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The Role of Development Banks in the Economic Development Policy of the Republic of Korea

SUMMARY: The study offers an insight into the economic development policy of the Republic of Korea, in particular the activity and the role of development banks. Since the beginning of the 1960s, the particular and successful Korean way of economic development has been largely based on the Japanese model of the developmental state, which includes, as a peculiar factor, the strong directing role of the state (the government). Several decades ago the Korean government developed a complex and efficient incentive system that allowed the companies, in particular the Korean giant companies (chaebols) to become the locomotives of export-driven economic development, along with predefined industrial priorities. The Korean central bank (Bank of Korea), the Korea Development Bank and other development-oriented banks have played an important role in every phase of the economic development. By way of a proactive monetary and credit policy, the central bank of Korea facilitated to direct the country's economic development into a solid track of growth in every critical period of the country's history, from the times of the Korean war (1950–53) after the establishment of the Republic of Korea (1948), through the two oil shocks of the 1970s, until the economic and financial crises at the end of the 1990s and in the years 2008–2009. The Korean experiences, in particular the methods that allowed a swift recovery from the latest two crises may also be instructive from a Hungarian point of view as well.

KEYWORDS: Republic of Korea, development banks, economic policy, incentive system

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The particular way of development of the Republic of Korea (hereinafter: Korea) is worth noting for several reasons, and there have been many studies (Kim, 1991; Lee, 2016; Noland, 2011) in the recent years—decades dealing with the lessons that can be learnt from the Korean model, the potentials for its adaptation, and analysing the role of state intervention, in particular the development strategy of the government, in achieving the successes of the

economy. Another current issue is the degree of adaptability of the Korean experiences in other countries, in particular with regard to the fact that Korea has become a significant donor country in the field of international development cooperation. Korea, as a peculiar example of the so-called developmental state model, is characterised by strong guidance and intervention by the state, including the implementation of the development policy. The direct guiding role of the government is very remarkable in the activities of the central bank, of other financial institutions

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for development purposes, and even in the case of the mainly privately owned large companies. The author's opinion is that the relatively extensive historical-descriptive part of the study is necessary, on the one hand, to provide a clue for this subtle system that barely resembles a classic market economy, and on the other hand, the presentation of the historical background may be a useful element of the basic literature as there are relatively few sources available in Hungarian language, especially about the early, postcolonial phase of Korea's development. It is, however, not the aim of this study to recommend as an example or an applicable model either the particular, specific periods of the development or even the Korean mechanism of crisis management, and similarly, it is not aimed at comparing this mechanism with those of other countries which follow a completely different policy of economic management. The study describes the Korean crisis management steps and measures from the point of view of the development policy presented in chronological order, and it does not analyse them as an independent research objective. (The crisis management experiences of Korea – as a developmental state – differ so much from the crisis management experiences of European states or of other classic market economies – the USA, the eurozone, or even Hungary – that a comparative study of it would require further research and another study.)

The main purpose of this research is to examine the changes of the Korean development policy – as well as its incentive and institutional systems – experienced in the recent decades, in the interest of maintaining and improving the economic competitiveness of Korea. The author sought answers to the following questions.

- ▶What are the main characteristics and focal points of the Korean development policy?
- ▶What are the main objectives and the factors of the companies' development system?

- ▶What are the priorities of direct foreign (working) capital investment policy?

- ▶What instruments of economic policy have been and are applied today by the Korean government?

- ▶What is the role fulfilled by the financial sector in the development of the Korean economy and what is the role it plays today?

MATERIAL AND METHODOLOGY

The study is fundamentally based on secondary research results, with its core being based on processing the literature focusing on the issues mentioned above. The sources originate from Hungarian and Korean universities, for example the Seoul National University (SNU), the Korea Development Institute (KDI), Korean financial institutions, the Bank of Korea (BOK), the Korea Development Bank (KDB) and the statistical data used are from international and Korean databases. The author had lived and worked earlier in Korea for a longer period (from 2000 to 2004); therefore, his personal experiences as well as his analyses published in the past on Korea's economy (in particular Neszvényi, 2004, 2017) have also been used as a starting basis. The study is built on the author's own research results in the framework of the 2018 research project on Asian development banks, supported by the Oriental Business and Innovation Centre of Budapest Business School (OBIC).

THE ROOTS: THE DEVELOPMENTAL STATE AND THE JAPANESE MODEL

The concept of the 'developmental state' was first introduced by *C. Johnson* (1982) in the literature on economics. He fundamentally applied this concept to Japan, but later on it

has been extended to other countries as well, in particular to the first wave of the newly industrialised Asian economies (ANIEs) (Korea, Taiwan, Hong Kong and Singapore). According to Ricz (2016), Johnson's 1982 model is still valid and in line with that the most important characteristics of the developmental state are as follows: a *'capitalist, plan-rational model, with a long-term commitment to the developmental-oriented approach, and active state interventionism in order to achieve the main socio-economic objectives. It is also tenable that for building or maintaining a developmental state some kind of social consensus is needed regarding the central role of state in development, as well as on the content of the main socio-economic objectives.'* (Ricz, J. 2016, 5–6). The classic school of Johnson as well as Ricz (2016) and Csáki (2016) underline that from the very beginning, the Japanese governance wanted to differentiate the approach it has applied both from the America model and the Soviet plan-rational economy. According to Woo-Cumings (1999, 1.), the developmental state is *'the condensed manifestation of the seamless web of political, bureaucratic, and financial power of the capitalist Northeast Asia'*. The developmental state is almost the complete opposite of the so-called rentier state, the peculiar features of which have been analysed by Gyene (2017), using the example of the post-Soviet countries of Central Asia. In these countries, the state/government control over the economy is also strong, but the source of the 'rent' is primarily the selling of natural goods, raw materials, rather than work representing an increasing share of added value.

According to Levi-Faur (1998), the trade policy of developmental states is usually aimed at having the maximum level of export with the minimum level of import. This trade strategy is called mercantilist, neomercantilist or directed trade, in accordance with the works of *A. Hamilton and F. List*. The principle

of *'export as much as you can and import only as much as absolutely necessary'* is based on this old mercantilist approach, which has been criticised by many scholars, but which has also supported many countries not only in their economic survival, but also in reviving the economies (Levi-Faur, 1998).

After the World War II, Japan strove for reaching a dominant position in its own region, and later on in the world, by developing its economy. To achieve this, it directed the economy consciously and systematically by way of its interrelated trade, economic and financial policies. This policy proved to be a success and by the 1990s Japan has become the world's second largest economy, and even today it is one of the world's largest economies. The industrial development policy of Japan induced a gradual shift towards the export-oriented industries representing an increasing share of added value: the first focus had been on the textile industry, followed by heavy industries in the 1950s and vehicle production, consumer electronics and micro-electronics in the 1960s and 1970s. In the 1980s the high-tech industries of biogenetics, aeronautics and space exploration, robot technology and the fifth generation computers were put into the focus. The industrial policy of Japan also applied several instruments for protecting their market, including discriminative customs tariffs, preferential taxes on domestic products, import restrictions based on foreign currency and exchange regulations. Additionally, as a part of their development policy, the all-time preferred industries have always been supported with low interest rate credits provided through financial institutions of the government (Nester, W. R., 1990, 165–166).

In the period of reconstruction after the war, Korea concentrated on the development of the industry, and later on from the 1980s the focus has been shifted from industrial development to innovation and competition policy.

However, the traditions of the developmental state still live on in many forms (Kim D-I, 2014). The government of Korea has always played – and still fulfils – a decisive role in the economy, and this role has reached its peak in the past decades primarily in the change of the financial structure after the Asian financial crisis of 1997–1998 and in the measures to reinvigorate the economy after the global economic and financial crisis of 2008. It is also well-known that the neo-liberal reform had a significant impact on the society. However, in Korea, this has not been a force towards democratisation and reducing the power and the role of the state, and the government used the reform program for justifying the widening of its own basis of power. The state strives for defining itself as an actor capable of solving economic problems that have been existing for a long time and as one capable of protecting law and order. However, with this approach, the governance narrows down the scope of action for non-governmental actors (Hundt, D., 2014, 2015).

THE KOREAN DEVELOPMENT POLICY

In Korea, the assessment of the state's influence on economic development has been subject to debates for a long time, as the features of the developmental state, the neoliberal state and the welfare state could be found in parallel with each other in the policies of the subsequent governments on power since the 1990s. Although the nature and the extent of state intervention have been varying regarding each government, but they fundamentally remained on the basis of the concept of the developmental state, while the neoliberal and welfare state instruments applied in parallel have served the purpose of the enhanced promotion of economic and

social development. The coexistence of the approaches in opposition are reflected in the existence of an alternative system of market economy (Suh and Kwon, 2014).

Today the Korean economy is one of the strongest economies of the world, although in the early phase, until as late as the early 1960s, it was a poor country with a per capita income lower at that time than in Mozambique or Bolivia. Foreign aid played an important role in the social and economic survival of Korea after the war and then, from the beginning of the 1960s, it has also contributed to reinvigorating the economy. According to *Tran* (2011), between 1946 and 1978, the USA provided aid and loans to Korea in the amount of as much as 60 billion USD. As a comparison, it is worth noting that in the same period, the USA provided aids to the whole African continent in a similar amount (68.9 billion USD), which supports the fact that the USA considered Korea as an important partner country even at that time. The Korean economy was able to utilise well the American aids. The latter was an important objective, too, as it was – among others – the basis of the accumulation of capital. At the end of the 1950s – when the value of the aids transferred was the highest – it covered as much as 80 percent of the country's import (Noland, 2011).

Planning, the system of Five-Year Economic Development Plans, was an important instrument for the development policy. In the period between 1962 and 1992, seven plans, setting concrete objectives and determining the directions of action, had been implemented in Korea. Industrial policy favoured the industries with high knowledge content, trade policies selectively managed import restrictions and export incentives, and exchange rates were managed to favour the exports of Korean goods (OECD). With respect to the swift performance increase of industrial sectors, three phases may be distinguished: the period

between 1953 and 1960, when the gross added value of the processing industry had been 12 percentage, which was raised to 23 percentage in the period between 1971 and 1980 and then to 27 percentage between 2001 and 2009. In the 1950s, light industry dominated the processing industry (as much as 80 percentage of the added value within the sector). Later on, light industry had been gradually replaced by heavy industry and chemical industry, increasing swiftly, in particular from the early 1970s. Within the processing industry, the added value of the latter ones reached 60 percent in the 1980s, 75 percent in the 1990s and 83 percent in the 2000s (UNCTAD, 2017).

From among the Asian economies following more or less the model of the developmental state, it is worth mentioning Taiwan as well, since there are several similar elements in the way Korea and Taiwan developed: they have big population on a relatively small territory, the scarcity of natural resources, a colonial past and the ‘heritage’ of devastating wars, strong handed political leadership, process of democratisation from the late 1980s, an export-driven economic development policy, the role of American aids, high rates of internal savings as well as the continuous tension in the direct geographical neighbourhood. There are, however, some remarkable differences between the ways the two economies developed, for example, the Korean government had practically monopolised the credit allocations, thus prioritising certain large companies selected in advance, which became the implementers of the export-driven policy. The latter ones have grown to become chaebols, i.e. giant companies later on. In contrast with that, in Taiwan, government intervention was not that strong and direct, and there the family-owned small- and medium-sized enterprises (SMEs) have become the engines of the economic development. While in

Taiwan any SME could become successful and could grow, provided that it was capable of it, in Korea, certain companies were granted the opportunity to grow on the basis of decisions made in advance (Neszmélyi, 2017).

Nevertheless, in today’s Korea, supporting the SMEs is an important issue and the government plays a key role in it through various channels. One of the most important channels are the credits granted through the financial institutions of the governance. Such institutions include for example the Korea Finance Corporation (KFC) and the Medium Business Corporation (SMBC). On-lending is another, more complex form of providing loans, when KFC provides 40 percent of the credit to the crediting bank, which shall be responsible for the remaining amount of the loan. This method has proved to be more efficient than the former one. In the year 2011, KFC and SMBC granted altogether credits to SMEs in the amount of 11.8 thousand billion South Korean Wons (KRW), which amounted to 85 percent of all credits granted to SMEs in that year.

The most widely used instrument of public support is credit guarantees, which promote loans to SMEs by reducing the lenders’ risks. In the period between 2007 and 2011, the amount of the credit guarantee provided to SMEs was 100 thousand billion KRW, equalling 8 percent of the GDP of the year 2011. This amount was significantly higher than the 42 thousand billion KRW of direct credit allocations. After the global economic and financial crisis of 2008, the upper limit of individual credit guarantee was raised from 3 to 10 billion KRW (approx. 9.6 billion USD), and the earlier 85 percent ceiling value of allocated credits was raised to 100 percent. Additionally, from time to time, the government also exercises a moral pressure on the financial institutions in the interest of the SMEs, for example, at the beginning

of the crisis of 2008, it requested the banks to automatically reschedule the credits of the SMEs in order to prevent the insolvency of otherwise well-functioning SMEs (Jones and Kim, 2014).

THE ROLE OF THE BANK OF KOREA AND THE KOREA DEVELOPMENT BANK

In Korea, the model of the developmental state has always meant the comprehensive role of the governance in guiding the economy, with the provision that not only the government in the narrow sense (the cabinet), but, in addition to it, several state institutions have played an important role in elaborating and implementing the development policy. Regarding the latter, the diverse activities of the financial sector are worth mentioning – including in particular the Korean central bank (Bank of Korea, BOK) – (in most cases the monetary policy instruments and in some cases the direct operations have played an important role). In addition to BOK, some other banks have also had a prominent role in the development policy. As far as the latter ones are concerned, Korea Development Bank (KDB) is worth mentioning, but other financial institutions have also played an important role in financing developments. The Korean Industrial Bank was established in the early 1960s with the duty of supporting small- and medium-sized industrial enterprises. The Korea Development Finance Corporation was set up in 1967, for the primary purpose of supporting private enterprises. The Korean Eximbank (KEXIM) was established in 1976. The latter three institutions have been in charge of supporting the development of the Korean industry, mainly by way of long-term loans. These financial institutions also differed from the traditional banks, as, in general, they were not allowed to accept retail deposits, especially

in the form of demand deposits. Thus, the Korean development financing has been characterised by a coordinated system, where the Korean central bank (BOK) implemented the development strategy in close cooperation with the commercial and development banks as well as with the specialised financial institutions (UNCTAD, 2016).

The beginnings – The liberation of Korea and the Korean war

The creation of the financial system of modern Korea dates back to 1878 when in Pusan, the first branch office of the Japanese Dai-Ichi Kokuritsu Bank (the first central bank of Japan, the predecessor of today's Dai-Ichi Kangyo Bank) was opened. After the subsequent establishment of a few other banks, in November 1909, the predecessor of the present central bank of Korea, the Bank of Korea (BOK) was set up. The BOK could not operate for long under this name, as in 1910, Korea had been annexed by Japan, and from 1911, the BOK continued to operate as Chosun Bank under Japanese control. The central bank only got back its original name after the end of the Japanese rule (1945) and the establishment of the Republic of Korea (1948).

After the World War II, the industrial and the agricultural production of Korea fell far below the level before the war; moreover, the majority of the production capacities and of the infrastructure was not or barely functional. This was also accompanied by unleashed inflation of three digits and a significant level of unemployment. The situation was even made worse due to the return of as much as half a million of Korean refugees arriving from other parts of the former Japanese empire. The level of human resources and the income per capita was higher in North Korea, where industry, mining and energy production had

been dominating sectors also earlier, while the southern part of the Korean peninsula was a typical agricultural region (Noland, 2011).

The Korean war broke up only 13 days after the BOK had commenced its renewed operation; thus, it had to immediately change to wartime operation. As the frontlines changed, the seat of the bank moved gradually southwards: first to Daejeon, then to Daegu and finally to Busan. In line with the developments of the economic situation, the wartime monetary and financial policy exercised direct control over the deposits, loans and financial transactions at the financial institutions. With the improvement of the situation this control had been eased and then released. After signing the ceasefire agreement to close the war (1953), the most important aim was to rebuild the country and reinvigorate the economy. The BOK returned to its peacetime mode of operating the financial system and it made efforts to curb the unleashed inflation. At that time, Korea was one of the world's poorest countries. In 1955, when the country joined the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), the amount of the GNI per capita was 65 USD. From early 1954, foreign aids for reconstruction and economic development started to arrive to the country, mainly from the USA. Its amount was 710 million USD between 1954 and 1956, accounting for as much as one-sixth of the Korean GDP at that time (60 years BOK).

Reconstruction after the war – The policy of selective financial support and the establishment of the KDB

In the period after the war, the General Banking Act was an important milestone, promulgated on 5 May 1950 with the Bank

of Korea Act, but as the Korean war broke out shortly after that (on 25 June 1950), the Act only entered into force actually on 15 August 1954. After the entry into force of the Act, the Monetary Policy Committee required the financial institutions to make a compulsory reserve rate for the deposits, and it also prescribed that the Office of Bank Supervision shall exercise supervision over them. The Act authorised the financial institutions to engage both in long-term and short-term financing operations, and the upper limit of the amount of long-term loans was set by the Monetary Policy Committee. The process of reconstructing the economy required an increasing amount of financial sources. The government, therefore, established in 1954 the Korea Development Bank (KDB) as a new financial institution, which has later become the centre for development financing and its main duty was facilitating the development of the national economy as well as to provide the industrial sectors with medium- and long-term loans (60 years BOK; UNCTAD, 2016).

In March 1954, the Korean government issued the first Industrial Rehabilitation Bond in the value of five billion Hwan for the purpose of increasing the capital available for setting up and operating the KDB. (Hwan was the official legal tender of the Republic of Korea between 15 February 1953 and 9 June 1962, 60 Years BOK). In the first years of its operation, the KDB provided financing for the reconstruction of industrial facilities and the basic infrastructure, and in the meanwhile it has become one of the most important actors in the financial system of Korea. By the year 1955, KDB has granted 40 percent of the bank-credits provided by Korean financial institutions (UNCTAD, 2016).

In the first phase of the reconstruction, public purpose projects and the production of basic necessities enjoyed priority. From the mid-1950s when the era of reconstruction

had ended, there was a shift of focus in the Korean aid policy of the USA as well: aids were replaced by the so-called soft loans. The Fiscal and Monetary Stabilisation Plan announced in 1957 was the first comprehensive economic development program that aimed to reduce inflation by monetary instruments and it clamped down on both the monetary and the fiscal regulations. In 1958 the BOK had reviewed the regulation on the financial management of financial institutions, then, from 1959, it allowed the increasing of providing loans at a rate higher than the growth of the amount of the deposits placed. It also simplified its interest policy and continued to narrow down the gap between the rediscounting rate and the interest rates of the loans granted by the commercial banks for the purpose of reducing the dependency of the banks on the so-called rediscounting window (60 years BOK).

The 1960s years – Laying down the foundations for the economic development of Korea

The early 1960s years was a period of intense political and social shocks in Korea. General *Park Chung-hee* came into power in a coup in May 1961, and his military governance soon launched a spectacular economic development. From among the many significant structural changes in the management of the economy, the establishment of the Economic Planning Board was one of the most important steps: it played a decisive role in achieving the economic results (Levi-Faur, 1998). The government, which has taken over from June 1961 the direct management of the commercial banks, introduced in 1962 – with the contribution of the BOK – the first five years plan of economic development with the purpose of raising the population from

poverty and to lay down the foundations of a self-supplying economy (!) (60 years BOK). It is important to note that at that time there was no mentioning of an export-driven development strategy; however, the change took place soon. KDB played an important role in implementing the export crediting program with such tools of key importance as the payment guarantee that could be applied for foreign loans, allowing the export-oriented companies to acquire foreign capital with favourable interest conditions (Cho and Kim, 1995). In March 1954, the government implemented monetary emergency measures and reforms with the aim of channelling capital to industrial developments as well as to absorb excess liquid capital. In the Fiscal Stabilisation Plan announced in 1963, the government applied fiscal and monetary instruments and price regulating measures in order to turn the economy into the direction of stable growth. Furthermore, the government and the BOK aligned the foreign currency exchange rates in 1964, and the interest rate in 1965, with the values reflecting the reality, this way helping the correction mechanisms of the prices as well as the rationalisation of the exchange rate-, monetary and fiscal policies.

The Foreign Capital Inducement Act entered into force in 1966, resulting in a significant growth of the inflow of foreign capital into Korea. The government continued to improve its links with the international financial organisations: in 1964 Korea joined the International Finance Corporation (IFC) and then in 1966 the Asia Development Bank (ADB). In the second half of the 1960s decade the economic growth remained high with the annual level of around 10 percent, but the prices rose swiftly, the deficit of the current balance of payments increased and the economy showed the signs of overheating. The Second Economic Development Plan launched in 1967 produced significant results

in the field of industrial development. In addition to the internal factors, it should be mentioned that in the relevant period Korea profited greatly from the current economic prosperity of the developed countries, from the Vietnam War and from other external factors (60 years BOK).

The 1970s years – The period of the economic boom in Korea

In the 1970s, heavy industry and chemical industry were put into the focus of the development strategy. In order to increase the effectiveness of the sectoral developments, the government established labour-training centres and research institutes, and it also expanded the role of developmental and specialised financial institutions that granted long-term loans with low interest rate. This also implied the expansion of the KDB's scope of activity with the financing of the energy sector and of the export-driven industries (UNCTAD, 2016).

Between the end of 1969 and the beginning of 1971, the government attempted to cool down the overheated economy in every sector by way of the so-called Comprehensive Stabilization Measures. Similarly, the BOK tightened its monetary policy. In 1972 the Korean governance introduced several new laws: the Act on Short-Term Financing and Banking Transactions, the Act on the Mutual Savings and Financing Company, the Act on the Credit Union, the Acts on the Development Support of Heavy- and Chemical Industry and on the Diversification of the Financial Structure (60 years BOK). For the purpose of strengthening the lending activity of the developmental and specialised banks, in 1974, the Korean government set up the National Investment Fund and then in 1976, the Korean Eximbank, and the deposit-

collecting banks were ordered to provide the Fund with sources in the form of loans to be granted by the Fund to developmental and specialised banks in the form of long-term credits with low interest rate. Between 1974 and 1981 when the most important sectors of heavy industry were established, 62 percent of the Fund's total lending activity went to the KDB, which also issued foreign currency bonds as an additional source of financing (UNCTAD, 2017).

At the end of 1973, the first oil crisis had a significant negative impact on the Korean economy, manifested in a slow-down, increasing inflation and the increasing deficit of the current balance of payments. After the second oil crisis (1979), not only the price of the sources of energy increased, but it resulted in a general boom of raw material prices, which significantly reduced the economic performance of the world's developed countries (60 years BOK). Evidently, Korea, where raw materials are scarce and there are no hydrocarbon sources of energy, was no exception.

After two oil crises – The 1980s

In the 1980s, the basis of heavy and chemical industries allowed the Korean economy to focus on improving the higher levels of the value chain, for example the vehicle industry and electronics. This again had resulted in yet another amendment of the KDB's scope of activity: supporting these sectors has become the primary activity of KDB, and – reflecting the structural change of industry – the KDB also opened its activity towards small- and medium-sized enterprises (SMEs) and providing them with loans has become one of its priorities (UNCTAD, 2017).

In 1982, the Korean government announced a package for the development of the economy,

including the reduction of the money offer by 20–22 percent as well as decreasing the rediscounting rate and the banks' interest rates for loans and deposits. The tax on acquiring and registering real estates was cut by 30 percent, which the government expected to reinvigorate the real estate market. The government also decided on providing more space for the development of the economy driven by the private sector and it also laid greater emphasis on market mechanisms, the openness of the economy and the processes of financial deregulation. In 1981, the Act on Regulating Tax Reduction and Exemptions was amended, shrinking significantly the scope of tax reductions and exemptions for the industries, to be replaced by a system of tax allowances available in the case of technology or human resources developments. Thus, the direct support system was replaced by a system of indirect support. In 1986, the Korea experienced a new period of economic boom with an annual growth rate of around 10 percent. By that time the country has managed to get rid of the former chronic deficit of the current balance of payments: the balance was positive, with a surplus of 30 billion USD. The positive balance reduced the excess demand for sources, thus contributing to the reduction of the interest rates on the money market. Korea also profited from the low exchange rate of the USD (compared to the Japanese yen) and from the low international credit interest rates. The government established several specialised institutions for the purpose of strengthening the R&D activities of the companies, for example the Korea Technology Development Corporation. There was also a shift of emphasis in the support of SMEs, too. While in the early 1980s the support of SMEs had served the purpose of making them able to better supplement the operation of big companies, from the second half of the decade the aim was to make the SMEs themselves become

compatible. On the basis of a provision adopted in 1982, certain business activities were reserved for SMEs, then, in 1983, the scope of SMEs with a high development potential and an ability to improve the quality of their products was defined as worth being supported. In addition to the government, the BOK also expanded its programme supporting SMEs, indeed, it encouraged the banks to increase the share of support granted to rural/ agricultural and fisheries sectors, too. In 1991, the BOK had participated in the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) initiative, then in 1997 it joined the Bank of International Settlements (BIS) in order to strengthen the link between the financial system of Korea and the central banks of the world's most important economies (60 Years BOK).

The 1990s years and the effect of the Asian financial crisis (1997–1998) on the economy of Korea

In the 1990s the KDB had remained the main financing party of the high-tech industries, then it started to gradually expand its activity also to the field of international investment banking. Beyond the general intention of becoming an internationally compatible investment bank, its objectives included the supporting of Korean companies operating abroad, issuing bonds and supporting fusion and acquisition projects (UNCTAD, 2017).

By 1997, the significant and persistent current account deficit emerged, slowing down the inflow of foreign working capital, and by the second half of the year the trust of foreign investors in the Korean economy has eroded. The currency crisis of Southeast Asia penetrated into Korea with unexpected speed and the Korean companies had to face a serious challenge. The foreign currency

reserves of the country fell quickly and finally, on 3 December 1997, the Korean government and the International Monetary Fund (IMF) signed a standby credit agreement in the value of 21 billion USD. In addition to the IMF, the IBRD and the Asia Development Bank (ADB) also supported the Korean economy with loans in the value of 10 billion and 4 billion USD respectively. Additionally, some economically developed countries (for example the USA and Japan) offered a further total amount of 23.35 billion USD. In April 1998, the government restructured short-term international liabilities into new loans in the value of 21.7 billion USD, with an expiry date from one to three years and a government guarantee, helping to stabilise the country's foreign currency liquidity situation. Additionally, in the same year, it issued Foreign Currency Stability Fund bonds in the amount of 4.1 billion USD. The investors' environment improved significantly after opening up several sectors for the foreigners and foreign investors were allowed to buy domestic real estates (60 years BOK). The 1997's Asian financial crisis – still referred to in Korea as the 'IMF-crisis' (with reference to the loan package originating mainly from the IMF, as mentioned above) – added new functions to the KDB's portfolio that undertook an active role in the process of corporate structural change after the crisis (UNCTAD, 2016).

The Deposit Insurance Fund and the Non-Performing Loans Resolution Fund of BOK supported the banks by buying bonds and granting, at the same time, special liquidity loans for the purpose of preserving the financial stability (60 years BOK). As underlined by *Zéman et al.* (2014), having a management with a strategic approach is a key factor in the compatibility of the companies, as it allows the enterprises to adapt continuously and in a flexible way as well as to react sensitively to the market environment. It was in this period and from this time onwards, when it

has become a really important factor for the Korean companies. Therefore, after reaching an agreement about the basic principles with the actors of the business sector, the government launched, from January 1998, a new corporate restructuring program. As a result, 64 companies executed Financial Structure Improvement Agreements with the main crediting banks between February and April 1998. The total amount of outstanding loans granted by the financial institutions to these companies was 250 billion KRW. As the result of the structural change initiative, the five largest chaebols (with the exception of Daewoo) fulfilled the majority of the requirements aimed at the development of the financial structure undertaken in the agreement, the target value of the debt rate (200 percent), the elimination of cross-payment guarantees. In addition to the five largest companies, several other big companies performed the conditions of the agreement; thus, their debt rate was reduced to the half as compared to the situation at the end of 1998. This policy, as well as the measures referred to above contributed significantly to the stabilisation of the internal money market and the foreign currency market as early as in 1998, and then the real economy started to increase quickly with an unexpected pace. The current balance of payments closed with a significant positive balance, which was an important factor regarding Korea's debt repayment. Finally, by 23 August 2001, before the deadline, Korea managed to repay all of its loans taken from the IMF (60 Years BOK).

The financial-economic crisis of 2008–2009 and the post-crisis period

By the end of the 2000s years, the inflow of foreign capital increased significantly. The investors' interest was constantly high,

by June 2004, 43.9 percent of the Korean domestic stocks have been held by them. In 2007, foreign net purchase of domestic Korean securities (e.g. treasury bills or the Monetary Stabilisation Bonds) amounted to more than 32 thousand billion KRW. In 2008, the effect of the bankruptcy of the Lehman Brothers swiftly ran across the globe, shaking seriously the global financial system. The Korea Composite Stock Price Index, which had stood at around 1,400 before the bankruptcy of the Lehman Brothers was dropped to 939 on 24 October 2008. The volatility of the money market increased, the real economy shrunk significantly together with the falling share prices and the exchange rate of the South Korean Won. The primary reaction of the government was the cutting of budgetary expenditure. The BOK also made attempts to mitigate the effects of the crisis: Between October 2008 and February 2009, it gradually reduced the applicable interest rate in six steps from 5.25 percent to 2.00 percent, thus pumping liquid capital into (almost all) sectors affected by the credit crisis. In the framework of the latter, on 23 October 2008, it (re)purchased Monetary Stabilisation bonds from the banks in the amount of 700 billion KRW, and it also purchased sovereign debts on 19 November in the value of 1 thousand billion KRW. In addition to the above, from October 2008, it pumped 8.3 thousand billion KRW into securities companies to improve their liquidity, and it also purchased, in the framework of the agreements on repurchasing credit bonds, debentures and deposit certificates (CD) in the amount of 5 thousand billion KRW for the purpose of improving the market's operability.

Earlier, in the framework of open market operations, the BOK only issued state bonds, bonds guaranteed by the government, Monetary Stabilisation bonds; however, in November and December 2008, the scope of

the so-called acceptable coverages was extended with bank bonds, some special bonds and the mortgage-covered securities (MBS) of the Korea Housing Finance Corporation. In order to improve the balance of SMEs, the BOK increased its accumulated credit ceiling from 6.5 thousand billion KRW to 10 thousand billion KRW. As an important development, the BOK concluded foreign currency swap agreements with the central banks of the main partner countries for the purpose of stabilising the foreign currency market and to grant the necessary foreign currency liquidity for the market. As early as in the first quarter of 2009, all this had a positive effect on the GDP. In just ten months, share prices returned to the level before the crisis, and the foreign currency reserves of the country grew to a record level by the end of January 2010 (273.3 billion USD) (60 years BOK). Thus, Korea managed to get out of the crisis relatively quickly.

In the 2000s decade, the idea of privatising the KDB was raised several times. The reasons behind this idea were, for example, that the KDB, in its actual form – with its constant domestic expansion – slows down the development of the country's financial system; however, after the privatisation, the KDB could turn towards internationalisation: with its subsidiaries and branches abroad, it could slowly be transformed into a global investment bank. Although privatisation was taken off the agenda, still the aim is to modernise the KDB and to reinforce the key role it plays in the field of development financing (UNCTAD, 2016). Also today, the KDB has an international network: It is present in 21 countries with 9 overseas branches, 5 subsidiaries and 8 representative offices. In Europe, it has a branch in London, two subsidiaries (in Hungary and in Ireland) and a representative office in Frankfurt (KDB, Seoul).

In 2013, the former president *Park Geun-hye* announced the program of the 'Second Miracle

over the River Han’, with the program of the so-called creative economy in its focus. The subsequent speeches of the former president also contained references to the new forms of convergence affecting the ICT, the traditional industry and the cultural content (Connel, 2014). The present president, *Moon Jae-in* also maintained with minor amendments the program of the creative economy.

The swiftly changing macroeconomic environment of the past decade, including the consequences of the latest financial-economic crisis, underline more remarkably than before the need for the banks’ quick responsiveness (Kalmár et al. 2015). In line with that and with the government’s creative economic policy, the KDB supports the enterprises and companies that develop new technologies. The concrete form of it is the so-called Techno Banking fund

with its main areas in intellectual property (IP) and the supporting of future-oriented start-up businesses and SMEs, as well as a growth-inducing program that supports the companies with networking possibilities and mentoring in addition to the financial instruments. The further development is preconditional upon reducing the dependability of the economy on the (classic) processing industry sector. However, along with the initiatives to change direction as mentioned above, the traditional functions of the KDB remained unchanged and it is still a supporter of large-scale infrastructure projects (UNCTAD, 2016).

Despite of recovering from the crisis, the economic growth rate of Korea is now slower than it had been in the years before the crisis (see Figure 1). The reason is the world-wide increased precaution by the banks with regard

Figure 1

THE ANNUAL ECONOMIC GROWTH OF THE REPUBLIC OF KOREA BETWEEN THE YEARS 1980–2017



Source: own editing based on the data published by Index Mundi

to credit risks, as well as the tighter financial regulations by the governments.

Today, in addition to the BOK, the financing operations of the KDB play a key role in the growth of the Korean economy, indeed, its activity already covers the leading industrial sectors of the world as well as multinational conglomerates. Its scope of activity mainly includes company banking transactions and structural change, investment and enterprise banking, technology financing and consulting, financing international business transactions, pension- and asset management, research and loan review (KDB, Seoul).

CONCLUSIONS

After the latest global economic and financial crisis, the world economy is facing a change of paradigm and the Korean economy should again adapt to the changed circumstances in a proactive way. As demonstrated in the seventy years', three-quarter of a century's history of the Republic of Korea, the country has almost always managed to give adequate responses to the new external challenges, and it made Korea able to achieve the spectacular results of the past decades. The division of the Korean peninsula and of the Korean nation, the heritage of the Japanese colonial past, the devastations of two wars and the bipolar world order, just as the Japanese model built upon the concept of the developmental state, have all been circumstances that determined the economic development of Korea. Korea applied a special version of that model, adapted to the local political, social and cultural environment. However, in terms of the fact that the governmental and central financial institutions have played – from the very beginning and even today – a strong role in forming and implementing the economic

development policy, it is the same as the Japanese model.

Due to the structure of the state of South Korea, the governance is very centralised. The link of economic guidance implemented between the large companies and the state is a special feature of the economy, and as a result, the privately owned companies are linked to the centralised governance, which also means that the large companies are supported in the form of a kind of centralisation. It means, on the one hand, the distribution and the utilisation of state resources, and on the other hand, the participation of privately owned companies in the programs of economic development. Of course, the utilisation of supports granted from public funds are controlled by way of central financial audit. This peculiar model is the visible joint result of a business branch and the role undertaken by the state, and it supports transparency and development to the maximum extent. The author considers this model of governance as such an example that significantly facilitates the efficient utilisation of public funds.

For a long time, the 'chaebol model' implemented by Korea had put the focus of the export-driven economic development on large, preselected industrial companies as beneficiaries; however, in the past decades, the government has paid much more attention to the SMEs; thus, the central financing programs and instruments to support their development are operating in parallel with the older, traditional financing structures of the large companies. As the development policy and its set of instruments have changed over time, the structure and the scope of activity of the financial system of Korea have changed the same way. This financial system shall have to face important challenges in the future as well in terms of the post-industrial society, the sustainable development and the creation

of the creative industry that is also promoted by President Moon Jae-in. The Korean experiences are noteworthy and certain elements of it (e.g. crisis management, the

coordination of the development policy) may even serve as concrete lessons for the RDI and economic development policy of Hungary or of other countries.

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