

Spring 5-31-1999

Response to Woo-Cumings

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Recommended Citation

Szitta, Christina (1999) "Response to Woo-Cumings," *Macalester International*: Vol. 7, Article 17.
Available at: <http://digitalcommons.macalester.edu/macintl/vol7/iss1/17>

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Response

Christina Szitta

Dr. Woo-Cummings provides a valuable picture of corporate governance in East Asia and embeds it in a rich historical and political framework. The current crisis in East Asia can be viewed as a failure of regulation, implying that we must carefully examine institutions and the role of the state when considering the particulars of the situation. She cautions us to examine and perhaps set aside our assumptions about regulatory frameworks and proposals for reform that might well be applicable to the U.S. economy but not necessarily to parts of East Asia. Reforms can only be effective if they are specifically suited to the contexts in which they must function.

The central unit of the Korean economy is the *chaebol*, which consists of various subsidiaries, only a few of which need be profitable in order to keep the *chaebol* afloat. Despite their negative aspects, *chaebols* have played a major role in the breakneck rate of Korea's growth over the past few decades. Dr. Woo-Cummings states that the *chaebol* cannot and should not be eliminated from the Korean economy.

An important feature of Dr. Woo-Cummings's essay is her discussion of the relationship between the *chaebol* and the government. When Korea began its rapid industrialization, a dearth of accumulated capital meant that business had to rely on credit from banks. These banks were controlled by and, until the 1980s, owned by the state. Businesses were forced to maintain good relations with the government to avoid the possibility of default on loans. The problem of corporate governance cannot be adequately addressed without examining the existence of corruption and the discretionary power of the politicians and bureaucrats in Korea. These discretionary practices, as Dr. Woo-Cummings notes, "create the sense that the rules of the game in Korea are endlessly negotiable." The *chaebol* cannot continue to operate as they have in the past. She stresses that there is no one-size-fits-all corporate governance and that solutions cannot exist outside of the context of the cultures within which those solutions must operate.

Although I commend Dr. Woo-Cummings for her thorough examination of the history and current cultural context of East Asian corporate gov-

ernance, particularly the Korean *chaebol*, I believe there are several issues critical to our discussion of the globalization of economic space that she did not sufficiently address. My first point of concern is that she does not describe how the *chaebols* and their participation in the global market affect economic polarization within Korea, both in terms of businesses and individuals. If these huge and generally family-owned conglomerates control a large fraction of economic activity, what role is left for the small business owner or the budding entrepreneur? This is especially important in terms of innovation, which is the engine of economic growth. Remember, many of today's large firms were, in the not-so-distant past, fledgling operations. The most obvious example is Microsoft.

Dr. Woo-Cumings notes that the state has tended to ignore the property rights of its average citizens in favor of bailing out the big firms. The economic system, with its emphasis on rapid growth, as measured by GDP, has been geared toward protecting domestic producers at the expense of domestic consumers. Professor Byun Hyung Yoon, once ostracized for his criticisms of the *chaebol* but currently called on for his opinions on free-market practices, told the magazine *Far Eastern Economic Review*: "Our policy-makers in the past were obsessed by growth and efficiency at the expense of fair competition and income. Now it's time to consider equity as a central factor in our economic development."¹ What possibilities exist to make equity, both in terms of treating smaller firms fairly and not disadvantaging domestic consumers, a more important goal, while maintaining the *chaebol* system in some form?

My second contention is that we should be hesitant to look to the Japanese model of corporate governance. It is certainly crucial to consider the history of the relationship between Japan and the other countries of East Asia, but the Japanese model, as we have seen in recent years, is having its own difficulties adapting to globalization. In addition, the countries of East Asia are themselves so varied that some argue we should not even discuss "one" Asian crisis because of the diverse problems in the different countries. Today's world changes so swiftly that models from the past may not be appropriate for the future. In addition, no single model can adequately address the economic difficulties faced by different countries. While the recent economic history of Japan is more applicable to Korea than, say, that of the United States, Korea and the other East Asian economies should,

while studying the past, also chart new courses in an uncertain but certainly changing future.

In the book *The Commanding Heights*, Daniel Yergin and Joseph Stanislaw offer five “critical tests” that they believe will be used to evaluate any model of corporate governance and economic reform.² Their first question is: does it deliver the goods? Do the reforms serve to improve the standard of living of individuals? Second: Do the new practices ensure fairness in that success is widely distributed? Third: Do the new practices uphold national identity? Fourth: Do they secure the environment for current and future generations? And fifth: Can they cope with demographic changes in the years to come? It would be instructive to examine these questions when considering various options, based upon past and current examples of corporate governance.

My third and primary concern is Dr. Woo-Cumings’s suggestion that the history of past reform efforts should teach the Korean government to institute the rule of law — that is, to change the rules of the game and then stick to them. Both corporations and the government must be subject to the rule of law. In countries with histories of corruption in government, as well as arbitrary government involvement in the regulation of corporations, this approach obviously would offer certainty and stability. Under the rule of law, it would be easier to attract and retain foreign investment because that investment would appear more secure from the whims of the politicians.

But what exactly does the rule of law mean, particularly in countries as diverse as those in East Asia? As Dr. Woo-Cumings says, these countries have different political and cultural histories, and do not have the same traditions that aided the development of the modern capitalist society in other parts of the world. How can the rule of law be implemented in such a way as to preserve some of the structures that Dr. Woo-Cumings stresses are important parts of the culture, such as the *chaebol*, while at the same time altering and improving upon those structures so they are better able to function in a global marketplace? What formal rules will function with the existing and embedded informal rules? There are no easy answers to such questions. Thomas Carothers wrote in a recent issue of *Foreign Affairs*: “Rule-of-law reform will succeed only if it gets at the fundamental problem of leaders who refuse to be ruled by the law.”³ The effective institution of the rule of law demands “patient, sustained attention that will take generations.”⁴

I would now like to place Dr. Woo-Cumings's contributions into the framework I use to consider questions of globalization and economic space. As Adam Smith said, the test of any economic system needs to be the welfare of its consumers. Using this as our guiding principle, we must ask: What are our goals when discussing globalization? I contend that government's main goal should be to increase the standard of living of all its people. In this context, standard of living refers not to narrow, materialistic gain, but, rather, to an increase in human capacity, in the ability of people to lead life as they choose. Consumers consume not merely material goods, but also opportunities. How, I ask, can Korea, or any nation, respond to or influence the forces of globalization while pursuing the goal of an improved standard of living?

Globalization, as Daniel Yergin points out, is both a condition and a process.⁵ While discussing the process of globalization we must accept that it already exists in some form. Shaping both of these discourses are certain fundamental principles upon which economists' assumptions about growth and development are based. The first fundamental assumption is that truly free trade, because it takes advantage of the gains from specialization, will bring an aggregate benefit to all parties involved. One can disagree with this conclusion, but I hope we can agree that trade barriers have lasting negative effects, particularly for consumers. The second assumption is that competition is the vital force that promotes efficiency. The "gales of creative destruction" described by Joseph Schumpeter serve to ensure that producers meet the needs of consumers to the best of their abilities. The third assumption is that interest rates, stock prices, and other such financial instruments should reflect the risk involved, which means they should not be forcibly set by governments. While subject to criticism from many perspectives, the practical application of these fundamental principles has brought tremendous wealth to the industrialized world. The challenge now is for nations to apply these fundamentals so that the nations themselves have more control over their economic and, hence, their social, political, and cultural destinies. Economic growth provides greater means with which to create and institute change.

By emphasizing economic fundamentals, I do not wish to imply that we should throw out all of our accumulated knowledge about market inconsistencies and failures, pretend that the global playing field is level, and declare all economic activity fair game for worldwide com-

petition. However, risky loans and lower competitiveness leave countries vulnerable to the kinds of shocks and crises currently plaguing East Asia. What works at one particular time, and for certain leaders, in this ever-changing world economy may not work at the next point in time.

What seems to remain, however, is the ability of these economic fundamentals to create wealth, and the ability of strong institutions, financial and otherwise, to deal with shocks more adequately than systems dominated by changing political interests. As Dr. Woo-Cumings states: "The interventionist state in Korea has been profoundly 'results-oriented,' privileging outcomes over established procedures and rules." While this may have produced the rapid growth of previous decades, the current crisis has exposed to the world many flaws and potential disasters that were shrouded during more prosperous times. Because governments can come into and out of power so rapidly, particularly in times of economic hardship, rules that adhere to the economic fundamentals highlighted earlier must be established so they become integral parts of the economic culture. And both corporations and the government must abide by these rules.

Rules and reforms are most urgently needed in the financial sector. Joseph Stiglitz, chief economist of the World Bank, says that the current crisis, which clearly exposes globalization's double-edged sword of opportunity and risk, "reinforces the belief that countries will benefit most from globalization when they have transparent, robust and well-regulated financial markets."⁶ In the wake of freely flowing capital, investors and borrowers alike seem to have forgotten that debt implies risk and not cheap funds.⁷

According to Stiglitz, the financial sector will be strengthened by making borrowers and lenders pay the full costs of their risks rather than relying on government favors. This necessitates the establishment of lending standards, methods of asset valuation, and disclosure and accountability standards. It also means dealing with insolvent institutions without offering government bail-outs or loan guarantees. While Stiglitz notes that the regulatory structures must be adapted to the specific situations and informal rules of different countries, he points out there are certain fundamentals, such as greater transparency, that are necessary if reforms are to be effective.

How will these reforms affect individuals and improve their condition? As Dr. Woo-Cumings observed, current policies in Korea favor producers over consumers in numerous ways. Policies that do not

shelter domestic industries from the forces of global competition will allow consumers more say in how they want to improve their lives. Along the same lines, policies must protect small investors. Some *chaebols* that have been newly exposed to competition have already taken this into account. To paraphrase one *chaebol* executive, to emphasize growth at the expense of other considerations often leads to stupid investments.⁸ Stockholders and consumers play a valuable role in developing strong institutions that are able to ride out the shocks of the global economy.

Dr. Woo-Cumings emphasizes that Koreans will view the current problem as the need to preserve and even nurture “the essential logic of the *chaebol*.” I agree that the *chaebol* has contributed enormously to the Korean economy, and I believe the best way to preserve and accentuate its value is to expose the *chaebol* to market forces and to eliminate the political protections under which it has grown. Globalization brings with it a necessity to accept market forces as a reality. Those *chaebols* that have already initiated reforms have been exposed to very strong competition and now realize that they “must restructure or perish.”⁹

I would like to stress my agreement with Dr. Woo-Cumings on what I believe is the crucial point to remember as we discuss these issues: Because no specific model is “right,” we should not impose what has worked in the past, in other countries, on those countries now experiencing hardships or those in the process of development. However, when considering models appropriate to the current needs, certain economic fundamentals are important. Strong institutions, however they are built, that abide by these fundamentals allow for more autonomy, less exposure to shocks, and the ability to attract more (and more stable) foreign capital, which can lead to growth. This growth, if stable and lasting, can provide the means with which to address the concerns of those most vulnerable to the globalization of economic space.

Notes

1. Shim Jae Hoon, “Dream Team,” *Far Eastern Economic Review* 30 (April 1998): 14.
2. Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: The Battle between Government and the Marketplace That Is Remaking the Modern World* (New York: Simon & Schuster, 1998).

3. Thomas Carothers, "The Rule of Law Revival," *Foreign Affairs* (March/April 1998): 96.
4. *Ibid.*, 105.
5. Yergin and Stanislaw, 14.
6. Joseph Stiglitz, "Road to Recovery," *Asiaweek* (17 July 1998): 67.
7. Jonathan Sprague and Alejandro Reyes, "Cramschool Daze," *Asiaweek* (17 July 1998): 45.
8. Charles S. Lee and Dan Biers, "Remaking Korea Inc.," *Far Eastern Economic Review* 30 (April 1998): 13.
9. *Ibid.*, 10–11.