OPINION

Korea's Costly War on Conglomerates

[Business Asia]

BY RAPHAEL AMIT

Rarely have large South Korean companies faced as much political blowback as they do right now. As South Korea's December presidential election approaches, candidates, the media and the public are decrying *chaebols*, the large, mostly family-owned conglomerates at the heart of the country's economy. All three presidential candidates have embraced the concept of "economic democratization" as a way to boost employment, reduce income inequality and spread wealth. But this populist movement would have precisely the opposite effect.

With the economy slumping, it's not surprising political arrows are targeting chaebols. After all, the eight largest conglomerates account for about two-thirds of Korea's economic output. Once lionized, chaebols now are castigated for having amassed far too much power, contributing to the yawning abyss that separates the ultra-wealthy from the remainder of Korean society.

So front runner Park Geun-hye of the New Frontier Party promises her version of economic democratization will usher in an "era of grand national unity," in part, by challenging the chaebols her father, President Park Chung-hee, helped to create. Ms. Park is pushing for tougher enforcement of the law assuring a fair market economy, as well as regulation limiting chaebols from issuing new shares to expand their cross-ownership of businesses.

Both her competitors favor new regulation to restrict all kinds of cross-shareholding arrangements that allow chaebols to grow quickly. Former human rights lawyer Moon Jae-in, running on the Democratic United Party's ticket, also wants to raise corporate taxes and pledges to protect "mom-and-pop stores" by banning chaebols from some industries.

Independent presidential candidate Ahn Cheol-soo, a political rock star among South Korean youth, declares the nation "needs a new economic model" that would expand welfare and provide for sustainable economic growth.

Nor are politicians alone: Courts and prosecutors also are getting in on the anti-chaebol act. Hanwha Chairman Kim Seung-youn, a leader in solar energy innovation, was recently imprisoned by a Seoul court before given the opportunity to appeal his conviction on financial impropriety charges, a rare judicial decision.

But politicians and voters must remember South Korea's economy is unique. Chaebols were responsible for rapidly pulling the nation out of the rubble of the Korean War and to the forefront of industrial development. The model continues to work today, and should for the foreseeable future. Chaebols are the reason consumers across the globe drive Korean cars (Hyundai and Kia); launder their clothes in Korean washers and dryers (LG, Samsung); watch Korean flat screen TV's and inform and entertain themselves with Korean smartphones (Samsung); and warm their homes and offices with Korean solar panels (Hanwha).

> Politicians have targeted the mighty *chaebols*, but the firms remain central to growth and innovation.

The contrast is often drawn between chaebols in Korea and entrepreneurs in the West. Yet there is no legendary garage in the Seoul suburbs where two young entrepreneurs emulated the success of Apple's Steve Jobs and Steve Wozniak. Korea lacks a rich tradition of entrepreneurs who put their own capital and careers on the line in pursuit of radical innovations, particularly since Korean culture discourages risk taking, assigning a steep social cost to failure, which, of course, is the most common result for entrepreneurs.

In this environment, innovations, which are the cornerstone of social and economic prosperity, come primarily from large enterprises. Chaebols are the risk-takers, a fact I witnessed firsthand as chairman of the advisory board of a South Korean venture capital firm. Chaebol leaders time and again have made bold business decisions backed by substantial capital and strong organizations. Start-ups don't have access to the same resources.

Rather than threatening small enterprises, chaebols deliver income to their millions of employees who then spend that money, in part with neighborhood retailers and other small firms. That helps explain why the model has been so durable—and why it continues to work today.

Despite recent economic stresses, unemployment in South Korea is relatively low, at 3.1% as of August. In the face of a global slowdown triggered largely by European debt worries and a sputtering China, South Korea's export-driven economy continues to deliver growth, which the International Monetary Fund forecasts at 2.7% for 2012.

As they provide for South Korea, chaebols already confront substantial restrictions to expanding the breadth of their business holdings. In contrast to Japanese *keiretsu*, chaebols aren't thoroughly bound up in the financial system. This prevents improper or easy credit guarantees. Under the Korean Banking Act they are limited to owning no more than 9% of financial institutions. As a result, foreign investors with no national ties to chaebols hold a majority of the shares in major Korean banks.

The Fair Trade Act also imposes cross-ownership restrictions governing relationships among chaebols. Proper enforcement of these regulations is all that's needed to prevent chaebols from gaining unfair competitive advantages and should address public concerns about the family-owned firms.

For the good of South Koreans and the nation's prosperity, the politically motivated assault on chaebols should be put to rest. The presidential candidates, in their effort to win election are threatening to kill the goose that continues to lay South Korea's golden eggs.

Mr. Amit is the Robert B. Goergen Professor of Entrepreneurship at the Wharton School of the University of Pennsylvania.

Fishing for Trouble in Iceland

BY BRIAN M. CARNEY

Reykjavik, Iceland

Four years ago, this remote country on the edge of the Arctic Circle became the most spectacular casualty of the 2008 global financial crisis.

Practically overnight, Iceland's banking system collapsed, taking the currency and much of the rest of the economy with it. The krona plunged by some 75% in a matter of days before it essentially stopped trading altogether. The country's three large banks, which had between them borrowed the equivalent of many times Iceland's annual economic output, imploded as money rushed out of Iceland even faster than it had poured in during the boom years.

> Reykjavik is on a collision course with the country's most important industry.

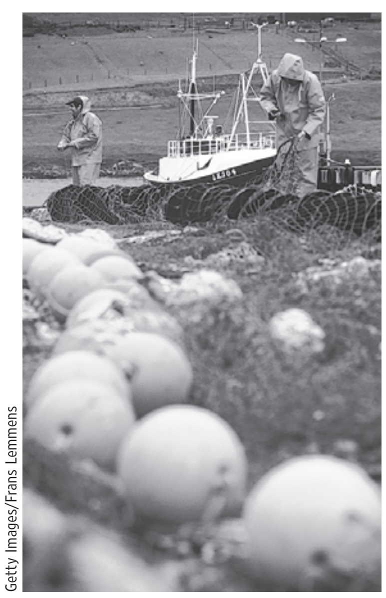
By the middle of 2009, it no longer felt like hyperbole to suggest that Iceland, economically at least, could sink beneath the waves altogether. The krona was on a fast track to worthlessness. International creditors, including the governments of Britain and Holland, were demanding huge sums that Iceland patently did not have in recompense for losses suffered when the banking system fell apart.

But in the past couple of years, Iceland has staged a recovery of a sort. Unemployment is down to nearly 5%, although work-force participation isn't what it was in the boom years, and there's been some emigration from the population of 320,000. After shrinking 6.6% in 2009 and 4% in 2010, Iceland's economy grew 2.6% last year and could hit 3% this year.

The rebound is in no small part thanks to the business that has been the island's mainstay for a millennium—fishing. Fish account for more than 40% of Iceland's total exports.

What's more, fishing in Iceland is profitable. It wasn't always so. In the 1970s, Iceland's fish stocks were collapsing, and the industry in trouble. But starting in the late '70s and '80s, the government in Reykjavik introduced a kind of property right into its fisheries, called an individual transferable quota, or ITQ.

The quotas represent the right to take a percentage of the total allowable catch set by the government. And these quotas can be bought, sold and borrowed against. ITQs have become a valuable asset in their own right, and have allowed the owners of these fishing rights to rationalize their operations, increasing productivity and profits in a business long plagued by overcapitalization and poor returns.



Getty Images/Frans Lemmens

Icelandic fishermen at work.

In fact, Iceland's fishing-rights system has been so successful that, in its own way, it helped contribute to the country's financial boom: The strength of its fishing industry helped the country earn the triple-A credit rating that in turn allowed its banks to set off on the unprecedented global expansion that ultimately ended in the 2008 bust. The fishermen themselves also poured their money into (bad) investments in the boom years, helping to stoke the Icelandic bubble.

Those banks are now shadows of their former selves, but the fishermen are still here. This is where the saga takes a dark turn, however. In the wake of the financial crisis, the government of the time was swept aside in favor of a left-wing coalition that has made it its mission to undermine the property-rights system that has served the country so well—and has helped it recover from the crash. It has put forward legislation to restrict the buying and selling of quotas, and to allocate more of the catch rights politically.

There are many reasons for this antagonism toward the current system. Opponents argue that the fisheries belong to the nation and should never have been "privatized." They claim the original recipients of the quotas in the 1980s didn't pay for them and therefore received an unwarranted windfall.

There is also a kind of class warfare argument at work: The most successful fishing companies have reinvested their profits by buying out others' quotas, leading to an industry increasingly concentrated in a few hands. This has led to calls in Iceland for some way to redistribute those fishing rights to those shut out of the industry and unwilling or unable to pay the market rate for gaining access.

The waters around Iceland may belong to the nation, or to no one. But no one disputes that when the right to fish them was unrestricted, the fishermen nearly fished themselves out of their heritage altogether. The ITQ reforms came in after fishing stocks collapsed in the 1970s. Up to that point, the fishermen were spending more and more to catch less and less. They were headed for a crash of their own.

Today, fish exports are a precious source of foreign exchange for a country that, four years after the crisis, still imposes draconian currency controls on its population to keep the krona from falling further. Even families wishing to take a vacation abroad must seek permission to get the dollars or euros they need for their trip.

This country, with a population about equal to Malmö, Sweden, is one of the top-20 fishing nations in the world. Undoing the reforms that saved Iceland's fisheries, at a time when the country is still recovering from the worst economic shock in its long history, smacks of economic suicide. And yet the government in Reykjavik, it seems, would rather pursue some ideal of redistributive justice, even if it damages a fragile economy.

Mr. Carney is editorial page editor of The Wall Street Journal Europe.

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