

# Corruption scandal points to South Korea's continuing economic instability

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The administration of South Korean President Kim Dae Jung is currently embroiled in a corruption scandal that is symptomatic both of the country's fragile economy and of divisions in the ruling elite over the direction of economy policy.

Last week the opposition Grand National Party (GNP) accused four leading members of Kim's Millennium Democratic Party, including Kim's first son Kim Hong-il and Kim Dae Jung's right-hand man Kim Ok-doo, of involvement with the central figure in the latest scandal—entrepreneur Chung Hyun-joon.

Chung is alleged to have paid bribes to Chang Rae-chan, a former top official with the government's regulatory body, the Financial Supervisory Commission (FSC), following large losses on the stock market. In return, Chang kept quiet about illegal loans that Chung had received, amounting to an estimated 63.7 billion won (\$US58 million) from three mutual savings and finance companies.

Chung was the major shareholder in all three—the Chungwoo Mutual Savings and Finance, Dongbang Mutual Savings and Finance and Daeshin Mutual Savings and Finance—and used the loans to prop up his now bankrupt business Korea Digital Line. This type of loan, now illegal in South Korea, was once routine for the country's conglomerates or *chaebols*. Banks and financial institutions controlled by chaebols were used to bail out failing sections of far-flung business empires.

The opposition alleges that Chung used political connections to influence the FSC's decisions. Government spokesmen have hotly denied the allegations and threatened to file a libel suit against the GNP legislator who made the charges.

The FSC was set up by Kim Dae Jung's administration to restructure the country's financial institutions and chaebols—part of the agenda set out by the International Monetary Fund (IMF) following the Asian economic

crisis of 1997-98. The scandal raises a question mark over the FSC's work and the government's claims to breaking up the old financial practices of the chaebols.

While it has seized on the scandal to score political points off the government, the opposition has generally been critical of Kim Dae Jung for proceeding too quickly with economic restructuring. The GNP is connected to South Korea's previous military-backed regimes and is closely identified with the policies of national economic regulation that led to the rise of the chaebols and their close ties with government.

The scandal takes place against a backdrop of economic fragility in South Korea. Economic growth is predicted to be 8.3 percent for 2000 and 5.7 percent for 2001 but this expansion has been dependent on government spending and the strong exports to the US market.

Total trade between the US and South Korea has risen from \$40.4 billion in 1998, to \$54.3 billion in 1999 and is predicted to reach as high as \$60 billion this year. Any economic downturn in the US would have a severe impact, given that the country's banking and financial system is heavily laden with bad debts.

Conglomerates like Daewoo and Hyundai hold debts amounting to \$630 billion or 150 percent of the country's gross domestic product. About \$100 billion of that figure is listed by South Korean banks as non-performing. A recent survey by the Korean Development Institute of 4,800 large companies found that 362 had not earned enough money to cover their debt costs for three years in a row.

Daewoo Motors, the country's third largest automaker, was formally declared bankrupt yesterday after the union rejected a company restructuring plan. The company had to pay its creditors \$155 million this week to avoid bankruptcy. Unable to raise the capital, management had requested a further line of credit, which was contingent on an agreement with the unions over the axing of 3,200

jobs.

Ford pulled out of plans to buy Daewoo Motors for \$7 billion when it became clear the figure was far more than the company was worth. GM has been in negotiations since September to take over the company with a bid of about \$3 billion. Creditors are worried that the bankruptcy declaration will delay the sale and result in an even lower price.

The government has been forking out millions of dollars each week to keep Daewoo operating and prevent large job losses. It has used public money to prop up other companies as well. A recent bill passed in the national assembly has allocated 50 trillion won (\$44 billion) in public funds for the restructuring of the financial sector. Some estimates put the amount needed at more than double that figure.

The government is facing growing criticism from foreign investors. “Nonviable companies being kept alive by creditors is a backwards step in Korea's efforts to reform,” Peter Kim of SG Securities commented. “The quicker banks decide to let them go bust, the quicker it will be for the restructuring of the overall economy”.

In its “Asia Strategy Monthly,” Merrill Lynch predicted last month that South Korea's credit rating will be lowered from “positive” to “moderate positive,” citing the government's failure to press ahead with market reforms.

There are fears that capital will move out of South Korean markets, sparking a repeat of the currency crisis that hit the won in 1998. Already there are signs that investors are dumping South Korean stocks. The stock index has fallen by 34 percent since the beginning of the year and 50 percent from its peak. The market value of domestic stocks held by foreign investors dropped to \$46.26 billion as of October 16, compared to \$63.59 billion at the end of August.

The Kim Dae Jung administration has been attempting to refurbish the image of the South Korean economy from one dependent on “old industries”—cars, steel and shipbuilding—to one based on new technology industries. Information technology now makes up nearly 8 percent of the economy and is expected to reach 11 percent by the end of the year.

According to a recent *BusinessWeek* cover story entitled “Korea's Digital Quest”: “Export earnings from the tech sector, plus consumer spending on tech gadgets and the Internet, accounted for almost half of last year's 10.7 percent GDP growth, and they are driving a projected 9 percent expansion this year.

“South Korea is, arguably, already, the most wired nation in Asia—and by some measures, such as online stock trading and broadband access, a world leader. Sixty percent of its 46 million people already use mobile phones, and nearly half will be logging onto the Internet by yearend. More than 60 percent of trading is now done online. By 2002, 3 million Korean households will be using high-speed Internet connections, such as asymmetric digital subscriber lines and cable television modems, versus 2 million in the US and 300,000 in Japan.”

But for all the hype about the new economy, the tech stocks, which are sensitive to fluctuations on Wall Street, have slumped dramatically. Having shot up by 240 percent in 1999 to reach a market capitalisation of nearly \$100 billion, the Kosdaq—the South Korean equivalent of the US Nasdaq technology index—has plummeted by 60 percent since the beginning of the year. Some companies such as Daum Communications, Serome Technology, and Haan Soft, are down by 80 percent from their peaks.

Analysts have been quick to blame the government's failure to press ahead with the restructuring of the chaebols for holding back the new information technology section as well as for the country's continuing economic instability. As a result there is continuing pressure for Kim Dae Jung and his government to accelerate market reforms.

Commenting on Kim's Nobel Peace Prize in its October 30 issue, *BusinessWeek* called on the South Korean president exploit the prestige of the prize to “bite the bullet and let hundreds of insolvent companies go bankrupt and out of existence”. Tens of thousands of jobs have already been destroyed as a result of the impact of the Asian financial crisis, leading to rising levels of poverty and homelessness. International capital is now demanding many more should go.



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