate giants may not have performed well over the last fifteen years, and they have certainly lost markets to Japan
and to late-industrializing countries like Korea. Yet the economies of Japan and late-industrializing countries are also dominated by corporate giants. Economies of scope, moreover, may benefit one firm at the cost of another, but society at large can still benefit if size improves the international competitiveness of the aggrandizer. The point, therefore, is that nothing can be said a priori about the effect of bigness on performance. Instead, how well big business performs depends on how well it is coordinated and on the context in which it functions.

In general, the chaebol's economic performance has been impressive even if its social effects have been sinister, the popular perception being that while the chaebol benefited from public subsidies, they have not shared their wealth (and their derived power) with the rest of society. In terms of economic performance, during the period from, say, 1962 through 1979, the chaebol may not have maximized every possible source of efficiency or minimized every possible scrap of waste. Yet they never intended to. As profit-maximizing firms, their objective was to grow, not to pare costs to the bone. Korea has one of the highest investment rates in the world. In 1983 the share of investment in GDP was 31 percent, a rate less than in Singapore, which reached a staggering 48%, but greater than in Japan (29%), India (21%), Mexico (17%), and so on (see Table 5.2). Moreover, as output in Korea has increased, so, too, has productivity, contributing to the eradication of national unemployment and acute poverty. As already noted, Korean industry was productive enough to allow Korea's debt/GNP ratio to remain unchanged at the beginning and end of the Big Push into heavy industry, in 1973–1979. And while international comparisons of productivity that include late industrializing countries are statistically problematic, the most careful attempts show Korea well in the lead. According to estimates of Chenery et al. (1986), *total factor productivity as well as output grew faster in Korea's highly concentrated economy than in that of almost any other country studied.*

We may take aggregate indicators of output, productivity, and investment as evidence for the time being of outstanding performance *(p.119)*
on the part of the chaebol, insofar as it was the chaebol that
dominated the economy described by the aggregate indicators.
Like the multidivisional enterprises of the United States, Germany,
and Japan, those of Korea can be said to have acted as the agents
of industrialization. They were responsible for developing the
forces of production in economies that expanded at unprecedented
rates.

This chapter is concerned with two issues related to big
business. The first concerns the magnitude and causes of
concentration. As yet, there is no systematic study of why big
business groups have evolved into critical factors in late
industrializing countries. Some proposed explanations take a
market failure perspective (Leff, 1978, 1979, 1979a; S.K. Kim,
1987). According to one such study: “The business group is an
entrepreneurial response to the environment of market
imperfection” (HBS, 1986a, p. 9). This explanation, however, is
not altogether satisfactory. It implies that if markets were
perfect, firms would pursue a strategy of specialization. In
fact, there is little evidence to support this. The United States
—if any country—industrialized under fairly competitive
market conditions. Yet the upshot was the multidivisional firm

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### Table 5.2 International Comparison of Percent Share of Investment\(^a\) in Gross Domestic Product, 1973 and 1983

<table>
<thead>
<tr>
<th>Country</th>
<th>1973</th>
<th>1983</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea</td>
<td>24</td>
<td>31</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>22</td>
<td>26</td>
</tr>
<tr>
<td>Japan</td>
<td>37</td>
<td>29</td>
</tr>
<tr>
<td>Singapore</td>
<td>34</td>
<td>48</td>
</tr>
<tr>
<td>Argentina</td>
<td>20</td>
<td>16(^b)</td>
</tr>
<tr>
<td>India</td>
<td>15</td>
<td>21</td>
</tr>
<tr>
<td>Mexico</td>
<td>21</td>
<td>17</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>20</td>
<td>17</td>
</tr>
<tr>
<td>United States</td>
<td>18</td>
<td>17</td>
</tr>
</tbody>
</table>

(a) Gross capital formation.

(b) 1982.

Source: U.N. Statistical Yearbook, various years.
—and more recently, the conglomerate—not the specialized corporation. Another explanation for the rise of diversified business groups could conceivably be developed from a transactions cost approach (see, for example Williamson, 1985), although this approach is almost impossible to test empirically.

Alfred Chandler's (1989) study of the multidivisional enterprise in the United States, Britain, and Germany suggests that diversification by business is an integral part of expansion whatever the country. We take this historical proposition as a starting point for understanding the rise of the big business group in Korea. From this stylized fact two further questions arise which are the subject of speculation in the first part of this chapter: Why did the chaebol exceed most multidivisional firms in diversifying so broadly; and why, despite a high degree of diversification, does coordination appear tighter in the chaebol than in, for instance, the American conglomerate?

The second major issue with which this chapter is concerned relates to discipline. As stated in Chapter 1, a defining characteristic of Korean industrialization has been not merely support but also discipline of big business by the government. Yet discipline has by no means been flawless. In this chapter we wish to air some of the limitations. In particular, we wish to focus on the government's waning ability to control a particular type of business activity, whatever its ability to control the overall performance of business to produce goods and services efficiently. The particular type of business activity with which we are concerned is the one that typically is anticipated to arise from a high degree of market power: namely, monopolistic abuses such as creating scarcities, price gouging, and ruining smaller competitors. The time period with which we are especially concerned is the 1980s, following the assassination of Korea's iron-fisted ruler, Park Chung Hee. It was in this time period that the new military dictatorship adopted a policy of "liberalization", one intent of which was to mitigate monopolistic abuses by strengthening freer markets as a particular form of discipline over big business.
Market Concentration

High levels of economic concentration exist in Korea at both the industry and the aggregate levels. Table 5.3 provides data on industry structure. The data for 1982 cover 2,260 commodities and suggest that only about 18% of all commodities that year, or 30% of all shipments, were produced under what are typically considered to be competitive conditions—that is, a three-firm concentration ratio of less than 60% (or a combined market share of the top three producers of less than 60%). The remainder of commodities was produced by either monopolies, duopolies, or oligopolies (see Table 5.3 for definitions).

Table 5.3 also suggests that over time, the share of shipments produced under a competitive structure declined, while the share of the remainder of shipments shifted among the three types of noncompetitive market configurations. Comparing 1982 with 1970, the percent share of shipments produced under monopolistic conditions increased (p.121)
### Table 5.3 Structure of Manufacturing Industry: 1970, 1977, and 1982

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Commodities</th>
<th>Monopoly</th>
<th>Duopoly</th>
<th>Oligopoly</th>
<th>Competitive</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>(29.6) (18.2) (33.2) (18.5) (100)</td>
<td>442</td>
<td>279</td>
<td>495</td>
<td>276</td>
<td>1,492</td>
</tr>
<tr>
<td>Shipments&lt;sup&gt;a&lt;/sup&gt;</td>
<td>110</td>
<td>204</td>
<td>439</td>
<td>498</td>
<td>1,252</td>
<td></td>
</tr>
<tr>
<td>(8.8) (16.3) (35.1) (39.8) (100)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1977</td>
<td>(31.6) (20.1) (32.0) (16.3) (100)</td>
<td>667</td>
<td>425</td>
<td>674</td>
<td>343</td>
<td>2,219</td>
</tr>
<tr>
<td>Shipments&lt;sup&gt;a&lt;/sup&gt;</td>
<td>2,264.0</td>
<td>1,536</td>
<td>4,716</td>
<td>5,404</td>
<td>13,920</td>
<td></td>
</tr>
<tr>
<td>(16.3) (11.0) (33.9) (38.8) (100)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>(23.6) (11.1) (47.4) (17.9) (100)</td>
<td>533</td>
<td>251</td>
<td>1,071</td>
<td>405</td>
<td>2,260</td>
</tr>
<tr>
<td>Shipments&lt;sup&gt;a&lt;/sup&gt;</td>
<td>5,649</td>
<td>3,275</td>
<td>24,967</td>
<td>15,481</td>
<td>49,372</td>
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<tr>
<td>(11.4) (6.6) (50.6) (31.4) (100)</td>
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<sup>a</sup> Billion won.

Concentration ratios (CR):
The Spiraling of Market Power

1. Monopoly (one-firm CR accounts for a market share of more than 80%).
2. Duopoly (two-firm CR accounts for a market share of more than 80%).
3. Oligopoly (three-firm CR accounts for a market share of more than 60%).
4. Competitive (three-firm CR accounts for a market share of less than 60%).

Duopoly proved to be a nonviable arrangement, and its percent share of shipments decreased. The share accounted for by oligopoly, however, rose by 15 percentage points, from 35% in 1970 to over 50% in 1982. Korean industry is even more highly concentrated than that of Japan. This is suggested in Table 5.4, which compares the average three-firm concentration ratios of Korea, Japan, and Taiwan (or the average shares of the top three producers in all manufacturing industries). Furthermore, in that high degrees of concentration at the level of individual industries are complemented by ultrahigh degrees of concentration at the level of the entire manufacturing sector, the whole may even be greater than the sum of the parts. In short, Korea has acquired one of the world’s most concentrated economies. (p. 122)

Table 5.4 Comparison of Simple Average Three-Firm Concentration Ratios for Korea, Japan, and Taiwan

<table>
<thead>
<tr>
<th>Country (year)</th>
<th>Average share (percent)a</th>
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<tbody>
<tr>
<td>Korea (1981)</td>
<td>62.0</td>
</tr>
<tr>
<td>Japan (1980)</td>
<td>56.3</td>
</tr>
<tr>
<td>Taiwan (1981)</td>
<td>49.2</td>
</tr>
</tbody>
</table>

(a) Average share of top three producers in all manufacturing industries.


Measured by sales, the ten largest diversified business groups accounted for a phenomenal 67% of total sales in 1984 (see Table 5.1). Sales, of course, exaggerate the chaebol’s share of manufacturing activity because they include inputs purchased from other firms. Nevertheless, concentration measures in terms of sales may give an accurate picture of the chaebol’s command over the economy insofar as the development of a subcontracting system in Korea has rendered many of the chaebol’s suppliers mere satellites (see Chapter 7). In terms of shipments, which are a close approximation of value-added, the percentage accounted for by the chaebol is also impressive (see Table 5.5). In 1982 the top ten diversified business groups...
accounted for as much as 30.2% of manufacturing activity (but only 12.2% of employment).

Table 5.6 compares aggregate economic concentration measured
### Table 5.5 Percent Change in Concentration of Economic Power of Business Groups, a 1974-1982

<table>
<thead>
<tr>
<th></th>
<th>Shipment</th>
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<th>Employment</th>
<th></th>
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<tr>
<td>Top 5 business groups</td>
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<td>15.7</td>
<td>22.6</td>
<td>NA</td>
<td>9.1</td>
<td>8.4</td>
</tr>
<tr>
<td>Top 10 business groups</td>
<td>NA</td>
<td>21.2</td>
<td>30.2</td>
<td>NA</td>
<td>12.5</td>
<td>12.2</td>
</tr>
<tr>
<td>Top 15 business groups</td>
<td>NA</td>
<td>25.6</td>
<td>33.9</td>
<td>NA</td>
<td>14.4</td>
<td>14.5</td>
</tr>
<tr>
<td>Top 20 business groups</td>
<td>24.6</td>
<td>29.3</td>
<td>36.6</td>
<td>13.5</td>
<td>17.4</td>
<td>16.0</td>
</tr>
<tr>
<td>Top 25 business groups</td>
<td>NA</td>
<td>31.9</td>
<td>38.8</td>
<td>NA</td>
<td>18.9</td>
<td>17.1</td>
</tr>
<tr>
<td>Top 30 business groups</td>
<td>NA</td>
<td>34.1</td>
<td>40.7</td>
<td>NA</td>
<td>20.5</td>
<td>18.6</td>
</tr>
</tbody>
</table>

NA, not available.

(a) Manufacturing sector only.

*Source:* Compiled from the Census of Manufacturing data base, Economic Planning Board, as cited in Lee et al. (1986).
Table 5.6 Percent Aggregate Concentration Rate by Shipment of the Largest Companies in Korea, Japan, and Taiwan,\(^a\) 1970-1982

<table>
<thead>
<tr>
<th>Year</th>
<th>Korea Top 50</th>
<th>Korea Top 100</th>
<th>Japan Top 100</th>
<th>Japan Top 100</th>
<th>Taiwan Top 50</th>
<th>Taiwan Top 100</th>
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<tbody>
<tr>
<td>1970</td>
<td>33.8</td>
<td>44.6</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>1975</td>
<td>NA</td>
<td>NA</td>
<td>28.4</td>
<td>15.8</td>
<td>21.7</td>
<td></td>
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<tr>
<td>1977</td>
<td>35.0</td>
<td>44.9</td>
<td>NA</td>
<td>15.2</td>
<td>22.4</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>NA</td>
<td>NA</td>
<td>27.3</td>
<td>16.4</td>
<td>21.9</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>37.5</td>
<td>46.8</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td></td>
</tr>
</tbody>
</table>

NA, not available.

(a) Manufacturing sector only. It is unclear how company as distinct from business group is defined.

Source: K. U. Lee et al. (1986).
in shipments for the largest companies (not business groups) in Korea, Japan, and Taiwan. Aggregate economic concentration is by far the highest in Korea, more than twice as high as in Taiwan and approximately 1.7 times as high as in Japan. Countries that have industrialized since the 1880s share high aggregate economic concentration because huge firms tend to diversify. Chandler (1989) called such firms “modern industrial enterprises” and noted their synchronous emergence in the 1880s in the United States, the United Kingdom, and Germany. They emerged slightly later in Japan and considerably later in Korea because both countries industrialized later. We return again to Chandler's model of the modern industrial enterprise because it provides a benchmark to examine big business in late-industrializing countries. Here we are interested in one aspect of Chandler's model, the one that relates to diversification. For Chandler, diversification is a defining characteristic of the modern industrial enterprise, although there is considerable variation among the members of the family, which include the chaebol, zaibatsu, and American conglomerates. There is variation in the degree of diversification, measured roughly by the relatedness of products and the degree of centralized management coordination, in terms of financial and human transfers among firms within a single corporate group. In the standard case, diversification tends to be restricted to related products. The firms that produce these products also tend to be centrally managed, as evidenced by the rise of managerial hierarchies—another defining characteristic of the modern industrial enterprise—and by the multidivisional organizational structure—still another. Thus, in a graph with degree of diversification on the vertical axis and degree of coordination (of both financial and human resources) on the horizontal, the modern industrial enterprise
enterprise falls in the lower right-hand corner (see Figure 5.1). Although diversification in the United States has typically conformed to the pattern just noted—diversification into related products only, under fairly tight coordination—the United States has also been characterized by what has come to be called conglomerate. According to Chandler,

The large, diversified [modern industrial] enterprise had grown primarily by internal expansion—that is, by direct investment of plant and personnel in industries related to its original line of products. It moved into markets where the managerial, technological, and marketing skills and resources of its organization gave it a competitive advantage. The conglomerate, on the other hand, expanded entirely by the acquisition of existing enterprises, and not by direct investment into its own plant and personnel, and it often did so in totally unrelated fields. (1977, p. 481)

Conglomerates are known to be coordinated to the degree that they have central budgeting. Nevertheless, there is little, if any, transfer of people across affiliates (Mueller, 1982). In terms of Figure 5.1, therefore, the conglomerate occupies the space in the upper left-hand corner.

We come now to the diversified business groups in Korea and Japan. We note first that they are far from homogeneous, showing significant variations among themselves. The new and old zaibatsu differ in degree of diversification, and the prewar zaibatsu and postwar keiretsu differ in degree of coordination. Among the chaebol, too, there are variations in the extent of diversification, depending on the overall size of the business group. Moreover, the tendency of the chaebol
before 1980 was to grow by internal investment; thereafter its
tendency has been to grow by acquisition. These variations
notwithstanding, there is a single theme. The big business
groups of both Korea and Japan are more diversified than the
modern industrial enterprise described by Chandler, and they
are more coordinated than the American conglomerate. Thus,
in terms of Figure 5.1, the zaibatsu and the chaebol belong in
the northeast quadrant, exhibiting high degrees of both
diversification and coordination. This corporate structure—
more widely diversified than the modern industrial enterprise
and more centrally coordinated than the conglomerate—
appears to be typical in late industrialization. Two questions
follow: Why do business groups in late industrializing
countries tend to diversify so widely, and how do they manage
to stay closely coordinated?

Corporate Strategy Toward Diversification
As Chandler pointed out, whatever the national character of
industrialization, whether driven by borrowing technology or
by creating it, large corporations diversify into related
business activities—where related refers to skills or markets—
through vertical or horizontal integration. In Korea, the
Hyundai group branched out vertically from construction to
cement manufacture and shipbuilding, and from shipbuilding
to shipping and steel structures. The Samsung group
diversified horizontally in entertainment with a broadcasting
company, a daily newspaper, and a hotel. The Hanjin group
includes tourism industry business—an airline, a bus line, and
a travel agency. The KIA group makes vans and the
machine tools that are used in their manufacture. The Doosan
group makes bottling equipment and owns a bottling
franchise. The impulse to diversify into related businesses is
illustrated by a statement made by the chairman of the Lucky-
Goldstar group, which reported 1984 sales of $9.2 billion.
According to the chairman,
My father and I started a cosmetic cream factory in the late 1940s. At the time, no company could supply us with plastic caps of adequate quality for cream jars, so we had to start a plastic business. Plastic caps alone were not sufficient to run the plastic-molding plant, so we added combs, toothbrushes, and soap boxes. This plastics business also led us to manufacture electrical and electronic products and telecommunication equipment. The plastics business also took us into oil refining which needed a tanker-shipping company. The oil-refining company alone was paying an insurance premium amounting to more than half the total revenue of the then largest insurance company in Korea. Thus, an insurance company was started. This natural step-by-step evolution through related businesses resulted in the Lucky-Goldstar group as we see it today. For the future, we will base our growth primarily on chemicals, energy, and electronics. Our chemical business will continue to expand toward fine chemicals and genetic engineering while the electronics business will grow in the direction of semiconductor manufacturing, fiber optic telecommunications, and eventually, satellite telecommunications. (Harvard Business School, 1985b)

The impulse to diversify into related businesses is illustrated by the lower right-hand corner of Figure 5.1, the area occupied by the modern industrial enterprise, or multidivisional firm. Nevertheless, after the initial move into related businesses, the extent of diversification among firms differs. In the case of innovators, say those in the United States, the tendency has been to build on expertise, whether technological or marketing, and hence to diversify further only into related fields. On the other hand, in the case of firms with no expertise, for example those of late-industrializing countries, or of firms with expertise whose rate of return is narrowly bounded, the tendency has been to diversify into unrelated areas. A large chaebol like Lucky-Goldstar has diversified in part because local inputs were in short supply, and it needed to become its own supplier. In other cases market size was too small to specialize; or too risky to do so. The supposed relationship mentioned earlier between its plastic injection-molding operation and its oil refinery is farfetched. The so-
named backbone of the group—chemicals (Lucky) and electronics (Goldstar)—is more like disconnected vertebrae.

Assuming an equal desire on the part of all firms to diffuse risk, the above suggests that quite possibly learners in late-industrializing countries tend to diversify widely because their level of experience in particular industries does not enable them to develop related products or processes, or to grow by moving into a higher quality niche in their existing markets. Instead, they are constrained to diversify widely and often to expand laterally. They compete on the basis of price and reliability at the bottom end and at the middle layers of many altogether unrelated markets. The choice between a competitive strategy of price versus one of high quality product differentiation is mused upon by the chairman of the Daewoo group, one of the most meteoric of chaebol and one that relied more than most on acquisitions in order to grow (because it started late):

Up to the present, I have succeeded, to a certain degree, in building new businesses and increasing employment opportunities. I have done this through hard work and by turning around troubled companies. I believe that these accomplishments demonstrated to the Korean people the possibility of succeeding with almost any business in Korea. Looking back, however, I feel I could have concentrated on developing a Korean company which produced the best quality product in the world, rather than diversifying to various fields [wishful thinking?]. When we have spun off the present collection of companies [the chairman plans to free each of Daewoo's affiliated companies from equity control by the parent corporation by 1990], I shall resign as chairman of Daewoo and start a new venture. And the product I am going to develop will be the best quality product in the world from Korea, like those of Japan's Sony or Germany's Leica. (Harvard Business School, 1985a; my italics)

One leaves as speculation the zaibatsu's and chaebol's location in the northeast quadrant in Figure 5.1 as a function of their status as learners.

Diversifying widely is a big gamble, especially when diversifications occur in rapid succession as they did in most
Korean business groups. How, then, did the chaebol manage to grow so fast and yet prosper?

First, as latecomers, they bought the industry-specific technical expertise they needed from foreigners. Second, they borrowed abroad (p.128) with credit guarantees and subsidies from the government. This helped them to grow very large, with high debt equity ratios, yet maintain their family ownership structure. By contrast, in the business histories of advanced countries, the family form of ownership is diluted for want of finance to grow. Third, as they grew, the chaebol’s finances and status rose, and they were able to hire the most experienced salaried managers. Family firms in advanced countries have had much trouble recruiting the best salaried managers, who prefer to work for firms that are not owned by families so that their chances of rising to the top are greater. In Korea, promotion opportunities were greatest in the chaebol, the remainder of firms being even more family oriented.

Fourth, in the mid-1980s most chaebol were still nurtured by first-generation owners who had personally witnessed their sales growth as it progressed from thousands to billions of dollars and who also held an intimate knowledge of the human resources of their entire group.⁹ As will be demonstrated in later chapters, a new subsidiary would most likely be established by a task force typically formed at the group level and comprising qualified managers, engineers, and even supervisors from existing companies within the group. In the case of Hyundai, for example, managers from its construction arm were transferred to its shipbuilding arm to aid in project management. Later, engineers from its shipbuilding arm, who had a knowledge of anticorrosion, were loaned to its automobile affiliate where a new paint operation was coming on stream. Such transfers increased the capability to diversify and were facilitated by a central “brain” and a uniform group culture. Within a very short time, therefore, the business groups in Korea were multiproduct yet still under family management, with salaried managers in command at the industry level and with a capability to enter new industries quickly.

Under conditions of rapid growth and a succession of diversifications and capacity expansions, Korean management appears to have accumulated experience in the areas of
feasibility studies, task force formation, purchase of foreign technical assistance, training, equipment purchase, new plant design and construction, and operation start-up. This experience became an invaluable competitive asset in the absence of proprietary technology because it allowed the chaebol to be Korea’s first movers in many industries. Investment costs were also kept to a minimum, which enabled new affiliates to start operations with a relatively light financial burden. This control over costs complemented the group strategy of competing in a wide range of industries on the basis of price.

(p.129) The group coordination pattern just described influenced the conduct of risk diffusion, which became more than simply a strategy of investing in unrelated industries. It meant shifting people and money around the group to increase the probability that risk-diffusing projects would earn profits. It meant converting ailing acquisitions into moneymakers. Group coordination implied a more proactive approach to averting risk and financial loss. In general, one may venture to guess that the group’s ability to enter new industries rapidly and cost effectively became a major economy of scope.

Discipline of Monopoly Power

Oligopolistic Competition

Korea’s economy may be highly concentrated, but its leading firms appear to engage in intense competition with one another in overseas as well as in domestic markets. The Economic Planning Board controls most prices, so only firms supplying differentiated products have a chance to compete on price. However, big business competes primarily on the basis of nonprice factors, as do oligopolists in other countries.

The specific nonprice factors that the chaebol compete on are characteristic of a particular type of oligopolist—the learner. First, learners compete to get additional favors and industrial licenses from the government. They do so by wining and dining bureaucrats, by preparing investment packages that meet planners’ specifications, and by distinguishing themselves on the basis of their achievements (like introducing products novel to Korea, winning Korea’s equivalent of the Deming Award for quality, exporting Korean-made steel to Japan and Korean-made cars to the United States, etc.). Second, they compete to get foreign technical licenses on the best terms from the (p.130) foremost
international firms. Third, they compete in the labor market for the best college recruits and the most experienced skilled craftspersons, supervisors, managers, and engineers (see the discussion in Chapter 8). Fourth, they compete in the marketplace on the basis of quality and delivery. In the case of the automobile industry, domestic price is not a competitive factor because it is set by the government according to liter capacity. But the two major automobile companies compete—in the local market and abroad—on the basis of gas mileage, appearance, safety, service, and resale value (Amsden and Kim, 1985a). The spirit of competition between the two major automobile makers is such that one of them does not allow anyone driving the other's car to enter its parking lot.

The likelihood of intense competition also rises in the presence of uncertainty and multiproduct oligopolists. When it is unclear which markets will grow the fastest, and when demand is rising rapidly in a number of markets, multiproduct oligopolies will be inclined to compete vigorously in all of them to maintain parity in terms of, say, sales at the group level. Overall size could be considered critical for raising finance, attracting the best labor, winning the most favorable foreign licenses, and so on. Parity is particularly important when group affiliates are subject to central coordination. If resources can be shifted throughout the group, higher profits in one market may improve competitiveness in all. Finally, when the government dispenses largesse according to criteria that are corrupt but performance oriented, competition becomes almost a certainty.

Countervailing Power

Government policy was almost completely in harmony with the strategy of the chaebol to grow through diversification. Yet a consequence was a spiraling of market power. To curb the “appalling power of mammoth enterprise,” policies were first conceived in the spirit of democratic pluralism (Park, 1962, p. 228).

The intention to curb monopoly power by protecting the interests of diverse social groups (one interest group being small- and medium-size firms) was articulated by Park when he still ruled by popular vote:
It is thought in many quarters, both capitalist and communist, that large-scale industries are unconditionally the best. But we cannot ignore the fact that there are many industrial fields where small and medium businesses may have independent domains. The present stagnation of these smaller businesses suggests they could be stimulated to increase their productivity through (p.131) prompted coordination of management, and assistance rendered by the state and improvement of techniques, so that the income ratio of these businesses would not be less than that of the bigger enterprises. (1962, pp. 226–7)

With respect to consumers, Park wrote,

It is desirable that the state should give special attention to possible dangers to the public interest presented by some industries which face no competition to prevent their trespassing on the interests of the consumers. The state may grant some form of consumer groups a kind of admonitory voice over industrial operations. (1962, p. 236)\(^\text{12}\)

Park even hinted at encouraging the growth of trade unions:

To protect against the mounting power of big enterprises, employes should be allowed, with the reasonable backing of the state, to have equality with management. Special measures should be worked out so that skilled laborers and others can utilize their creativity individually and collectively to contribute to the improvement of industry. By so doing, the state will be able to protect the interests of the employed and rally strongly the voluntary support of workers for the improvement and expansion of industry. (1962, p. 26)

However, none of these countervailing forces to big business ever gathered much strength under Park. Even when he pursued a strategy of socializing big business by pressuring leading companies to sell equity to the public, Korea's stock market remained moribund, and the chaebol remained closely held family concerns (see Chapter 4).\(^\text{13}\)

The frenzy of activity surrounding the building of heavy industry in the late 1970s characterized a shift in power toward big business, because as subsidies sweetened, restricting entry became more difficult. Takeovers in the 1980s of smaller firms by the chaebol became endemic. The newspapers were filled with exposés of monopolistic abuses.
The crisis surrounding the second oil shock and President Park's assassination led to an attempt by the government of Chun Doo Hwan, therefore, to restructure and liberalize the economy.

(p.132) Restructuring

A period of restructuring appears to characterize most industrial expansions, each in its own form, for example, the merger movement at the turn of the century in the United States or the capacity reductions in Germany and Japan in the 1920s. By comparison, the reorganization of heavy industry in Korea in 1979–1982 seems relatively superficial because only a few industries were permanently affected. After much delay, the shipping industry was rationalized by a drastic reduction in the number of firms from about sixty to fifteen (World Bank, 1987). The heavy electrical equipment industry witnessed a merger of major chaebol (Hyosung, Kolon, and Ssangyong), as did the fertilizer industry. But another move in heavy electrical equipment was temporary—a nationalization that was soon rescinded. An attempt to reduce capacity in the automobile industry through merger was also short-lived and abortive. As the Korean and world economies recovered and prosperity returned (eventually even to fertilizers and petrochemical producers), restructuring became as redundant as capacity had temporarily been. Restructuring was also limited in scope in the sense that the industries affected had accounted for only a small share of total investments in the 1970s. The machinery industry was the most vexed by excess capacity and by restructuring, yet the technology of adding capacity in the machinery sector is such that investments had accounted for only 10% of total investments during the Big Push (Y. C. Park, 1985, quoted in Amsden, 1987).

The form that restructuring took under Chun Doo Hwan was in keeping with the spirit of state intervention practiced under Park Chung Hee (although the firms involved did not all acquiesce under Chun Doo Hwan). In exchange for the favors they had received, the big firms were rounded up and forced to merge. The World Bank observed, “It is clear from these cases that government has bypassed competitive solutions in most of its restructuring operations” (World Bank, 1987, vol. 1, p. 50). On the other hand, American forms of regulation did not play a major role in restructuring. The
enactment of a Monopoly Regulation and Fair Trade Act along the lines of American antitrust legislation appears to have been out of character and has not been vigorously enforced.

Although the number of corporations designated by the government as dominating their respective markets increased from 105 in 1981 to 216 in 1985, no more than 10 were accused of having abused their power. Out of 1,172 applications for “corporate integration,” or horizontal merger, all but 2 were approved (K.-U. Lee et al., 1986). The act, moreover, did not include a restrictive clause on conglomerate integration because “there was a concern that such policies would harm enterprises that had fallen on hard times since the recession beginning in 1979.” Further, as expressed by Lee et al., “the problem of the concentration of economic power is very complicated and difficult to solve by the Monopoly Regulation Act alone” (1986).

Instead of regulation, liberalization was the means by which the new military rulers and economic advisors hoped to discipline big business and reverse the institutional legacy of two decades of state controls. In this reversal they were aided by the World Bank, which supplied Korea with a restructuring loan. Liberalization was supported in bits and pieces by the Federation of Korean Industries, the mouthpiece for big business. Basically, big business wanted trade barriers to remain, except on agricultural goods, but it also wanted privatization and freedom from government controls in financial markets. At first, liberalization affected direct foreign investment, trade barriers, industrial licensing, state credit allocation, public enterprise, price supports, and price fixing. Ultimately, zeal was confined to two major areas—trade and finance. At U.S. prodding, the government liberalized imports; to compensate the chaebol, the government rewarded big business with freer financial markets.

Trade Liberalization

To assess the openness of Korean trade after liberalization is as hard as assessing godliness in a reformed heretic. As the World Bank pointed out,
the automatic approval concept—whereby import items are transferred from a restricted to a nonrestricted list—is imperfect: [It] suggests more openness than it actually measures because items so designated may still be subject to some other possible administrative review procedures, such as the Special Law mechanism. Thus, the conventional “AA ratio” is biased upwards. (World Bank, 1987, vol. 1, p. 63)

Nevertheless, the World Bank believed that Korea had, in fact, liberalized trade: “Korea’s liberalization program is very much on track, and government merits unequivocal high marks for its effective implementation.” (1987, vol. 1, p. 74)

The United States disagreed. It took a lively interest in the matter in 1987 by virtue of a $7 billion U.S. trade deficit with Korea, which simultaneously ran a $7 billion trade deficit with Japan. The U.S. government pressured the Korean government to liberalize imports, which Korea did only by increasing imports from Japan (Korea Traders Association, 1987; Amsden and Min, 1989). According to a U.S. Embassy report, the extent to which Korea liberalized was fictitious:

Use of the word “liberalization” in reference to Korea’s shifting items off its restricted list is somewhat misleading in the first place. At the time of their “liberalization,” duties on the 104 items “liberalized at U.S. request” averaged 33%, with none subject to duties of less than 20%, and many subject to duties of 30%, 40%, or 50%. Generally, other NTB’s [nontariff barriers] (e.g., the rule that only Korean cosmetics manufacturers can import cosmetics) remained in place. (1986, p. 3)

Besides, of the 104 items that both sides agreed were “liberalized,” the total value, according to the U.S. Embassy, was only 6% of the growth in Korean exports to the United States in a three-year period.
Financial Liberalization

In exchange for whatever trade liberalization actually occurred, the big business groups won critical concessions from the government in *(p.135)* the area of finance. (The United States also pressured Korea to liberalize its financial system.) First, the government reduced regulation of nonbank financial intermediaries (NBFIs), many of which had long been controlled by the big business groups. [According to one study, the chaebol had “controlling interest in some NBFIs such as insurance companies and investment and finance companies” (Y. J. Cho and Cole, 1986, p. 14).] As a consequence of deregulation, the share of total deposit liabilities held by NBFIs increased from 27% in 1980 to 42% at the end of 1984 (Ministry of Finance, quoted in World Bank, 1987, vol. 1, p. 89). Second, the government began to denationalize commercial banks in 1981 by divesting its shares. It also restricted single shareholders of nationwide commercial banks (except for joint venture banks) to 8% of total ownership, to prevent the banking industry from being controlled by big business groups.

Shortly thereafter, it became clear that the government had by no means altogether relinquished administrative control over the banking system.18 It had also become clear that the big business groups had not been prevented from taking equity control. Cho and Cole remarked in a footnote in their study of financial liberalization:19

> While an effort was made to limit concentration of ownership by the private purchasers of these shares, it is widely believed that the large conglomerate groups . . . succeeded in gaining control of individual banks. (1986, p. 14f)

With increased deposits in the nonbank financial intermediaries under chaebol ownership, and with their new major interests in national banks, the Korean big business groups became more like the zaibatsu. They also became more liquid. They used their new financial resources for at least two purposes: to buy state enterprises that were being privatized and to buy financially troubled firms, sometimes at the government’s instigation.20 One group, Sunkyong, was catapulted into the league of the Big Ten chaebol as a result of the privatization of a public oil refinery. In the 1980s, the chaebol grew almost exclusively through acquisitions (S. K. Kim, 1987).
The result of such buyouts was a rise in economic concentration. (p.136) As indicated in Table 5.3, the relative value of shipments produced under competitive market conditions declined between 1977 and 1982, whereas it had held fairly steady throughout the rise of heavy industry in the 1970s. The increase in concentration was especially sharp at the aggregate level. As Table 5.1 indicates, the share of manufacturing output of the largest business groups rose from 32.8% in 1979, the year of the second energy crisis and the end of the Big Push, to 67.4% in 1984. This increase in aggregate concentration was about the same in percentage points as between 1974 and 1979, when one would have expected concentration to rise as a consequence of capital-intensive investments. Liberalization, therefore, contributed to a rise, not to a decline, in economic concentration. Nor should this have been unexpected. It is difficult to achieve equity through market forces in the presence of large agglomerations of economic power.
Conclusion
The big business groups in Korea were the product of a harmony of interests between the state and private enterprise. Private business groups, driven by what may have been a lack of technological capability to expand into higher quality niches, diversified widely into the bottom end and middle level of many markets; fairly close coordination of financial and labor flows among group members allowed this. The state supported such diversification because it promised to provide the clout necessary for Korea to penetrate deep into world markets and to compete against the big business groups of Japan (which provided a model that the Korean president consciously followed). Such harmony has stood at the heart of “Korea, Inc.”

By the mid 1980s, the top ten chaebol accounted for almost 70% of GNP, yet out of the interstices of ultra high aggregate economic concentration has come rapid increases in GNP and productivity. As noted in earlier chapters, productivity rose against a backdrop of government discipline of big business, in the form of pressures to export, price controls, restrictions on capacity expansions and entry into certain markets, prohibitions on sending speculative capital overseas, and sweeping financial controls. An additional backdrop to rising productivity was provided by competition, which was stimulated by fast growth, rivalry among the big business groups, and oligopoly rather than monopoly at the industry level. Learners-cum-oligopolists competed for government favors, the most favorable foreign licenses, and the best managers, engineers, and workers.

In the 1980s, however, the government's forcefulness and credibility (p.137) declined and the private business groups augmented their power, prompting popular demands for reform. The response on the part of the government of Chun Doo Hwan was market “liberalization.”

Nevertheless, big business grew even bigger and concentration increased further as a result of liberalization measures in Korea. As indicated in Table 5.1, aggregate economic concentration doubled in less than five years after liberalization was introduced in 1979. The ownership (if not the control) of commercial banks fell from government hands into those of the private sector. As the World Bank observed in a footnote in one of its reports: “There are, perhaps
surprisingly, some similarities between Korea's and Chile's reforms. In both cases, big conglomerates bought major interests in the national banks” (1987, p. 82f).

In the presence of large concentrations of market power, reliance on the market mechanism for reform appears to produce some perverse results, not just in Latin America but also in the Far East. (p.138)

Notes:
(1) For information on Taiwan's business groups, see Chou (1988).


(3) While the principle of economies of scale is demonstrated repeatedly in the commonplaces of everyday life, its significance in the profit-making sphere is still open to debate among economists. For two interesting discussions, see Gold (1981) and Buzacott et al. (1982).

(4) On economies of scope, see Bailey and Friedlaender (1982) and Spence (1983).

(5) Nevertheless, Taiwan probably has a higher level of economic concentration than Korea in “upstream” industries like petrochemicals, shipbuilding, and steel, in which typically a government monopoly presides (Amsden, 1989).


(7) From 1981, when the Fair Trade Act was passed, until June 1986, there were 1, 136 reported cases of chaebol beginning to own new businesses. Among these the number of horizontal integrations (intraindustry) was 324 (28.5% of the total), that of vertical integrations was 215 (19.9%), and that of diversifications into other industries (interindustry) was 597 (52.6%). The methods of expansion included acquiring stocks, establishing new companies, merging, acquiring management participation, and acquiring business rights. Acquiring stocks accounted for 45.7% of all cases; establishing new companies accounted for 19.8% (Donga Ilbo, 1986).
(8) In the United States, diversification into unrelated businesses occurred mainly when industry growth declined: “The creators of the first conglomerates embarked on strategies of unrelated acquisition when they realized that their own industries had little potential for continued growth” (Chandler, 1977: 481). Typical industries employing this strategy were textiles and ocean shipping.

(9) See the study by Hattori (1984) on the family structure of the chaebol.

(10) As of April 1, 1987, 32 chaebol were reported to have 3,474 billion won in cross-investments among their subsidiaries. Such investments amounted to 43.9% of their net assets (Maeil Kyōnjie Sinmun, 1987a).

(11) For example, in the case of general trading companies (GTCs):

The government’s primary objective in establishing Korean GTCs was to promote exports, and it has used all sorts of means to increase the exports of Korean GTCs. As a stick, the government annually increased the minimum requisite export amount that a Korean GTC must reach to retain its GTC title. As a carrot, the government created a variety of prizes, citations, and medals. More important, it provided low-cost financing for each dollar exported, which often more than compensated for losses incurred in export transactions. These government measures, together with the competitive spirit of the management, encouraged Korean GTCs to vie fiercely against each other to increase the export amount. (D. S. Cho, 1987, p. 57)

(12) Consumer advocacy groups are weak in Korea, as they are in other late-industrializing countries, but see Sobija Poho Danché Hyŏpūihoe (1987) and Tachan Chubu Kūllŏp Yŏnhaphoe (1987).

(13) As late as 1984, the Securities Supervisory Board was still attempting to upgrade the auditing and accounting practices of firms in order to strengthen the stock market (Chūnggwon Kamdogwon, 1984). The stock market only began to boom in the late 1980s.
(14) Reorganization of financially troubled firms had dragged on in the late 1980s, especially in the shipping and construction industries. H. Y. Song (1987) stressed the inequity of reorganization, since healthy firms are often forced to acquire ailing ones (and the taxpayer is forced to pay for all parties' mistakes). An article in *Han'guk Ilbo* (1986a) noted that reorganization resulted in higher levels of aggregate economic concentration. The government was reluctant to let ailing firms go bankrupt because commercial banks would have gone bankrupt simultaneously. In 1986 there were fifty-six firms under government reorganization (*Donga Ilbo*, 1986a).

(15) The machinery industry is typically given as an example of the failure of state intervention, presumably because the industry suffered from excess capacity beginning in late 1979. Nevertheless, the troubles of the industry after 1979 were as much a function of the world recession and the “teething” associated with developing a skill-intensive sector as they were a function of government blunders. By as early as 1986, the machinery industry in Korea was booming. See *Donga Ilbo*, 1986b, 1986c; *Maeil Kyŏngje Sinmun*, 1986b, 1986c.


(17) In 1987 the Federation of Korean Industries lobbied for fewer government controls. Its representatives complained that it took 530 days and sixty-two steps to establish a new firm. Firms allegedly had to spend 0.77% of sales (33.4% of profit) on “tax-like” expenditures (official contributions such as defense tithes, donations to government-related organizations, charities, etc.). The government, according to the Federation, regulates prices, production volumes, inventories, and labor-management relations (*Han'guk Ilbo*, 1986b). The Federation of Korean Industries, along with four other federations representing business, wanted Korea's new constitution to minimize government interference in the economy [as well as to support infant and growth industries, to promote harmonious labor relations, and to deny labor the right to participate in management decision-making (*Maeil Kyŏngje Sinmun*, 1986d)]. There appears to be no study on industrial
licensing in Korea, but for a review of government regulation of licensing, see Donga Ilbo (1987).


(19) Son (1987) discussed how the chaebol circumvented legislation to limit their holdings of bank equity to not more than 8%. Son also gave figures on the extent of private ownership of major commercial banks, local banks, life insurance companies, and securities firms.

(20) For example, the government forced the Ssangyong group to acquire a bankrupt textile-machinery manufacturing company employing about 400 workers in the interests of preserving the textile machinery industry in Korea.

(21) It is unlikely that the rise in concentration between 1977 and 1982 was confined to 1978, the year before stabilization and liberalization began.