



Consolidation of the Developmental State and Chaebols in Korea: After the 1997 Economic Crisis*

Min-Ho Kuk

Chonnam National University

The developmental state and chaebols as two important institutions for the Korean economic development were criticized as the main culprits of the Korean economic crisis in 1997. The Korean government and the IMF saw the Korean economic crisis as the problem of the inner social structures. They tried to reform these two institutions to recover the Korean economy. They also tried to end the rule of the developmental state and dismantle chaebols. But the Korean economic crisis was actually caused by the economic cycle of the world economy. The Korean economy recovered when the problem of the foreign debt crisis was solved without changing the developmental state and chaebol system. The two institutions persisted after the reform and even became stronger. These institutions were too strong to be reformed by the reform efforts of the government. The persistence of these institutions can be explained well by the path dependency theory.

Keywords: developmental state, chaebol, institutions, economic crisis, path dependency theory

INTRODUCTION

The popular view of Korean society and the IMF's suggestion immediately after the Korean economic crisis in 1997 were focused on the reform of internal structural factors such as abandoning industrial policies of the state and dismantling chaebols. This is because the key mechanisms of the developmental state as the Korean development model were the industrial policies of the state and the chaebol-centered economy.

In actuality, the Korean developmental state played a crucial role in achieving the rapid economic development of the past several decades. The developmental state that led the

* The author thanks three anonymous reviewers of KJS who gave valuable comments. This paper revised the paper originally presented at the 2009 International Workshop of the Research Institute of Asia and Pacific Rim at Chonnam National University. Direct all correspondence to Min-Ho Kuk, Department of Sociology, Chonnam National University, Buk-gu, Gwangju, South Korea 500-757 (E-mail: mhkuk@chonnam.ac.kr; Telephone: 82-62-530-2645).

Korean industrialization in the 1970s and 1980s was characterized by autonomous state bureaucracy and economic intervention of the authoritarian government. It pursued the market economy through market-oriented industrial policies. The state established long-standing economic plans, selected target industries, controlled financial institutions and financed the selected enterprises, directed or allocated credit, distorted the market price, presented strong export incentives and selective import liberalization, suppressed workers, and so on (Amsden 1989; Chu 2009; Deyo 1987; Haggard 1990; Hughes 1988; Johnson 1982; Wade 1990). The state enhanced 'the productive powers of the nation' and narrowed 'the technology gap' between Korea and the already industrialized countries. It could use both 'an elite bureaucracy staffed by the best managerial talents' and 'a supportive political system.' The bureaucratic elites, who were relatively free from any of the social pressures, could effectively carry out the planned industrial policies. Also, there was an 'institutional government-business cooperation' (Weiss 2000: 23).

However, on the other hand, the optimistic role of the state was undermined by the negative effects of state activism, such as the creation of inefficient industries and the escalation of rent-seeking activities. The long history of the anti-democratic policies of the authoritarian military regime stained the positive image of the economic success of the developmental state. From a negative view point, people saw chaebols as largely responsible for Korea's woes. It included 'excessive borrowing' from finance, 'non performing investment, non transparent and at times misguided management, the illegal accumulation of wealth by the owners, and the obstruction of reform' (Cherry 2005: 320-328). This view created a widely shared public opinion after the economic crisis in 1997 that economic recovery was inconceivable without the radical reform of chaebols (Mo and Moon 2003: 127).

The role of resource distribution of the state was thoroughly dependent on government-led industrial policies, which pursued export-oriented economic strategies and concentrated capital with the export-oriented industrialists in the name of 'export loans.' The export-oriented industrial strategy of the developmental state pursued 'economies of scale' to cope with the international competition. Such a strategy of economies of scale was further extended with the government's distorted resource distribution and eventually created big business conglomerates, so-called chaebols. Chaebols worked as a growth engine and grew big enough to compete in the international market.

But the government's economic favor inflated the size of chaebols without the parallel development of substantiality and soon chaebols became an economic monster with a huge debt ratio. In the 1990s, chaebols grew big enough to lead the Korean economy and to control the overall Korean economy. Thus, when some chaebols were bankrupted in the middle of the 1990s, the national economic crisis followed. When the economic crisis abruptly hit Korea in 1997, many people thought that the social ills of chaebols and the developmental state were the main culprits of the economic crisis, and tried to solve the derived problems by minimizing

economic intervention of the state and dismantling chaebols. In this way, many Koreans saw that the main cause of the Korean economic crisis was the structural problems derived from the developmental state. The IMF's view on the Korean economic crisis was not so much different from the general public's view. Only few raised objections against this perspective (Shin and Jang 2004).

As a result, people asked questions if the developmental state itself was really the main cause of the Korean economic crisis in 1997. Many of the critical studies following the general public view argued that internal structural factors such as the wrong industrial policies of the developmental state, including the creation of chaebols and the over-economic intervention, were the main causes of the Korean economic crisis, and, thus, presented the dismantlement of chaebols as a solution to recovery (Kang 1998; D. H. Kim 2002; Kim and Kim 1999; K. W. Kim 2002).

Today, more than a decade later, Korea has successfully recovered from the economic crisis and became leading country in the world economy. At this point, we can ask some questions. How much have the internal structural factors, which were criticized by the public as the main culprit of economic crisis, been changed since the economic crisis? How many big chaebols have been dismantled since the chaebol reform policy of the Kim Dae-Jung government? As we all know, most chaebols have not been dismantled. Rather, chaebols' economic performance has been even greater, and their socio-economic status has become stronger. Chaebols have played an even more crucial role than ever. Nowadays the top four chaebols dominate various high-tech industries and lead the export-oriented Korean economy. They are the leading group of the Korean economic development and have achieved the international reputation as world leaders in the high-tech industries. How can we explain this recent trend of economic dynamics and the astonishing economic achievement of chaebols? Is it the result of chaebol reform or is it related to the leading role of the state in the name of the post-developmental state? Have chaebols already developed into international powers uninfluenced by the government's reform policy? If so, how can we explain the current state-chaebol relationship?

Korea was one of the poorest countries in the world in the early 1960s when Korean industrialization began. The rapid economic growth during the last several decades has turned Korea into one of the world's economic powers. How can Korea achieve such great economic success within a short period of industrialization? Many of the scholars agree that the developmental state played a crucial role in the economic success of Korea within such a short period.

In this paper, I will explore how much the developmental state in Korea has changed since the 1997 economic crisis. I will also reconsider the role of chaebols before and after the economic crisis. I will try to show that the Korean state still has an important role in economic decision making and also that the fundamental relationship between government and chaebols has not changed drastically even after the economic reform.

THEORETICAL CONSIDERATION

When the economic crisis hit Korea in 1997, the Korean government thought it was time to transform its long-standing inefficient economic structure through economic reform. The progressive reformers thought the main culprits of the Korean economic crisis were the inefficient industrial policies of the developmental state and the economic monopoly of chaebols. The Kim Dae-Jung government tried to reduce the political power of the state to intervene arbitrarily in the economic decision-makings and to reduce the economic power of chaebols by dismantling the chaebol structure.

What was the result of the economic reform? Even though there was partial success in the economic reform process, there was not a fundamental change in the economic structure itself. The government still intervenes in various ways in the economic decision-makings and chaebols have expanded their influence in the society by increasing the size and the number of affiliated companies. Nowadays chaebols dominate the Korean economy more than ever. Also, the Korean economy itself developed and expanded more than ever even though the economic reform was not entirely succeeded. How can we explain the continuity of the developmental state and the existence of the more strengthened chaebols even after the government's reform efforts?

One way to explain the continuity of the previous internal economic structure despite the government's strong reform efforts is path dependence. Path dependency theory provides an explanatory framework appropriate for explaining why the reform was unable to obtain the expected results and why the existing social structures persist even after the change of the political and economic conditions.

Although we are not able to demonstrate why path dependency patterns merit special attention, path dependence can be defined vaguely as "history matters" or "the past influences the future" (Mahoney 2000: 507). That means the relevant previous events in history influence future ones in a temporal sequence. Here, contingent events work as institutional patterns that have deterministic properties. Thus, path dependence involves "both tracing a given outcome back to a particular set of historical events and showing how these events are themselves contingent occurrences that cannot be explained on the basis of prior historical conditions" (Mahoney 2000: 507-8).

Within the framework of path dependence, there are two dominant types of sequences. One is "self-reinforcing sequences" such as "increasing returns." With increasing returns, once an institutional pattern is adopted it delivers increasing benefits with its continued adoption and becomes difficult to transform the pattern time by time. The other is "reactive sequences," which are chains of temporally ordered and causally connected events. The sequence is partly a reaction to temporally antecedent events, dependent on the prior steps. Here, the historical

event that sets the chain into motion must have properties of contingency. This approach focuses on particular outcome, temporal sequencing, and the unfolding processes over long periods of time (Mahoney 2000: 509).

Mahoney presented some defining features of path dependence. Path dependent analyses are highly sensitive to events that take place in the early stages of an overall historical sequence. The early historical events are contingent occurrences that cannot be explained on the basis of prior events or “initial conditions.” Once contingent historical events take place, path dependent sequences are marked by relatively deterministic causal patterns or what can be thought of as “inertia,” which produce a particular institutional pattern over time (Mahoney 2000: 510-11).

Path dependence analysis can enhance its explanatory dynamics with the concept of “increasing returns.” Increasing returns is, as mentioned above, a self-reinforcing process. The process of increasing returns applies to the persistence of a broad range of social and political institutions. Institutions are understood as enduring entities that cannot be changed instantaneously or easily (Mahoney 2000: 512). When small events are continued and remembered, the outcome will be locked in. Certain events down to a particular path may eventually “lock in” as a solution (Pierson 2000: 253). If the reproduction mechanisms lock in a given institutional pattern, it is extremely difficult to abolish or transform the existing institution (Mahoney 2000: 515). Thus, the costs of switching institutions from one to another will increase markedly over time (Pierson 2000: 251).

Path dependency perspective argues that a long movement down a particular path will increase the costs of switching to some previously foregone alternative. It rests on a conception of historical causes. Some original movement triggered particular returns, and the activity is continuously reproduced even though the original events no longer occur (Pierson 2000: 263). The necessary conditions for current outcomes occurred in the past. Thus, structural factors once constructed in times past have already influenced the political policies and economic decision-makings of today. The choice of the policy makers is greatly limited or influenced by the norms and habits institutionalized in the historical process. Increasing returns and reactive chains make it really hard to change or transform the existing institutional or structural framework.

The concept of path dependence provides a useful analytical framework to explain why the fundamental structures in Korea such as the developmental state and chaebols did not change so much in spite of the strong reform drive of the Kim Dae-Jung government and the IMF. The developmental state in Korea was established during the Park regime. These two institutions were established contingently under the Park regime, and self-reinforced sequentially. Many scholars and politicians predicted the death of the developmental state several years before the economic crisis in 1997, but the traits of the developmental state persisted in the reconfigured form (Chu 2009). Also, in spite of the hard drive to reform chaebols, the main traits of chaebols

were too strong to be changed by the reform efforts of the new government. Furthermore, the Kim Dae-Jung government could not have overcome the transaction cost that might have happened by dismantling the chaebol system. Rather, the chaebol system became more stable and stronger after the economic crisis. Path dependence provides a good theoretical tool to explain why these institutions were able to persist and become even stronger despite the strong reform drive of the new political regime.

THE TRUE CAUSES OF THE KOREAN ECONOMIC CRISIS

Those who see the internal structural factors as the main cause of the Korean economic crisis argue that the Korean economic crisis was an inevitable result of the inefficient and corrupt internal economic structure. They put the government-led economic system and its inefficient industrial policies at the center of the problem. They criticized the fact that the Korean government poured huge amounts of public loans into chaebols to develop the target industries. State-controlled banks loaned money to chaebol companies without strictly investigating the companies' financial structures and management situations instead they simply followed (or obeyed) the government's orders. They argued that it caused the moral hazards of chaebols, and it made both chaebols and the banks insolvent (W. S. Kim 1999: 264-266). Thus, the irresponsible chaebol economy that was created by the state's favors developed into an uncontrollable monster with a huge debt ratio (Kang 1998: 62).

The long-standing authoritarian military regime in Korea resulted in people having an anti-government attitude. When the economic crisis hit Korea, Koreans still had a strong anti-government feeling that had originated from the authoritarian military regime. They directed all their anger and negative feeling towards the Park regime (1962-1979), especially against the developmental state and chaebols. The IMF's view on chaebols was not so different from the public view at that time, and new president Kim Dae-Jung, who had a strong anti-chaebol feeling, also had the same attitude. Thus, the IMF and the new government's solutions were focused on dismantling the chaebol structure and weakening the role of the state in economic decision-makings.

The initial IMF reform program relied on the typical ideas of neo-liberalism. It was based on the assumption that the Korean economic crisis was caused by the internal structural problem of the economy. Thus, it claimed to reform both the domestic industrial structure and financial institutions. If that was the case, what was the specific IMF program to solve the Korean economic crisis? The IMF's program was composed of three elements. They were long-term economic retrenchment, market liberalization, and structural reform. Long-term economic retrenchment forced high interest rates and a reduced budget policy. Market liberalization led to the abolition of trading subsidies and the complete removal of import

barrier. Additionally, the abolition of the upper limit of foreign ownership of domestic stocks and the complete opening of the bond market followed. The newly established Financial Supervisory Commission (FSC) applied the BIS (Bank for International Standard)'s capital-adequacy requirements and required banks to submit restructuring plans. Chaebols were forced to reduce the debt-equity ratio up to two hundred percent and to stop intra-group mutual payment guarantees. Labor also agreed to follow the more permissive rules on layoffs and the employment of temporary workers.

However, the direct adoption of the rule of neo-liberalism without consideration of the Korean economic situation forced the Korean economy to go deeper into its quagmire. This IMF program retrogressed the resurrection of the Korean economy, which was already in big trouble. The stabilization policy and structural reform policy worsened the Korean economy rather than help it to recover the credit. Adding to the structural problem, the execution of the reform program emphasized by the IMF had compromised the international confidence for the Korean economy and caused the evasion of the foreign direct investment by changing that the Korean economic crisis was caused by the insolvency problem not by lack of liquidity. It deteriorated the Korean economic situation. The high interest rate policy following the IMF advice increased bankruptcy of industries and amplified economic insecurity. The devaluation of Korean money continued, and price of the Korean stocks plummeted.

The Korean economic crisis was barely settled by the extension of expiration of short-term foreign debt with the help of the Treasury Department of the United States. At last, IMF recognized that it was needed to change the IMF policy to recover the Korean economy.

The Korean economic recovery began just right after IMF had changed attitudes on the Korean macroeconomic policy. IMF accepted the Korean government to change the macroeconomic policy totally and to choose the package of comprehensive Keynesian economic policy. Now, again, the government began to intervene in the economic activities. The Korean government reduced the interest rate dramatically, presented safety-net to the unemployed workers through the deficit finance policy, and supplied public loans to banks more than the need of the foreign investors. Korean banks were recovered from the insolvency problem with this policy and could extend the maturity term of the industrial sector. Now, banks could augment loans to companies without worrying too much of the bankruptcy of the companies. From that time on, the Korean economy could recover from the shock of economic crisis. In this way, Korean economic recovery was practiced once again by the strong government intervention in the economic activities.

Thus, we can say that Korean economy could be recovered not by the IMF program but despite the IMF program. IMF program at that time was symbolized as the execution of Washington consensus, or as an advanced guard point of neo-liberalism. As soon as the Korean economy was recovered, foreign capital returned. Foreign capital was reinvested in Korea because the outlook of the Korean economy was bright through the recovery of the Korean

economy. When we see the inflow of foreign direct investment, it was 6.9 billion dollars in 1997, the year of economic crisis, and 8.8 billion dollars in 1998. But it increased greatly to 15.5 billion dollars in 1999 (Shin and Jang 2004: 107).

On the other side of the fault of the IMF program, people thought that government's inefficient industrial policy was one of the main problems for the Korean economic crisis. They believed that the government's financial control brought the cozy relationships between politics and business, which led huge amount of public loans to be invested to chaebols. It caused moral hazards of chaebols, Chaebols' over- and duplicated-investment caused by over-competition made many of the companies to be bankrupt and the financial sector to be insolvent. Thus, the government-led industrial policy was thought to be the major factor of the Korean economic crisis (W. S. Kim 1999: 264-266).

The typical word to explain the moral hazards of chaebols is "too-big-to-fall." But the idea of "too-big-to-fall" in Korea should be interpreted differently than those which usually being thought of. Generally, the relief of companies in terms of "too-big-to-fall" means the relief of the owners or the managers of the companies who made the company to be insolvent. But most the cases in Korea it came together with the change of the owners and managers in the company. In 1997, the year of the Korean economic crisis, six of the top thirty chaebols defaulted. They were Kia, Hanla, Jinro, Hanbo, Sammi and Haitai. The Korean government invested huge amounts of money to relieve the insolvent companies in trouble by using state-controlled banks. But the investment was performed under the premise of the replacement of the owners and managers of the chaebol in trouble. There were no exceptions. The target of relief was the company itself, not the relief of the owners or managers (Shin and Jang 2004: 87-91).

On the other hand, no industrial policies were executed in Korea during the four years before the economic crisis in 1997. After the assassination of President Park in 1979, the power of the Department of Commerce and Industry, as the major institution for industrial policy, weakened drastically. Soon after, the technocrats of the Economic Planning Board (EPB), as representatives of the neo-liberal economy in the 1980s, led the post-Park industrial policies. Industrial policies of the Korean developmental state began to change from that point forward (H. A. Kim 2005: 344-350). At the end of 1980s, almost all industrial policies, except some areas which needed R&D funds for high-tech development, disappeared. The Kim Young-Sam government, which came to power in 1993, dismantled all the industrial policies and officially ended the 30-year old Five-Year Plan for Economic Development. With the dismantlement of the industrial policy, the generally known form of the developmental state in Korea officially ended. But the legacy of the developmental state could not be eliminated. It lurked behind the prosperity of the economic liberalization.

Thus, the argument that the industrial policy of the developmental state was the main cause of the Korean economic crisis is preposterous. The industrial policy of the developmental state

in Korea had already been stopped in 1993. The concept to be criticized in the process of the Korean economic crisis was not the industrial policy but the stoppage of industrial policy without any alternative plans.

How can we explain the Korean economic crisis in 1997? In my opinion, the Korean economic crisis was caused by the economic cycle of the world economy. The Korean economy started to face temporary trouble in 1996. One important problem of the Korean economy in 1996 was the trade deficit. The trade deficit in 1996 was 23.7 billion dollars, which amounted to 5 percent of the GDP. The trade deficit in 1995 was only 8.9 billion dollars. The rapid increase of trade deficit was due to the fall of the price of semiconductors and steel, as the major products for Korean export. But the reduction of exports led to the slowdown of imports, and thus, the current account deficit in 1997 was manageable. It was only 3 percent of the GDP in 1997 (Shin and Jang 2004: 71). Thus, the trade deficit itself was one of the prime causes of the Korean economic crisis in 1997.

The next aspect to be considered was the insolvency problem of several of the top thirty chaebols based on the total assets. The insolvency of Hanbo in January 1997 was related to the corruption network of the high ranking officials including the President's son, and the insolvency of Kia in June 1997 was caused by the frequent changes of policies in the process of transition from Kia to Samsung under the influence of the Kim Young-Sam government. The insolvency problem of these chaebols in 1997 was strongly connected with the corruption of the regime, the policy failure of the government, and the management failure of the companies.

In reality, the direct cause of the economic crisis in 1997 was the huge amount of short-term foreign debt, which increased dramatically within a short period. The total foreign debt of Korea increased from 44 billion dollars in 1993 to 120 billion dollars in 1997. The problem of the short-term foreign debt was the maturity structure. The portion of foreign debt which had less than one year maturity structure increased from 43.7 percent in 1993 to 58.3 percent at the end of 1996 (Shin and Jang 2004: 77). The three fold increase of the total foreign debt and the rapid increase in the portion of short-term foreign debt during the four years (1993-1997) were the main causes that changed the foreign debt crisis into the national economic crisis.

The Korean economic crisis started when foreign financial institutions rejected the extension of the maturity term of the short-term foreign debt. Thus we can say that the government failure of the financial policy was an important cause of the Korean economic crisis. In actuality, the government implemented some burdensome procedures to get permission from the Ministry of Finance and Economy for the long-term borrowing contract, but they did not make any restrictions to the short-term borrowing contract. This policy mistake induced the borrowers to resort to short-term borrowing to reduce the indirect fee (Shin and Jang 2004: 129). The rapid increase of the short-term foreign debt was due to the failure of the financial policy, not due to the inefficiency of the previous industrial policies of

the developmental state.

DEVELOPMENTAL STATE AND THE ECONOMIC CRISIS

Now we are wondering if the economic crisis was a problem that happened only to Asia. In reality, economic crisis in capitalist societies had already started in the early 1970s when a serious economic problem hit the manufacturing sector in the United States. It brought the collapse of the Bretton Woods Conference and GATT system which held up the postwar capitalist economic system. The change of the fixed exchange rate to the floating exchange rate predicted the prosperity of financial capitalism. Great Britain had already taken the relief loan from the IMF in the late 1970s. The economic crisis of the United States and Great Britain in the 1970s caused the momentum of the transformation of their economies to neo-liberal economies. They had become the leading countries of neo-liberalism. The other Western European countries also suffered from the high unemployment rate of young people and low economic growth rate caused by the over-expenditure on the welfare state in the 1980s. Japan jumped into a long-term economic depression when the economic bubble collapsed in 1990. The Japanese economic depression still continued even today. Central American countries such as Mexico had already experienced a crucial economic crisis in the early 1980s and still suffer from the periodical default crisis. The economic crisis of the socialist countries including Russia resulted in the collapse of the socialist system in the early 1990s. In this way, from the beginning of the economic crisis of the capitalist economies in the early 1970s, so many countries around the world had suffered from the worldwide economic crisis. It was accelerated with the development of neo-liberalism in the 1980s and 1990s.

Form this perspective, the economic crisis of Asia in 1997, which was highly influenced by the economic cycle of the world economy, seemed to be rather late in comparison to the crisis of other countries. It can be said that the developmental state's efficiency might have helped the Asian countries either not to fall into an economic depression or to delay their economic crisis until 1997. In the case of Korea, the efficiency of economic policy of the developmental state had helped the country to overcome its moments of economic crisis, such as the foreign debt crisis in the late 1970s and the financial support from the IMF in the early 1980s. As a result, it made the country stronger. Korea was soon ranked as approximately the 10th biggest economy in the world in the early 1990s.

It took only four years for the Korean economy to request relief loans from the IMF, since the Korean government gave up the developmental state policy in 1993. If we may agree that the economic crisis of Korea was due to the developmental state, how can we explain the rapid recovery of the Korean economy since 1998, just one year after the economic crisis? Korea was able to recover its economy within such a short period of time because the basic economic

fundamentals of the Korean economy were strong enough. Also, how can we explain the case of Taiwan, which was able to escape from the fever of the Asian economic crisis even though it still was a developmental state? And how about was China? China continued its rapid economic growth during the period of the Korean economic crisis. Both Taiwan and China were able to escape from economic crisis through the control of financial institutions by the state. At that time, in contrast, Korea had already liberalized its financial institutions, and the state gave up the control mechanisms. Thus, just before the economic crisis, chaebol companies and financial institutions in Korea were able to borrow huge amounts of foreign capital without any sanctions from the government.

Then how can we explain the relationship between the Korean economic crisis and the Korean developmental state? Actually, neo-liberalism began to develop dealing with the economic problems of the United States. After experiencing a big economic depression in the early 1970s, the United States changed its economic priority from industrial sector to finance, depending on the development of information-communication technology. The United States had invested huge amounts of money into the development of the IT sector in the early 1970s. In addition, the U.S. government forced the world to adapt the neo-liberal standard using its vast economic power and strong military background. Ever since, the naked economic principle of the survival of the fittest has become widespread in the world.

Some important principles of the developmental state survived until the early 1990s in Korea, and the Korean economy was effectively able to stop the spread of neo-liberalism. But since the collapse of the Soviet Union and other Eastern European Socialist countries in the early 1990s, the ideology of neo-liberalism became more widespread. The other economic systems soon became weakened. Welfare states of Western Europe, developmental states in East Asia, and socialism in Eastern Europe and Russia weakened rapidly. The developmental state in Korea was able to survive until the early 1990s, but it had to open its financial market by the attacks which came from outside. When Kim Young-Sam took power in 1993, the Five Year Plan of Economic Development, which had been intact since 1962, was abolished, and the Economic Planning Board, as the symbol of the developmental state, was integrated into the Ministry of Finance and Economy. The developmental state project in Korea ended formally in 1993.

From 1993-1997, the Korean economy experienced a period of chaos. The typical form of the developmental state flourished under the rule of President Park (1962-1979). However, after his assassination, it continually weakened year by year. After the Great Struggle for Democracy in 1987, the military regime itself became the number one target of criticism from the people's power. They tried to erase all the legacies of the authoritarian military regime in society. People thought that the developmental state and chaebols were the representative legacies of the authoritarian military regime.

Furthermore, the neo-liberalism-oriented economic bureaucrats who enlarged political

power pursued strong neo-liberal policies to open the economy and liberalize the financial market. Also, chaebols, equipped massive production facilities and achieved high-tech skills, was able to accumulate huge amount of capital and claim economic and financial liberalization. In the process, the government's role of surveillance and supervision of the economy weakened dramatically.

The success of the developmental state ironically led to the dismantlement of the developmental state (Yoon 2005). With the progress of democratization and globalization, the potential autonomy of the state weakened clearly and the society was changed into a place for struggle. Yoon presented the developmental states' 'grave-diggers' as the major power groups who dismantled the developmental state. They were the militant working class and civilian group, private capitalists including chaebols, and neo-liberal economic bureaucrats. They became the leading power groups that dismantled the developmental state by reducing the autonomy and cohesion of the state (Yoon 2005: 107-10). The state also played an important role by giving chaebols 'the wherewithal to get the state out of their hair' and by completely dismantling the EPB (Weiss 2000: 36).

Under pressure to alleviate the government's economic intervention and the cry of economic liberalization under Kim Young-Sam's populist regime, the government pursued economic and financial liberalization more resolutely. The fatal blow for the Korean economic crisis was financial liberalization without any control mechanisms. The Korean developmental state in the 1960s and 1970s was characterized as industrial capitalism, where the state established the prior target for the national economic development and used the financial institutions as a tool for the effective industrial policy. Under the developmental state regime, an elegant and elaborate financial system could not develop. The developmental state was an economic system depending on strong fundamentals, where the development of elaborate financial institutions lagged far behind.

When the Korean government tried to end the developmental state and actively join the neo-liberal economic system, the most important thing to be considered was the establishment of a strong surveillance and supervision mechanism to control risks that might occur in the process of financial liberalization and foreign capital inflow. In reality, these needs had been presented constantly under the Kim Young-Sam regime. But the Kim government was more concerned with distancing itself from the previous authoritarian regime's policies by ending the Five Year Plan of the Economic Development and the abolition of the Economic Planning Board rather than strengthening the control mechanism to deal with the problems occurring in the process of economic and financial liberalization. Also, the Kim Yong-Sam government was concerned more piling up achievements of the regime such as joining the OECD Club. The Kim government was indifferent to financial policies to control or regulate financial institutions, which chaebols would have disliked. The government bureaucrats closed their eyes and ears to the side-effects that could have occurred in the process of economic and

financial liberalization. They lost their eyesight to the rosy fantasy of joining the OECD Club and achieving concomitant positive globalization effect.

Here, we can say that the Korean economic crisis of 1997 was not caused by the developmental state but by the government's policy failure which could not cope pertinently with globalization and the concomitant financial liberalization. The Korean economic crisis came not from the developmental state but from the result of the naive economic policy of the neo-liberalism-oriented government which pursued economic and financial liberalization being spurred on by the rosy fantasy of globalization without developing a counter plan.

CHAEBOL REFORM AND THE ROLE OF CHAEBOLS IN THE KOREAN ECONOMIC DEVELOPMENT

Now, let us to examine the process of chaebol reform. How did chaebol reform work after the economic crisis? Before going further, we briefly discuss the Korean chaebols.

The term chaebol is used widely in Korea without any clear definition. The literal meaning of chaebol is 'financial clique' (財閥). But the term is generally used as 'big private companies' or 'those who run these large private companies.' Sometimes it is used to indicate economic elites, large industrialists, large capitalists and so on (Kuk 1988: 108). Thus different definitions are possible according to how we use the term. In many cases, we define and select top-ranked chaebols by using 'total assets' or 'total sales.'

The number of chaebols whose total assets were more than one billion won in 1982 were 217, and more than one hundred billion won were just 56. In the early 1980s, because of the conceptual ambiguity of chaebols, many considered only the top 50 chaebols ranked by total sales or total assets as the representative samples of large private companies. In 1987, the government appointed 33 big private enterprises as chaebols whose total assets were more than 400 billion won. But the numbers increased to 78 in 1992. Since 1993, the Fair Trade Commission has appointed the top 30 chaebols with total assets (Song and Lee 2005: 45-46).

Chaebols are a very unique organization that could develop only in Asian culture. Typically the entrepreneurial founder establishes one company and leaves its management to direct family members as he moves on to a new venture. Each chaebol has few core companies at the center controlled by the founder himself and his direct family members, and each of the core companies usually owns further percentages of equity of many subsidiary companies. Each chaebol appears as a big conglomerate of related companies over a range of different industries. The founder and his direct family members exercise supreme economic power in the chaebol's economic venture and in recruiting new executive managers by using voting power as the largest share holders.

The evaluation of Kim Dae-Jung government's chaebol reform was, in reality, a kind of

failure in spite of the partial success of the reform (G. W. Kim 2002). Chaebol reform was actually dominated by the IMF and the World Bank. The draft of chaebol reform was drawn by these two international institutions (Song 2005: 166). Both the two international institutions and the Kim Dae-Jung government considered chaebol reform as crucial for the recovery of the Korean economy.

After the failure of the initial IMF reform policy, the method of the chaebol reform was changed from market-oriented to government-led reform. They requested a strong governmental role in the chaebol reform. The Korean government established the Financial Supervisory Commission (FSC), reached agreements between the creditor financial institutions and the debtor companies by making agreements for structural reform, and operated it by establishing the Committee For Structural Reform of Companies. The government, with the cooperation of the IMF and the World Bank, selected the target industries and the target companies. They strategically divided chaebols into two groups. One was the top five chaebols such as Samsung, Hyundai, Daewoo, SK, and LG, and the other was small and medium-sized chaebols ranked from 6 to 64, estimated based on total assets. The structural reform of the former group was carried out through the 'Big Deal,' and the latter was done with the 'work out.' These strategies were guided by the IMF, and the government enforced the reform policies with direct government intervention. Following the advice of the IMF, the government entrusted the FSC with full power, and the FSC controlled the banks by distributing public loans. Banks that did not cooperate with the government's reform policy were excluded from getting public loans. Through the distribution of the public loans the government was able to enforce the structural reform of chaebols (Song 2005: 169). This institutional legacy of the developmental state to distribute public loans was revived when it was needed.

But when the Korean economic recovery was somewhat achieved and when the IMF left Korea, the weakness of the Kim Dae-Jung government appeared on the surface of the power structure. In the latter half of the term, the Kim Dae-Jung regime lost public support by losing hegemony in struggle with the opposition party. At that point, the voice of chaebols, which had shrunk under the strong government's reform policy, began to revive. Also, the government thought that the national economy was recovered enough to get out of the IMF's surveillance. The government gave up the reduced budget policy to stimulate the economy. It also changed the economic policy from continuous economic reform to socio-economic stability of the state. The Kim Dae-Jung government also changed the economic policy to support chaebols by alleviating various limitations being inflicted on chaebols' economic activities (Song 2005: 172-174).

In reality, chaebol reform of the Kim Dae-Jung regime was not a real structural rearrangement of chaebols. The 'Big Deal' as the key for the reform of the big chaebols was not a reform to dismantle chaebols but was a reform to stabilize the current chaebols and to strengthen the competitive power of chaebols in the world economy. Thus, chaebol reform was actually not a

reform to renovate the current chaebols. It was a reform to strengthen the chaebol system. The partial success of structural reform also means not dismantling chaebols but strengthening the existing chaebol system (Kim and Kim 1999: 27).

Consequently, chaebol reform under the Kim Dae-Jung regime was not to dismantle chaebols but to stabilize and even strengthen the existing chaebols by enhancing the competitive power of them in the world economy. Chaebols could not be a target to be dismantled because of the huge transaction costs. The chaebol system was already strong enough not to be dismantled by any reform policy of the government. The ideal of chaebol reform being symbolized as chaebol dismantlement was just an ideological heart's desire for the desirable future of chaebols or a desirable image of honorable companies. It was only a wish without considering the possibility of realization in the real world (Hong 2002: 299).

The socio-economic status of chaebols is very stable and the economic power of chaebols in Korean became even stronger. The economic performance of the top four chaebols such as Samsung, Hyundai · Kia Motors, LG and SK is outstanding. The top four chaebols in 2004 earned more than half of the total foreign currency that Korea had earned the same year, and their exports exceeded more than half Korea had exported. They held many patents in high-tech industries and invested huge amounts of capital in R&D to strengthen their competitive power. The total sales of the top four chaebols at the end of 2004 were 251.4 billion dollars. It was almost the same as the total GDP of Indonesia (257.8 billion dollars), and exceeded the total GDP of Denmark (242.3 billion dollars), Saudi Arabia (248.8 billion dollars), and Norway (250.4 billion dollars). The total sales of Samsung as the top chaebol in Korea in 2004 were 91.8 billion dollars. It was more than the total GDP of Egypt (77.0 billion dollars), Pakistan (82.6 billion dollars), and the Philippines (85.1 billion dollars) the same year. The total sales of SK, as the fourth chaebol, was 47.3 billion dollars in 2004, which exceeded the total GDP of Vietnam (43.9 billion dollars) (Dong-A daily newspaper 2006. 3. 31).

The chaebol system is not a weak economic institution that only follows rules made by the government. Rather it is a strong economic institution that plays games in the international market with its own economic rules. Chaebols had already grown up strong enough not to be influenced by any criticism from the people or the government. Chaebols today play the center to lead the Korean economy in the competitive world market. The economic performance of chaebols and their contribution to the Korean economy are too outstanding to be criticized by non-economic standards. Now, the time has come to criticize or praise chaebols not with the ideological perspective but with the real output they produce and the economic role they play in society.

DISCUSSION

The idea of this paper can be summarized with some questions. Did the economic crisis of Korea in 1997 occur because of the excessive economic intervention of the developmental state which had a strong control of power on the economy? Or did it happen because of the incompetence of the government which lost its control power of the economy? And, was it due to the inner structural problems or was it due to the policy failure of the government in the process of financial liberalization? In this paper, I strongly argue that the Korean economic crisis was not the result of the structural problems of the developmental state but the result of policy failure of the government to open the financial market without preparing the appropriate control mechanism.

Chaebols in Korea are the subject of both love and hatred. When people evaluate chaebols without any personal relationships with them, they are generally critical of them. Koreans generally have critical views of chaebols, and many Korean scholars insist on the dismantlement of chaebols or chaebol reform whenever they have a chance to comment on chaebols. They even think that it is the duty of scholars to criticize chaebols. But when students choose jobs after graduation, most of them are eager to begin their careers in one of the chaebol companies and are proud of getting a job in the chaebol company. Also, so many politicians and bureaucrats want to have a good relationship with chaebols. Even those scholars who are critical of chaebols try to obtain funds from the chaebol companies whenever they have the chance. Therein lies the contradictory dual attitude of the Korean people on chaebols.

Chaebols in Korea have contributed a lot and played an important role in the country's national economic development. Korea could develop as an economically leading country by enormous economic achievements of chaebols. But many Koreans stick to the negative side of chaebols, where chaebols accumulated capital by the support of the authoritarian military regime. Koreans seem to enjoy self-satisfaction by criticizing and ignoring powerful institutions.

Before the economic crisis of 1997, people had a somewhat positive image of the Korean economic development. 'Developmental state model' was respected as the representative development model to explain the East Asian economic development. But when the Asian economic crisis happened in 1997, the positive attitude disappeared and the developmental state model was criticized as the main culprit for the Asian economic crisis. This criticism in Korea has a history. After the success of the civil right movement in 1987, the twenty-five year long authoritarian military regime became the target of criticism from the civil society. But the consistent economic development restricted the criticism only to the political area. The economic crisis in 1997 served as momentum to concentrate on the economic criticism of the previous authoritarian military regime, especially the Park regime. In the process, both the

developmental state and chaebols, as the direct recipients of the Park regime, became targets of criticism. The political criticism of the authoritarian military regime was extended to the criticism of their economic activities. Naturally the positive side of the previous government was hidden and the negative side was enlarged.

But when looking back on the response of the government to the Korean economic crisis we doubt about the diagnosis and prescription of the government and the IMF. Chaebol reform did not follow the plan they had advised. Chaebol reform had proceeded in the direction to stabilize the chaebols' economic status and strengthen their competitive power. Not a single chaebol was dismantled by the pre-designed reform plan of the government and the IMF. Even though some chaebols like Daewoo were bankrupted and disappeared, it was not due to the plan of the government but the insolvency problem of the chaebols. Chaebols in Korea today became more powerful and their economic status became more solid than ever before.

As discussed in the previous pages, the role of the developmental state in Korea had already been stopped in 1993. It was not a developmental state when the economic crisis arose in Korea. It might be a more logical explanation to say that the Korean economic crisis occurred not because of the strong state but because of the policy failure of the weak state. The weak state could not cope with the attack of the international speculative fund which penetrated the weak point of the Korean economy. In other words, the major cause of the Korean economic crisis was not the inner structural problems but the policy failure of the state which could not develop the control mechanism for financial liberalization.

Korea is a relatively small country with a small territory, lack of natural resources, and weak purchasing power. Thus, the Korean economy depends highly on exports in international trade. The role of the state is relatively important to keep fair rules in the economic activities, to protect the domestic economy from the power of cruel exchange speculation, and to protect the domestic industries from severe international competition, etc. The state intervenes in the economic activities not to distort the market structure but to regulate the effective operation of the market.

Today, neo-liberalism has become the dominant economic system in the world economy. Here, knowledge and information play key roles in economic production. In the process deregulation and the forcible opening of markets are the rules (Chu 2009: 280-281). But the Asian developmental states such as Korea have developed a 'modified regulatory state' that matures the practice of regulations and preferential loans. The government provided 'monetary, financial and trade benefits to chaebols' even in the neo-liberal economic system. With this policy 'Korea has performed best in the area of information technology equipment, especially electronic components, communications equipment and information equipment' (Chu 2009: 282-283). The important thing is not 'the left wing or the right wing' or 'neo-liberalism or developmental state.' The desirable direction of the economic policy of the state is to restructure the institutions of the government and society to operate transparently and effectively to cope

with the rapidly changing international conditions and to realize the interests of the people. In this sense, there is no reason to reduce the role of the state. Yoon referred to the current Korean economy as 'developmental neo-liberalism.' He argues that even in the neo-liberal economic system the economic interest of the state is also pursued naturally and necessarily. The neo-liberal economic policy itself works as a way to achieve the goal of the developmental state, such as economic growth, export increase, and catch up. The neo-liberal economy in Korea today is largely the product of the thorough economic intervention of the state during the economic reform period (Yoon 2009: 42). Neo-liberalism in Korea did not bar state intervention but simply regulated or transformed the form of state intervention. The neo-liberal economic policy in Korea itself is used as mobilization strategy to achieve developmental goals and to increase national economic power.

There is some selective affinity between the neo-liberal economy and the developmental state model. Both put growth first and distribution later. Also, both of them show faith towards the 'trickle-down effect' which argues that the problem of extreme economic inequality and poverty can be solved by increasing investment and the concomitant economic growth. Both of them are skeptical of the role of democracy in developing the economy. Rather, they show faith in elites and elite-led economic development (Yoon 2009: 56).

The Korean government relies heavily on chaebols to increase economic growth and to enhance national competitive power. Under the hypothesis of the developmental neo-liberalization all the economic policies in Korea are directed to strengthen national competitive power, and chaebols contributed greatly to the surplus of the trade balance with export-oriented accumulation. Chaebols now lead exports and work as a prop for Korean economic growth. Both the developmental state and chaebols are persistent and even strengthened even after the economic reform of the government. The government tried to transform these institutions after the economic crisis, but it couldn't transform the institutions. Rather the chaebol system became more stabilized with the reform. Path dependency perspective presents a good theoretical explanation for the persistence of chaebols and the developmental state even after the strong reform policy of the government.

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