Daewoo collapse threatens further financial crisis in South Korea

Luciano Fernandez, Peter Symonds
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Fearing a major financial crisis, the South Korean government of President Kim Dae Jung announced a package on Monday aimed at stabilising the country's investment trust industry, which has been thrown into turmoil by the failure of the Daewoo group.

Daewoo, the country's second largest conglomerate or chaebol , has been on the point of bankruptcy since July 18 when management announced it could not meet its debt repayments. The corporation needs to pay off $US500 million a month in short-term debt. This is the interest on its total debt of $57 billion, which is a sum equivalent to the combined Gross Domestic Product (GDP) of the Philippines and Sri Lanka.

President Kim was forced to act to shore up the financial markets. From November, under existing regulations, investors will be able to redeem 80 percent, rather than 50 percent, of their funds invested in Daewoo bonds with investment trust companies (ITCs). Financial commentators have warned that a run on the bonds would threaten some of these companies with bankruptcy and send the financial markets into chaos. These companies hold around $40 billion of Daewoo bonds and commercial papers, of which an estimated $10 billion is owed to international investors.

The government's package delays any restructuring of the investment trust industry until next July, expands its bond restabilisation fund, and pledges to guarantee the unsecured bonds issued by the Daewoo group. But South Korean analysts have criticised the package for containing little more than “stop-gap measures”.

The South Korean stockmarket reacted this week with a huge fall of 102 points—from 941 to 839—or more than 10 percent. According to the *Korean Herald*: “The biggest influence on the market has been the indecisive attitude shown by the government toward resolving one of the world's largest ever financial defaults, the Daewoo group.”

A researcher at the Korean Development Institute warned: “The bulk of Daewoo's debts to local financial institutions, estimated at $24.7 billion, are feared to turn into non-performing loans, touching off a severe credit crunch. The tight money market will in turn freeze the corporate bond and commercial paper market, possibly resulting in massive bankruptcies of marginal enterprises.”

Last week the heads of the Korea First Bank and five other major creditors met to discuss plans to speed up their “rehabilitation blueprints” for Daewoo. Its electronics and telecommunications division is to be sold to US investment fund firm Walid Alomar and Associates for $3.2 billion. Daewoo Heavy Industries will be split into three—shipbuilding, machinery and the remaining businesses. Negotiations are continuing with the US auto giant General Motors to take a share of Daewoo Motors.

The dangers of a financial crisis triggered by the Daewoo debacle are in marked contrast to the official rosy picture of an economy that has “turned the corner” and resumed its high rates of growth. The GDP growth rate of 7 percent is dependent on exports, particularly to the US, and thus on the increasingly precarious rise of share values on Wall Street.

The South Korean conglomerates, which emerged in the aftermath of the Korean War, were heavily dependent on government economic protection and financial assistance in order to survive, as well as state repression to discipline their workforces. Kim Woo Choong began Daewoo in 1967 as a small textile company. It has grown into a combine owning 33 domestic companies with 372 overseas subsidiaries, and employing more than 320,000 employees internationally.

Daewoo grew by buying up bankrupt state-owned industries at bargain prices and then began an aggressive international expansion. The process culminated during the 1980s and it was held up as an example of the success of the Asian tiger economies, their expertise and business know-how. As a result, Daewoo was able to secure virtually unlimited finance and credit to maintain and expand its operations.

Troubles started to emerge in 1989 when Daewoo's shipbuilding unit made losses that threatened a collapse of the whole group. The government stepped in to save the conglomerate by providing emergency loans. Believing that the government would assist again if it ever fell into financial difficulty, Daewoo continued its borrowing unabated. It also utilised its trust funds to channel money into different units of the company experiencing financial difficulty and to help roll over debt, a practice the government has now made illegal.

As elsewhere in Asia, the IMF and international financiers have used the financial crisis which erupted in 1997 to insist on an end to all forms of national economic regulation and the close ties between government and big business that have acted as a barrier to foreign investors. In South Korea, the IMF insisted on extensive economic “reforms” in return for its $58 billion bailout package.

Sir Leon Brittan, Vice-President of the European Commission, who visited South Korea last year, bluntly told business leaders: "Korean conglomerates should receive no further preferential support, in trade financing, concessionaire loans in connection with the so-called 'Big Deals,' or in other areas. After all, their debt-finance overcapacity has distorted world markets and threatened industry in Europe and elsewhere, be it in shipbuilding or semiconductors... This unfair, anti-competitive behavior must be stamped out as the conglomerates need to have proper, transparent accounting procedures."

When a restructuring plan was first mooted in August, Daewoo chief Kim Woo Choong lashed out at those calling for a quick sale, arguing that the true value of the units would not be realised. He frantically maneuvered to halt the collapse of his once mighty empire, using his own considerable personal wealth as collateral.

On August 11, the Financial Supervisory Commission announced a delay in the final proposals for restructuring Daewoo until August 15. The decision immediately incurred the wrath of foreign investors. The benchmark Kospi stock index tumbled 2.5 per cent, sending a message to the government that no delays would be tolerated.

President Kim used his nationally televised Liberation day speech on August 15 to assure international capital that the restructuring of Daewoo and other chaebol would proceed. "The times have changed. The concentration of economic power in the chaebol is no longer accepted by the market,” he said. "I am determined to go down in Korean history as the president who first accomplished chaebol reforms and straightened things out in the economy for the middle and working classes. I will remain firm." The next day, the government announced its plan for Daewoo to sell many of its assets, leaving the corporation with just six out of its 25 units.

As for helping “the middle and working classes,” the restructuring is having a devastating impact on workers and small businesses dependent on Daewoo. Financial analysts predict that the majority of Daewoo's 6,400 subcontractors may go bankrupt, affecting as many as 130,000 jobs. Another 80,000 jobs in Daewoo companies could also be destroyed, and many more in the conglomerate's international affiliates.