
The Political Environment of Korean Business and Management



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Q) What factors shape the political environment affecting Korean business and management?

Topics to be covered

- Economic Relations between North and South Korea
- Recent Developments in Korean Politics
- Characteristics of Korean Politics
- Measurements of Country and Political Risk of Korea

I . Introduction



- Political environment

- Political risk affects the operation of business (domestic or foreign)

Ownership risk

Operational
risk

Transfer risk

- Performance of Firms

Factors

Macro: Political risk, Economic risk, Financial risk,...

Micro: Firm's strategy,...

II . Economic Relations Between North and South Korea

Q) Why North and South Korean have had bitter relationships with each other?

Key Events between North & South Korea

Period	Key Events
June 1950 – July 1953	Korean War
Jan. 21, 1968	Planned attack of the Blue House by N. Korean guerrillas
Aug. 15, 1974	Assassination of the First Lady
Oct. 9, 1983	Terrorists attack to South Korean Presidential delegation in Burma
Nov. 29, 1987	Blowing up of KAL 858
July 8, 1994	End of Il-sung Kim's rule

Key Events between North & South Korea

Period	Key Events
Feb. 1998 - Feb. 2003	<p>Sunshine Policy by Mr. Kim, Dae-Jung</p> <ul style="list-style-type: none">▪ June, 1998. Mr. Chung, Juyoung's visit▪ Nov, 1998. Start of Mt. Kumgang Tour Business▪ June 15, 1999. 1st Military Conflict in Yellow Sea▪ June 13-15, 2000. 1st N-S Summit Meeting▪ Aug 15, 2000. 1st Meeting of the Separated Families
Apr. 12, 2004	Opening of Kaesung Industrial Complex
Oct. 9, 2006	1 st Nuclear Weapons Testing
Oct. 2, 2007	2 nd N-S Summit Meeting
July. 11, 2008	Gunshot at a Civilian Tourist in Mt. Kumgang
May. 25, 2009	2 nd Nuclear Weapons Testing
Mar. 26, 2010	South Korean Navy Ship Attacked and Sunken
Nov. 23, 2010	Artillery Firing at Yeon-Pyung Island in Yellow Sea

II . Economic Relations Between North and South Korea

Inter-Korean economic relations

- Inter-Korean economic relations
 - ‘Sunshine Policy’ (Kim, Dae-jung administration , 1998-2003)
 - ‘Peace and Prosperity Policy’ (Roh, Moo-hyun government 2003-2008)
- The North Korean economy
 - Conventional centrally planned economy
 - Resources allocated by the state and the party
 - Wages, trade and banking all under strict government control
 - Since 1990s, the economy started to decline as other communist economies in Europe collapsed

Economic growth of North and South Korea (%)

	1990-98	2000	2004	2006	2008
N. Korea	-3.8/yr	1.3	2.2	-1.1	3.7
S. Korea	+5.7/yr	8.5	4.6	5.0	2.2

II. Economic Relations Between North and South Korea

Inter-Korean economic relations

Comparison of economic size between N. and S. Korea

	North Korea(a)	South Korea(b)	a/b (%)
Population (2007)	23.2 million	48.5 million	47.9
GDP(2007)	US\$26.6 billion	US\$969.9billion	2.7
GDP/capita(2007)	US\$1,148.4	US\$20,015.2	5.7

- ‘Four Point Agreement for Inter-Korean Economic Cooperation’ (2000)
- Economic reform in North Korea (2002)

Decentralization of the planned economy	Price setting in line with the market mechanism	The establishment of private markets
	Elimination of the rationing system	Wage rationalization

- After October 2002 nuclear crisis, N. Korea had pursued inter-Korean economic cooperation with greater urgency

II . Economic Relations Between North and South Korea

Inter-Korea Trade, FDI and Tourism

Inter-Korean trade volume (unit: US\$1000)


	1990	1995	2000	2005	2008
North to South	1,188	64,435	152,373	715,472	888,117
South to North	12,278	222,855	272,775	340,281	932,250
Total	13,466	287,290	425,148	1,055,741	1,820,366

- FDI(South → North) has not expanded as quickly as inter-Korean trade
- The scenic Mt. Kumgang in North Korea's southeast (1998)
- The Kaesong Industrial Complex project (2004)

II . Economic Relations Between North and South Korea

Implications

- Strongly affected by North South political climate as well as the progress of the nuclear talks.
- Future developments of North Korea's 2002 economic reform are constrained by lack of business partners (China, Russia, Japan, and S. Korea)
- Fragile and dysfunctional North Korea's economy
- S Korea's need to engage economic cooperation with N. Korea



Short-term: fluctuating trend
Long-term: cautiously optimistic

III. Recent Developments In Korean Politics

Korean politics in transition

Rhee, Syngman (1948-1960)	Park, Chung-hee (1961-1979)	Chun, Doo-hwan (1980-1987) Roh, Tae-woo (1987-1992)	Kim, Young-sam (1992-1997) Kim, Dae-jung (1998-2003)	Roh, Moo-hyun (2003-2008) Lee, Myung-bak (2009-2013)
<ul style="list-style-type: none"> ▪ First Republic ▪ Fraudulent-Election(1960) ▪ Civil Revolution (April 19, 1960) 	<ul style="list-style-type: none"> ▪ Dictator's rule ▪ Third/Fourth Republic ▪ Five year Economic Development Plan ▪ Export Oriented Industrialization Policy ▪ Saemaeul Movement(1970) 	<ul style="list-style-type: none"> ▪ Fifth Republic ▪ Gwangju Uprising (May 18, 1980) ▪ The June Democracy Movement (June 10-29, 1987) ▪ Declaration of Political Reforms 	<ul style="list-style-type: none"> ▪ Sixth Republic ▪ Stabilization of Democracy ▪ Financial Crisis (1997) ▪ Sunshine Policy 	<ul style="list-style-type: none"> ▪ Market-based Reforms ▪ Peace and Prosperity Policy ▪ FTA ▪ Economic Reform

III. Recent Developments In Korean Politics

Korean politics in transition

■ 1948~1960 (Rhee, Syngman)

- First Republic
- Antagonistic policy toward North Korea
- Korean War (1950~1953)
- Pushed through an amendment to prolong the eight-year two term limit
- Intervened presidential election (Mar 15, 1960)
- April Civil Revolution (1960)

■ 1960~1961(interim administration)

- Second Republic

III. Recent Developments In Korean Politics

Korean politics in transition

■ 1961~1979(Park, Chung-hee)

- Militaristic Rule (*coup d'état* on May 16 1961)
 - Third Republic
 - Five Year Economic development Plan (1st and 2nd)
 - Export-oriented industrialization policy
 - “Development First, Unification Later”
 - Construction of the Gyeongbu Expressway (1970)
 - Saemauel Movement (“New Village Movement“, 1970)
-
- Yusin Constitution(1972)
 - Fourth Republic (Park’s permanent presidency)
 - Expanded 3rd and 4th five-year plans
 - Economically prosperous but politically tightly controlled
 - A sudden death of Mr. Park, Chung-hee on Oct 26, 1979

III. Recent Developments In Korean Politics

- Saemaul Movement ("New Village Movement")
 - Improve the quality of rural life, modernize both rural and urban societies

**Completing
foundation of
standard living in
rural area
(1971~1973)**

**Self-help and
co-operation
(1974~1976)**

**Self-reliance
Building up rural
infrastructure
(1974~1976)**

- Industrial complex
 - Effective handling Export-oriented policies
- Construction of the Gyeongbu Expressway (Infrastructure)
 - Linked Seoul to the port cities of Incheon and Busan
 - Accelerated industry development

III. Recent Developments In Korean Politics

Korean politics in transition

▪ **Chun Doo-hwan(1980-1988) & Roh Tae-woo(1988-1993)**

- Fifth Republic
- Took power through *coup d'état* (Dec. 12, 1979)
- Gwangju uprising (May 18, 1980)
- Indirect election
- Economy boom with notable growth in the electronics, semi-conductor, and automobile industries
- Widen gap between the rich and the poor, the urban and rural regions
- The June Democracy Movement(June 10-29, 1987)
- Declaration of Political Reforms

III. Recent Developments In Korean Politics

Korean politics in transition

- **Kim, Young-sam(1993-1998) & Kim, Dae-jung(1998 to 2003)**
 - Democratic government (Sixth Republic)
 - Substantial financial and economical reforms (joined the OECD in 1996)
 - Introduced “The real-name transaction financial system” (Aug. 1993)
 - All financial dealing became transparent, and underground economic dealings were revealed
 - Due to this system, former presidents (Chun Doo-hwan, Roh Tae-woo) were imprisoned
- Financial Crisis (1997)
- IMF relief funds
- Aggressive pursuit of foreign investment and industry's globalization
- A national pension system
- "Sunshine Policy”

III. Recent Developments In Korean Politics

Korean politics in transition

▪ **Roh, Moo-hyun(2003–2008)**

- Unique backgrounds (a lawyer with no particular school ties, NGO experience,...)
- left-wing liberal ideology
- Market-based Reforms , started FTA
- “Peace and Prosperity Policy” (stable North and South Korean relations)

▪ **Lee, Myung-bak(2008~2013)**

- Continued push for FTAs
- Rising expectations of the people on the integrity of politicians and government officials
- Widened gap between the rich and the poor (strong need for social welfare), and between *Chaebuls* and SMEs
- Less flexible North and South Korean relations

IV. Characteristics of Korean Politics

- Confucian Values (civil servants examination)
- Strong network among politicians, big businesses, and bureaucrats (and possible corruptions)
- Personality–based rather than institution–based leadership
- Regionalism (school and family ties)
- Opinion leading groups

IV. Characteristics of Korean Politics

Ideological Characteristics of Korean Politics

- Progressivism – conservatism based on
 - Rejection vs. acceptance of the anti – communist ideology
 - Liberalism vs. authoritarianism

Q) What is the difference between political risk and country risk?

Political Risk and Country Risk

	Political Risk	Country Risk
Exposed firm	Local Subsidiary	Int'l Lending Agency
Exposed assets	Resources for FDI including physical, human, capital and technological assets	Loans
Exposed period	Long-term	Short or medium-term
Types of risk	Expropriation, Confiscation, For. exchange control, Kidnapping, Local contents requirements, Tax discrimination	Default, Renegotiation of loan, Change in terms of loan
Impact of risk	Cash flow, and operational risk	Profitability of financial assets
Hedging means	FDI insurance, International Business Diversification	FDI insurance, Lending diversification

⊙ Political Risk

- Any governmental action, politically motivated events, or political climate change that affect the operations (or investment value) of a firm (non-market actors: gov't, gov't agencies, SOEs, NGOs)
- Uncertainties caused by political, social, and economic instabilities, expected or unexpected (market and non-market environments)

Leading Sources of Political Risk

- Expropriation or nationalization
- International war or civil strife
- Unilateral breaches of contract
- Destructive governmental actions
- Harmful actions against people
- Restrictions on the repatriation of profits
- Discriminatory taxation policies

Political Risk Types

- Macro vs. Micro
- Politically motivated government actions, War and terror (Events), Economic factors, or Social factors
- Inside vs. outside Korea

V. Measurements of Country and Political risk of Korea

OECD Country Risk Classification

-A composite index based on a quantitative assessment of credit risk and a qualitative assessment of political risk.

Table 2.5 Selected OECD Country risk classification(1999-2006) (scale:0-7; 0 lowest risk, 7 highest risk)

Country	1999	2000	2001	2002	2003	2004	2005	2006
Argentina	5	6	6	7	7	7	7	7
Australia	0	0	0	0	0	0	0	0
Brazil	6	6	6	6	6	6	5	4
Canada	0	0	0	0	0	0	0	0
Chile	2	2	2	2	2	2	2	2
China	2	2	2	2	2	2	2	2
Egypt	4	4	4	4	4	4	4	4
France	0	0	0	0	0	0	0	0
Germany	0	0	0	0	0	0	0	0
Hong Kong	2	2	2	2	2	2	2	2
India	3	3	3	3	3	3	3	3
Indonesia	6	6	6	6	6	6	5	5
Japan	0	0	0	0	0	0	0	0
Korea	0	0	2	2	0	0	0	0
Malaysia	3	2	2	2	2	2	2	2
Mexico	4	3	3	3	3	3	2	2
Philippines	3	3	4	4	5	5	5	5
Russia	7	7	6	5	4	4	4	4
Singapore	0	0	0	0	0	0	0	0
Taiwan	1	1	1	1	1	1	1	1
Thailand	4	3	3	3	3	3	3	3
Turkey	5	5	6	6	6	5	5	5
UK	0	0	0	0	0	0	0	0
US	0	0	0	0	0	0	0	0
Vietnam	6	6	6	5	5	5	5	5

Source: OECD (2007b)

V. Measurements of Country and Political risk of Korea

Country Risk by the Belgian Export credit Agency

-Focusing on payment defaults and losses of assets by war, expropriation and intervention

Table 2.6 ONDD risk ratings(January 2007)
(scale:1-7, 1 lowest risk, 7 highest; and A-C, A lowest risk, C highest risk)

Country	Export transactions				Direct investments		
	Political risk: short term	Political risk: long term	Political risk: special trans	Comm. risk	War risk	Expro-priation and inter-vention risk	Transfer risk
Argentina	3	7	4	C	2	3	6
Australia	1	1	1	B	1	1	1
Brazil	2	4	3	B	1	2	4
Canada	1	1	1	A	1	1	1
Chile	1	2	1	A	1	1	2
China	1	2	1	C	3	4	2
Egypt	2	4	2	C	3	4	3
France	1	1	1	A	1	1	1
Germany	1	1	1	A	1	1	1
Hong Kong	1	2	1	A	2	1	2
India	1	3	2	B	2	3	3
Indonesia	2	5	3	C	2	4	4
Japan	1	1	1	A	2	1	1
Korea	1	1	1	A	3	1	1
Malaysia	1	2	1	B	1	2	2
Mexico	1	2	1	B	2	1	2
Philippines	2	5	3	B	3	4	4
Russia	2	4	2	C	3	4	3
Singapore	1	1	1	A	1	1	1
Taiwan	1	1	1	B	2	1	1
Thailand	1	3	1	A	3	3	2
Turkey	3	5	3	C	2	2	4
UK	1	1	1	A	1	1	1
US	1	1	1	A	1	1	1
Vietnam	2	5	3	C	4	6	5

Source: ONDD (2007b)

V. Measurements of Country and Political risk of Korea

World Bank Worldwide Governance Indicators

-Measure across six indicators that are directly and indirectly related to country and/or political risk from business perspectives

**Table 2.7 World Bank worldwide governance indicators, Korea(1996-2005)
(percentile rank 0-100)**

Indicator	1996	1998	2000	2002	2003	2004	2005
Voice and accountability	67.3	66.7	67.6	68.6	66.2	70.0	68.1
Political stability	40.6	43.4	51.9	54.7	51.9	61.8	60.8
Govt. effectiveness	77.6	70.8	76.1	81.3	79.9	78.5	78.9
Regulatory quality	72.1	53.7	67.5	74.9	70.9	73.4	71.8
Rule of law	78.0	71.6	67.8	75.0	67.8	69.2	72.5
Control of corruption	76.6	64.2	67.2	67.2	64.2	59.3	69.0

Source: World Bank (2007)

V. Measurements of Country and Political risk of Korea

World Bank Worldwide Governance Indicators

Table 2.8 World Bank worldwide governance indicators: seven-year averages(1996,1998 and 2000-05) (percentile rank 0-100)

Country	Voice and accountability average (1996–2005)	Political stability average (1996–05)	Government effectiveness average (1996–05)	Regulatory quality average (1996–05)	Rule of law average (1996–05)	Control of corruption average (1996–05)
Argentina	58.2	41.2	56.6	44.8	42.8	42.8
Australia	96.5	81.5	94.2	94.2	95.6	94.4
Brazil	58.2	39.6	54.9	57.7	46.8	56.2
Canada	91.9	83.0	96.1	91.0	94.5	95.7
Chile	76.1	70.1	87.6	91.0	86.3	89.1
China	7.7	40.7	60.2	41.4	42.6	43.9
Egypt	21.3	27.6	50.6	39.6	55.6	50.0
France	87.9	67.2	91.0	81.9	90.0	90.3
Germany	92.8	78.5	92.5	90.7	93.9	93.5
Hong Kong	50.0	77.2	90.0	97.5	89.9	91.3
India	55.5	19.3	52.5	38.6	55.6	46.4
Indonesia	28.7	9.0	39.5	36.3	21.4	15.8
Japan	77.7	83.3	85.6	78.1	90.2	85.9
Korea	67.8	52.2	77.6	69.2	71.7	66.8
Malaysia	40.1	57.3	78.6	68.2	67.4	68.7
Mexico	50.1	36.1	60.7	67.0	43.4	45.5
Philippine	52.3	24.4	58.1	56.8	40.2	39.0
Russia	32.6	21.2	33.9	32.9	20.6	21.9
Singapore	47.5	87.5	99.4	99.4	96.7	98.8
Taiwan	70.5	67.9	86.4	82.2	78.1	75.5
Thailand	51.7	43.3	65.6	62.8	59.1	47.8
Turkey	35.9	18.7	56.6	61.4	55.0	52.8
UK	92.2	69.2	96.3	97.0	94.7	95.4
US	90.1	63.3	93.0	92.7	92.5	92.5
Vietnam	7.9	55.1	46.0	26.1	33.1	27.3

Source: World Bank (2007)

VI. Conclusions

Conclusion

- Political risk is increasingly important for international business
- It includes external conflicts, political stability, government intervention in business operations and social stability
- The political situation in Korea has undergone fundamental changes
- Based on several indicators, the political risk in Korea is quite low



- Korea is a reasonably safe country in which a firm can do business
- Serious military conflicts between the two Koreas are unlikely, isolated conflicts are likely though
- Political risk and intervention in business operations are not causes for serious concern

KOREA



Q&A