

BETWEEN NEOLIBERALISM AND DEMOCRACY: THE TRANSFORMATION OF THE DEVELOPMENTAL STATE IN SOUTH KOREA

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This study addresses the transformation of the South Korean developmental state since the early 1990s in relation to globalization and neoliberal restructuring. First, several key analytical-concepts are discussed for the study. Next, we examine two recent civilian-governments' major policies that have accelerated the transformation. Then, we spell out the changes of three major institutional actors in the developmental-state framework, i.e., the state, banks, and chaebols, which have resulted from the aforementioned conditions and policies. In conclusion, we argue that an alternative path should be followed instead of the current path of neoliberal transformation in South Korea to achieve a form of substantively-democratic development.

Key Words: *Developmental State, Neoliberal Transformation, Substantive Democracy*

INTRODUCTION

In the development-study literature, South Korea's case has been considered as a developmental-state model, which is characterized by state-bureaucracy's active role in economic growth and industrial transformation. During the high growth period of the 1960s—1970s, the Korean state played such a role using several institutional or practical tools, such as policy loans (Woo, 1991) and strategic industrial policy (Chang, 1994). The state insulated itself from the particularistic interests of the private sector (in particular, big business), but cooperated with it in purposeful ways (Evans, 1995). In the course, family-owned, large and diversified business groups called *chaebol* have grown up in the economy as gigantic growth-machines resulting in the transformation of even the developmental state itself until the 1980s (Kim, 1997). Since the early 1980s, such a model emphasizing the state's industry-promoting role was even been recommended by 'revisionist' scholars as an alternative way for economic development in developing countries, which is distinguished from both a neoclassical free-market model and a radical de-linking path (Johnson, 1980; Amsden, 1989; Wade, 1991).

However since the 1997 financial crisis in Asia and South Korea, there have been discussions questioning the effectiveness of the developmental-state model in the current era of 'globalization'. In addition, neoliberal changes in the Korean economy since then poses a more fundamental question: "does the developmental state still function or exist in South Korea?" Reform measures domestically implemented in the country with the IMF's bail-out funding have accelerated the dismantling process of the old "Korea Inc.", which was characterized by the "state-banks-*chaebols* nexus" (Shin & Chang, 2003).

In addition to gradual transformations of the developmental state under military governments since the early 1980s, recent civilian governments' key policy-drives were *ironically* critical to such neoliberal changes in the country. For example, the Kim Young Sam government (Feb. 1993 — Feb. 1998) mismanaged its globalization drive (domestically known as "segzehwa") finally to the economic meltdown in late 1997, and the Kim Dae Jung government (Feb. 1998 — Feb. 2003) implemented neoliberal reforms under IMF guidance after the crisis so intensively, that it accelerated the transformation of the country' economy by inserting it deeply into global turbo-capitalism.

This study attempts to examine the transformation of the Korean developmental-state in relation to two conditional factors: 'globalization' and 'restructuring'. Our focus is more or less limited to the changes concerning three major institutional actors of "Korea Inc.": the state, banks, and *chaebols*.¹ We intend to show how globalization and restructuring have largely weakened and dismantled major characteristics of the Korean developmental-state since the early 1990s and note that outcomes of the transformation, i.e., the deeper global integration and neoliberal changes of the economy, make the re-vitalizing of the old model of developmental state difficult. The relationship between this transformation of the Korean state and 'democracy' is also scrutinized as our main concern.

What follows is, first, the theoretical and analytical discussion dealing with the developmental state in relation to globalization and restructuring. Second, the trajectory of globalization efforts and restructuring policies in South Korea's recent history is described. Then, the neoliberal transformation of the Korean developmental state will be examined focusing on three

¹ This study is focused mainly on the three actors in the transformation of the Korean developmental state as an institutional configuration of the economy. As for the studies of other actors in the configuration and the social results of the transformation, such as labor flexibility and changes in class structure, see Lim, Hwang & Chung (2000); Lim (2002); Lim & Han(2003); Kim (2004); Chang & Chae (2004); and Park (2004).

major institutional actors. In conclusion, some implications of this study regarding the issues of state transformation and democracy will be addressed.

DEVELOPMENTAL STATE AND ITS DISCONTENTS

Developmental-State Theory

In discussions of economic development, there have been several competing theoretical paradigms.² In the case of East Asia, with the region's impressive growth over the past decades, two explanatory paradigms have been most prominent. One is the paradigm of orthodox/neoclassical economics, which mostly has been presented by economists in academia or international financial institutions (IFIs) like the IMF and World Bank (Balassa, 1978; Krueger, 1990; 1997). This line of explanation emphasizes the primary role of free trade and export-oriented industrialization in the Asian economic 'miracle' as well as the superiority of free-market principles while being critical of 'price-distorting' state intervention and bureaucratic 'rent-seeking'. The neoclassical paradigm was influential in refuting Latin American dependency theory's argument of underdevelopment in developing countries as the result of their linkage to the capitalist world-economy. In this way, East Asian high-growth economies became the examples for legitimizing such neoclassical arguments.

But since the early 1980s, there has been another line of explanation of East Asian development, which emphasizes the state's active role in the economy, and this has opposed the neoclassical explanation preoccupied with the free-market mechanisms of development in the area. At first, researchers with the new explanatory perspective were called 'revisionists' because they were different from 'orthodox' economists in their understanding of development mechanisms, and now their theoretical paradigm is named a 'developmental-state theory' (Woo-Cumings, 1999). Besides such efforts to explain economic development, the renewal of concern in state theory from a neo-Marxian paradigm to a neo-Weberian one during the early 1980s also contributed to the rise of this developmental-state approach elaborating theoretical concepts such as 'state autonomy' or 'state capacity' (Evans et al., 1985; Cho, 1997).

The seminal work in this new paradigm was Chalmers Johnson's study of

² Regarding competing paradigms in development theory, see Nederveen Pieterse (2001). As the explanatory frameworks of economic development, both neoclassical economics and developmental-state theory have been salient since the 1980s.

the Japanese economic bureaucracy, the Ministry of International Trade and Industry (MITI), and industrial policy formulated and implemented by the ministry, and this study focused on the bureaucracy's role in Japan's rise as an economic giant during the post-1945 era (Johnson, 1982).³ Johnson attempts to explain the state bureaucracy's active and strategic role in Japan's economic development, whose origin dates back to the 1930-1940s when similar bureaucratic activities were designed and adopted to effectively mobilize industrial resources for war-time purposes. He constructs the Japanese case as a different economic model from both the American system and the Soviet one. According to his typology, the Japanese model is 'plan-rational' (developmental state) while the American model 'market-rational' (regulatory state) and the Soviet one 'plan-ideological'. And he focuses his discussion mainly on the differences between the market-rational and the plan-rational economic models (Johnson, 1982: 18-26). His early construction of the ideal-types of different capitalist-systems seems to be a precedent for a 'typology of capitalisms', which has become increasingly popular in the current post-Cold War context (cf. Albert, 1993; Dore, 2000; Hall & Soskice, 2001).⁴

Since Johnson's work on the Japanese case, there have come out several works focused on other East Asian cases, such as South Korea and Taiwan. Amsden (1989) pays attention to efficient state-bureaucracy's role in South Korea's technological learning and industrial transformation from its war-torn condition of the 1950s into another economic giant of the region. She attributes this transformation to the state's "deliberately getting relative prices wrong" mechanism for achieving a long-term development goal. Wade (1990) suggested a 'governed-market theory' (GMT) in his analysis of Taiwan's (and Korea's) industrialization, which was also intended to refute a neoclassical 'free-market theory' (FMT) or a 'simulated-market theory' (SMT) of economic development.

³ After criticizing previous explanations of the post-1945 Japanese economic miracle, such as "projectionist", "national character", "no-miracle-occurred", "unique-structural-features", and "free-ride" analyses, Johnson presents his own approach as "the school that stresses the role of the developmental state in the economic miracle" (Johnson, 1982: 6-17). As for detailed explanations of the developmental state, see Cumings (1999) and Beeson (2004) on the genealogical issue, Chang (2002) on state theory, and also Bagchi (2000) on the historical cases.

⁴ Economic historian Gerschenkron's study on diverse paths to industrialization in European history set an earlier precedent for the typology of capitalisms because he denied the historical generality of the English case in industrialization and considered it even as an exception (Gerschenkron, 1962). Theorists in the developmental-state school including Johnson (1982) and Amsden (1989) depend largely on Gerschenkron's discussions. See also Shin & Chang (2003).

Regarding Again the case of South Korea's postwar economic development, Woo (1991) examined the important role of 'state-controlled' finance, while Chang's (1994) study focused on the role of industrial policy in the country. In a study on the development of the information technology sector in several states including South Korea, Evans (1995) constructed three ideal-types of the state in terms of its developmental functioning, such as 'developmental', 'predatory', and 'intermediate' states. He emphasized that state bureaucracy should be not only 'embedded' in the private sector, but also 'autonomous' of its particularistic interests in order to achieve domestically-based industrial transformation and further economic development.⁵ In this line of study, Eun Mee Kim (1997) also examined a trajectory of the relationship between the state and big business (*chaebol*) changing from state-dominance ("comprehensive" developmental state) until the 1970s to symbiosis ("limited" developmental state) between the two actors in Korea's recent history.

Meanwhile, Weiss (1998) considered not only East Asian states but also Germany to be cases of the developmental state, emphasizing strengths both in Japan and Germany as 'dualist states' which are distributive as well as developmental, while indicating weaknesses in the industrial transformation of the Swedish welfare-state as the 'distributive state'. Conceptualizing the government-business relationship in East Asia as 'governed interdependence' and opposing an 'authoritarianism thesis' of the developmental state by defining state power as 'infrastructural' rather than 'coercive', Weiss maintained that even under the pressure of globalization which is popularly assumed to have weakened the nation-state's capacity for intervening in the economy, state capacity as an institutional complex is still important for competitiveness. Recently, Chibber (2002) developed a detailed explanation of 'intra-bureaucracy dynamics' in his comparative study of India and South Korea suggesting an irony that bureaucratic mechanisms based on the logic of 'rationality' can weaken the 'state capacity of cohesiveness' as seen in the Indian case, which is in contrast to the developmental state in Korea.

And in such discussions of the South Korean case, three key institutional actors and their inter-relationship are prominent in workings of the Korean

⁵ Evans considers South Korea as the developmental state, Zaire as the predatory one, and both Brazil and India as intermediate ones. Most studies of the developmental state (cf. Kim 1997) including his work are focused mainly on the relationship between the state's administrative apparatuses and the business sector. But Evans also suggests the possibility of the developmental-state based on the state's cooperative relationship with non-business sectors like labor as seen in the case of Austria (Evans, 1995: 240-243).

developmental-state, that is, the Korean economic model is noted to have been “based on a close collaboration between the state, banks, and the *chaebols*, with the state as the dominant player” (Shin & Chang, 2003: 1).

While the developmental-state theory suggests as a condition for economic development specific institutional arrangements and the state’s activities that have been adopted in some countries, there is a critique that the suggestion may ignore the world-systemic or ‘geopolitical’ context if it tries to generalize the cases in an ahistorical manner (Johnson, 1999: 55; Pempel, 1999: 174-180; Woo-Cumings, 1999: 21).⁶ This critique is legitimate insofar as it pays attention to the developmental state as a ‘historically-conditioned’ outcome and its transformation according to changes in such conditions. In this study, ‘globalization’ and ‘restructuring’ are discerned as two important conditional-factors that have influenced the weakening or dismantling of the Korean developmental state since the 1990s.

Globalization and Restructuring

As a buzzword in the social sciences, ‘globalization’ has been discussed in many ways and from different perspectives. There are two types of globalization: one from above and the other from below (cf. Mittelman, 2000: 205). In response to ‘globalization-from-above’ driven by states and transnational actors including IFIs, TNCs, or global finance, there has emerged ‘globalization-from-below’ to reclaim the power that the former have usurped on planetary and local scales. Globalization-from-above can be called ‘neoliberal globalization’ because it accelerates the integration of individual countries into a single global economy by empowering transnational ‘market’ players and undermining states’ autonomy in domestic policy-making domains. Globalization-from-below can be considered ‘civil-society globalization’ that mobilizes social movements by non-governmental organizations (NGOs) across national boundaries (Keck & Sikkink, 1998).

Regarding the transformation of the developmental state in South Korea, our study focuses on neoliberal globalization.⁷ As noted, neoliberal globalization is oriented toward the deeper integration of individual countries into the capitalist world-economy, which in fact has been promoted by ‘restructuring’ within each country in the process of regime transition (e.g.,

⁶ On the one side, Johnson (1982) did not take the external factors seriously in his early work, and on the other, works based on world-systemic analyses often seem to accept the hegemonic determinism of development. In between, Wade (1990: 346) recognizes the partial importance of international situation in the workings of a specific developmental state.

⁷ As for critical analyses of neoliberal globalization, see Martin & Schumann (1997), Petras & Veltmeyer (2001), and Bello (2002).

post-Socialist countries in Eastern Europe and the former Soviet Union) or post-crisis structural adjustment.

'Restructuring' here refers to neoliberal structural reforms aimed at transforming the institutional framework of the economy. Its standard form recommended or mandated by IFIs such as the IMF and the World Bank is a set of structural adjustment programs (SAPs).⁸ According to one study (Nelson, 1990), the structural adjustment programs can be distinguished between two types, while the boundaries between the two are often blurred in real-world cases: first, short-run 'stabilization' (reduction of an aggregate demand) of one or two years through macroeconomic management, such as devaluing currency, slowing down inflation, and reducing balance-of-payment deficits, and second, medium-term 'structural change' (encouraging foreign-exchange earning or saving activities, trade liberalization, price deregulation, and tax reform) of three to five years.

And there are two ways of making such structural adjustments. 'Orthodox' adjustment programs attempt to achieve a *fast* transition, at the expense of low growth and high inequality, by tightening government budgets, downsizing public sectors, and loosening labor-protective laws. Meanwhile, 'unorthodox' or 'heterodox' adjustment programs prefer a *slow* transition, pursuing high growth and better equality simultaneously by investing in production as well as spending in welfare, having the risk of conflicting with foreign creditors. Noting the importance of 'political-regime type' in economic adjustments, some researchers assume that heterodox efforts are more likely to be implemented by more democratic or less authoritarian regimes due to their responsiveness to supporting political bases. In fact, however, the links between regime type and the adopted way of adjustments are often loose (cf. Kaufman & Stallings, 1989; Nelson, 1990: 334).

The two formulae of orthodox and heterodox programs have their own transitional costs. The orthodox programs tend to create severe social conflicts and political cleavages due to austerity measures, low growth, and high unemployment. According to mainstream discussions, the heterodox programs often fail to stabilize the economy and re-create economic crisis by not fixing structural deficiency for fear of the side effects of restructuring. Among the developing countries that have completed regime transition from authoritarianism or Socialism, some may have compounding obstacles

⁸ Theoretical and empirical studies abound on structural adjustment programs (Kahler, 1986, 1990; Nelson, 1989, 1990; Haggard & Kaufman, 1992; Williamson, 1990, 1994). As for a critical analysis of the negative effects of SAPs in developing countries, see Chossudovsky (1996).

originating from such social conflicts and political cleavages. In turn, a lack of 'democratic governance' is said to usually entail barriers to developing a long-term perspective on structural adjustments, since new democracies cannot solve the problem of distributing economic costs to cross the "transition valley" (Przeworski, 1991).

In fact, there have been more failures than successes in the developing countries that have undergone SAPs (Chossudovsky, 1996). Having critically evaluated empirical studies on the performances of these programs in different countries, Dasgupta (1998: 378) concludes that "there is no evidence that structural adjustment works". Indeed, almost all of the developing countries under restructuring imposed by the Bretton Woods institutions have shown a low degree of growth, often with denationalization of capital accumulation, growth without distribution, increased unemployment, and even worsened foreign indebtedness.

Which Democracy?

The last two decades have witnessed the collapse of various authoritarian or Socialist regimes in Latin America, Asia, and Southern and Eastern Europe. What is significant in this recent democratization is that new democracies have been influenced, or (re-) shaped to a large extent by globalization and restructuring geared to establishing the free market on a world-economic scale. *Globalization mediated and facilitated by restructuring* affects the ups and downs of democracy in individual countries since restructuring constitutes a specific logic of capitalist accumulation which (re-)shapes not only relations of production, but also modes of domination at both local and global levels.

Indeed, the IMF's neoliberal structural adjustment packages are designed to seek the deeper integration of the economy of developing countries into the capitalist world-system through trade liberalization and the removal of all barriers to the cross-border flows of capital, goods and services, with the extended role of the market and the re-oriented role of the state. In many developing countries, globalization and restructuring have had mixed results at best, or even disastrous ones in terms of democratic achievement and economic advance (Haggard, 1992; Smith & Korzeniewicz, 1997). It may be the case because globalization and restructuring exacerbate both international and domestic disparities resulting in the minority of winners and the majority of losers.

In most post-transitional countries, thus, democratic consolidation has been unable to go beyond a transition from authoritarianism in the midst of

growing disparities and inequalities. Globalization brings about the spread of democratic ideals in those countries, but often without corresponding democratic practices or institutionalization. In addition, what globalization promotes is in reality a specific type of democracy, which can be considered 'free-market democracy', giving priority to the free flows of capital, goods and services across country-borders to lead accumulations on a world scale. In the course, the democratic ideas of participation and equality and the free-market rationales of competition and efficiency clash with each other, and the latter usually dominate over the former (cf. Centeno, 1997; Singh, 1999: 143-5; Abrahamsen, 2000; Teivainen, 2002). Under the command of globalization and restructuring, even economic advance is often hindered because of increasing social cleavages and political tensions. Over the long run, these are detrimental to the sustainability of democracy.

Regarding the developmental state, globalization and restructuring function as transformative forces. Neoliberal globalization constrains the state's capacity to implement developmental tools such as industrial policy, while restructuring requires the re-orientation of the state's role and functions in order to incorporate the domestic economy deeply into global capitalism. This in turn weakens the state's autonomy and capacity in policy implementation from both inside and outside. In this way, globalization and restructuring tend to re-direct the state's role and functions in the economy in line with neoliberal ideals currently called the "global standards", which are in fact based on the Anglo-American economic model (Soederberg, 2004).

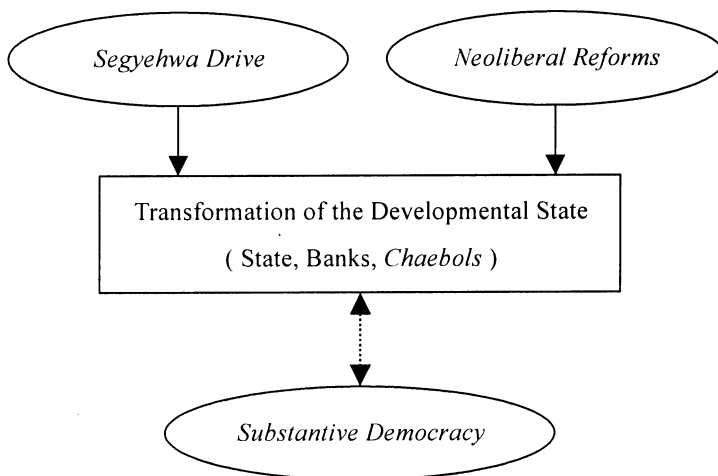


FIGURE 1. TRANSFORMATION OF THE DEVELOPMENT STATE IN SOUTH KOREA

Figure 1 suggests the analytical frame to examine the transformation of the Korean developmental-state over the last decade, which has been conditioned by the Kim Yong-Sam government's *seggyehwa* (globalization) drive in the mid-1990s and the Kim Dae-Jung government's neoliberal reforms (restructuring) since the 1997 financial crisis.

KOREA'S SEGYYEHWA DRIVE AND NEOLIBERAL REFORMS

In South Korea, the notion of globalization has been popularized with its domestically translated term "*seggyehwa*". Thus, globalization was considered mainly a national development strategy by the Kim Young-Sam government, which was the first civilian government in South Korea since the early 1960s. After coming into power, Kim Young-Sam suggested a bold idea of building a "New Korea" (*shin han'guk*) to cure the so-called "Korean disease" supposedly inherited from authoritarianism of the past. No wonder his globalization (i.e., *seggyehwa*) drive was the product of this "New Korea" policy. For him, *seggyehwa* signified a new vision for Korea in the twenty-first century with an upgraded status and role in the international theater. It was a self-claimed hallmark for his administration.

It is observed that the globalization drive developed through a two-stage conceptualization: first, *kukjehwa* (internationalization) in May 1994, and later, *seggyehwa* in November 1994. Internationalization was defined by the Foreign Minister as "an inevitable process which every nation must undergo to ensure sustained stability and prosperity" by "trying to induce foreign investment, liberalizing its financial market and preparing to join the Organization of Economic Cooperation and Development (OECD)" (Gills & Gills, 2000: 36-37). Yet, *seggyehwa* as a national development policy, as the government claimed, "entails rationalizing all aspects of life" and "reforms in every area". It meant "a sweeping transformation of society" requiring "productivity and flexibility" (Gills & Gills, 2000: 38). *Seggyehwa* was publicized as a necessity for South Korea to flourish. This could be found in one of Kim Young-Sam's speeches:

Globalization is the shortcut which will lead us to building a first-class country in the 21st century. This is why I revealed my plan for globalization [...] It is aimed at realizing globalization in all sectors — politics, foreign affairs, economy, society, education, culture and sports. To this end, it is necessary to enhance our viewpoints, way of thinking, system and practices to the world class level [...] We have no choice other than this (*Korea Times*, January 7, 1995)

In his *segyehwa* drive, Kim Young Sam launched a series of reforms in almost every area including military, politics, economy, finance, labor, education, law, and welfare. He might have thought that *segyehwa* was a panacea to cure irregularities and malpractices inherited from the past. Without clearly recognizing the potential risks inherent in globalization, he approached it mainly as a national development strategy. Kim Young-Sam's *segyehwa* drive, in fact, reflected both hasty financial liberalization since the early 1990s and the globalization of production by Korean *chaebols* around the time (E. M. Kim, 2000; Shin & Chang, 2003: 76-9). Such financial liberalization was the combined outcome of the Kim Young-Sam government's attempt to seek South Korea's OECD membership and the bilateral US-Korea Financial Policy Discussion Talks during the early 1990s, making the blueprint for the schedule of financial liberalization and market opening in the country (cf. Sakong, 1993: 182, 200; Kwon, 2004: 82-4). Meanwhile, a study draws attention to the relation between the domestic drive and the creation of the World Trading Organization (WTO) in 1995 after closing the ten year-long Uruguay Round talks (Moon, 2000: 127). Due to the result of the talks, the Kim Young-Sam government had to accept a large-scale market opening for agricultural products reversing its previous promise to Korean farmers which was made during the 1992 presidential campaigns. *Segyehwa* was able to be used as a justification for this reversal.

In the end, Kim Young-Sam's *segyehwa* drive turned out to be a dismal failure with the financial crisis in 1997. What Kim Young-Sam envisaged in his talks of a "first-class country" was to become a member of the OECD. Yet, the country did not have enough time to be prepared for sudden and profound changes in the rules of the game required for gaining OECD membership until 1996. After the 1997 crisis, Kim Young-Sam's rosy picture based on his ambitious *segyehwa* drive became a humiliation for the country by having to go through restructuring under the IMF's supervision.

The Kim Young-Sam government did not hesitate to push financial liberalization and capital-market opening along with a series of deregulations for international capital flows, even though some in the policy-circles were aware of and concerned about dangers in such *segyehwa* measures that would undermine state capacity in managing the economy. Without considerate safeguards for the economy, however, the *segyehwa* drive paved the way for financial meltdown in the region-wide crisis of 1997. At the end of his single five-year presidency, thus, Kim Young-Sam had to ask for a \$57 billion emergency bail-out from the IMF against national default in the wake of plummeting currency-value and the rapid exhaustion of dollar reserves.

With the financial bail-out arranged by the IMF, accompanying package programs which were intended for not only stabilization but also radical restructuring of the domestic economy included the shutdown of insolvent financial institutions, the termination of bank loans to financially distressed firms, the furthering of trade and capital-account liberalization, the establishment of the flexible labor-market, and improvement in transparency and the debt-to-equity ratio in the corporate sector. The IMF also demanded government budget-cut, higher interest rates, and reduced growth.⁹

The Kim Dae-Jung government, thus, from its inception had an urgent task of coping with the crisis situation. When Kim Dae-Jung, a long-time opposition party leader, was elected as the president in December 1997, the country was on the brink of default with a shortage of foreign exchange reserves. His solution to the crisis was to follow, with little reservation, the neoliberal reforms demanded by the IMF as the rescue condition, retreating from his earlier stance of being critical of its conditionalities (Gills & Gills, 2000: 45). This free market reform proceeded under the slogan of "Parallel Development of Democracy and Market Economy".¹⁰ It is not clear, however, how the post-crisis administration conceived it could deal with inherent conflicts and tensions between democratic ideals like participation or equality and market rationales like competition or efficiency. In Kim Dae-Jung's published vision of the "mass-participatory economy", of course, such problems as social disparities and external dependence associated with globalization and intensive restructuring could not be foretold (Kim, 1996). There is an analysis indicating that Kim Dae-Jung's early version of the 'mass participatory economy' having a social-democratic tone was transformed into the neoliberal version of "DJnomics" in 1998, and that many of problems in post-1997 restructuring can be found in such a change (Lee, 2001). The Kim administration-related scholars, however, would note that DJnomics was rather German social market-styled 'order liberalism' or a Third Way version than neoliberalism, because of its welfarist elements. Retrospectively, it cannot be denied that the 'real outcomes' of DJnomics were not so much different from those of neoliberalism.

⁹ These demands were later moderated or in part withdrawn in severely-worsening economic conditions and credit crunch in 1998 resulting from the implementation of those programs, and in the fear of global economic meltdown after the Russian default, the Brazilian crisis and the near-bankruptcy of Long Term Capital Management (LTCM) in New York of the same year (cf. Stiglitz, 2002: Ch. 4; Shin & Chang, 2003: 64-65).

¹⁰ "Productive welfare" was later added to it, which may be related to 'active labor market' in Scandinavian countries (Kim, 2003: 317). It aimed at improving living standards by incorporating the unemployed into the labor market through re-education and re-skilling. Apart from the statement of intention, its real outcomes seem to have been rather limited.

During the Kim Young-Sam government, the economy had declined on the whole, culminating in the currency crisis of 1997. The Kim Dae-Jung government had hardships to overcome the post-crisis economic downturn. South Korea increased foreign exchange reserves due to trade surplus shortly after the crisis. The trade surplus between 1998 and 1999 after many years of deficit, however, was mostly owing to decreased imports rather than increased exports.¹¹ The Kim Dae-Jung government incurred a huge amount of public debts in the process of recapitalization of the troubled financial sector and corporate restructuring. The privately-incurred debts in the corporate and financial sectors were socialized in the course, which was in fact characteristic of the cases of post-crisis restructuring in Asia (Singh, 1999: 97).

The Kim Dae-Jung government thus had to become a crisis-management government from the beginning. The administration attempted to complete structural adjustments in a short period, even with a goal of achieving growth and distribution simultaneously. Using a distinction between two ways of structural adjustments mentioned earlier, the goal of structural adjustments in post-1997 South Korea sounded more like a 'heterodox' way, but the way in which structural adjustment programs were in reality implemented in the country was rather an 'orthodox' one. It was not only due to the government's expectation and hope for *fast* economic recovery. Regardless of the goal of the government, the IMF's programs as the conditionalities attached to its financial rescue largely determined ways of implementing structural adjustments in the domestic economy with little room for heterodoxy.

Indeed, the assumption that the way of structural adjustments (orthodox, or heterodox) depends on the type of domestic political regime (non-democratic, or democratic) seems to be irrelevant in the Korean case, because the Kim Dae-Jung government was considered to be democratic inside and outside the country. The way of adjustments adopted by the government may reflect more the degree of both economic troubles and domestic vulnerability to external demands or pressures than its political regime-type. International financial institutions (IFIs) such as the IMF usually have preferred an orthodox way of structural adjustments in financially-troubled countries so far. Such a distinction between the two ways of adjustments seems to be only for a speculative purpose.

¹¹ The country's trade condition recently worsened as the import unit price skyrocketed while the export unit price fell. The terms-of-trade index of commodity between 1995 and 2002 decreased each year as follows: 138.5 (1995), 125.4 (1996), 122.2 (1997), 116.7 (1998), 114.1 (1999), 100.0 (2000), 95.5 (2001), 95.0 (2002) (BOK).

In sum, a misconceived *seggyehwa* drive in the mid-1990s was followed by wholesale neoliberal reforms in South Korea after the 1997 financial crisis. The neoliberal or “market-oriented” reforms consisted of orthodox structural-adjustment programs towards further financial and trade liberalization, labor-market flexibility and public sector privatization with financial recapitalization and corporate reorganization.¹² Such restructuring was considered by domestic policy-makers to strengthen national competitiveness by extending the transnational linkages of the domestic economy.

It is also noted that South Korea’s post-crisis reforms included the neo-corporatist elements of social partnership between labor, management, and government when the Labor-Management-Government Tripartite Commission (LMGTC) was established in January 1998.¹³ In addition, the Kim Dae-Jung government took some welfare measures, such as increasing ‘social-safety nets’, or promoting the venture industry in the so-called “New Economy” sector. The neo-corporatist arrangements, however, ran into a setback due to labor’s dissatisfaction about the government’s restructuring programs leading to massive lay-offs and labor flexibility, and the ‘productive welfare’ proved to be ineffective in reducing unemployment and inequality increased by restructuring measures.

The IT venture firms after all were unable to become business substitutes for *chaebols* in the large Korean economy, while highly welcomed foreign investment was focused mostly on often speculative portfolio investment (FPI) in domestic company stocks (*Hankyoreh* 21, September 24, 2004; Ellwood, 2001: 76; Hong, 2004: 316). In post-crisis Korea, speculative features in foreign investment were salient as seen in the pattern-like cases of buying local assets at discount prices in the wake of restructuring for selling with high returns in recovery.¹⁴ The speculative nature is also obvious in the

¹² A moderate form of neoliberal reforms in Korea dates back to the partial efforts of stabilization in the early 1980s after skyrocketing inflation caused by several factors including the second oil shock and political instability. Throughout the 1980s, liberalization was implemented in various areas such as the financial sector or trade, which included the privatization of government-held shares in nationwide commercial banks between 1981 and 1983 (Woo, 1991: Cf. 7; Sakong, 1993: 66-93).

¹³ Koo (2001:44) opposes some argument that the state corporatism of a Latin American or European style existed in Korea during the period of industrialization. If we accept his understanding, the establishment of the LMGTC in 1998 was the first attempt of corporatism in Korea. But the aftermath of the institutional arrangement was full of tensions and conflicts among major participants, and it often became more a way of labor control than that of consensus building in the wake of restructuring and downsizing.

¹⁴ Even former IMF deputy secretary Stanley Fisher gave an alarm in May 2004 when he visited Korea for attending an Asian Development Bank conference indicating that the current presence of foreign capital in South Korea was mostly speculative and unproductive for the

case of foreigners' investment in local real estate. It is reported that when the profitability target was met, which had been set before their investment, they soon sold the real-estate assets and left the country without hesitation. Moreover, the large part of funds for their recent investment in Korean real estate was domestically mobilized (*Hankyoreh*, November 12, 2003).

STRUCTURAL CHANGES AND GLOBAL INTEGRATION

As noted earlier, the main institutional-framework of the developmental state in Korea was "the state-banks-*chaebols* nexus" (Shin & Chang, 2003). The state's active role in industrial transformation by developmental planning, policy-financing to the business sector through government-controlled banks, and the business sector's venture into new industrial projects through state coordination or initiatives were major features of the model. In this section, we discuss post-1997 changes and characteristics in these three actors.

State

In addition to limited financial liberalization of the 1980s, which increased the number of non-bank financial institutions (NBFIs) including insurance or securities firms, further financial liberalization since 1993 made the institutional framework largely unravel. With the ownership of NBFIs, *chaebols* were able to increase their financial independence and power vis-a-vis the state during the 1980s, though they were still unable to have the full ownership of commercial banks by legal restrictions. During the 1990s, the Kim Young-Sam government increased the number of merchant banks (*chongkŭmsa*) from six to thirty between 1994 and 1996, and allowed banks and *chaebols* to freely borrow money or make investments abroad without the appropriate monitoring system.¹⁵ Such enactments made the state unable to financially control *chaebols*, causing their excessive overseas borrowings and uncoordinated investments, which were later to be blamed as 'moral hazards'. Financial liberalization of the 1990s also went side by side

economy. Thus, he emphasized inducing foreign capital with a long-term business plan in Korea. But it is ironic that such speculative outcomes had been associated with structural transformations accelerated by the IMF-demanded neoliberal reforms. In fact, IFIs such as the IMF and the World Bank have invested in FPI-oriented global finance capital ("Inside Story of Lone Star Fund," *Monthly Chosun*, May 2004).

¹⁵ Regarding the domestic and external causes of financial liberalization in South Korea in the 1990s, see Lee et al. (2000) for the role of *chaebols*, and Kwon (2004) for external pressures by such actors as the US, the IMF and the OECD.

with the globalization of production by *chaebols*, which also made the state's intervention in the corporate sector more difficult (E. M. Kim, 2000).

With the *segyehwa* drive, the Kim Young-Sam government attempted to implement reforms in the public sector as well. In its endeavors to downsize government bureaucracy, several ministries of the central government were merged. In this course, the Economic Planning Board (EPB) was merged into the Ministry of Finance, newly forming a mega-economic bureaucracy named the Ministry of Finance and Economy (MOFE) in 1994, which was a historical incident considering EPB's decades-long role in the development planning of the country. This resulted in a power monopoly by MOFE eliminating checks and balances among economic bureaucracies, and finally led to its irresponsible behaviors for the months before the crisis of 1997 (cf. Kang, 2000: 92-3; Thurbon, 2003).

With intensified financial liberalization between 1993 and 1997, *chaebols* and financial institutions including merchant banks were largely out of state control. The state itself became irresponsible in the wake of 'organizational reshuffling' driven by hasty government downsizing of the *segyehwa* drive. Combined together, these institutional changes led to the domestic financial crisis with *chaebols* and financial institutions' heavy short-term foreign borrowings and the rejection of debt roll-over by foreign banks in the regional contagion of the crisis during 1997.

Under the crisis-ridden conditions after 1997, the Kim Dae-Jung government made the final blows with the IMF's adjustment programs against the developmental state that had been already being dismantled since the 1980s in a stop and go fashion. With the goal of reforms in four main sectors, namely, the financial, corporate, labor and public sectors, the government in some ways imposed strict reform-standards and measures on those sectors. Newly introduced 'post-crisis regulatory rules' such as the Bank for International Settlement (BIS)'s capital adequacy standard and the forward-looking criteria (FLC) in the financial sector, and the requirement for drastically reducing the debt-to-equity ratio in the corporate sector within a short period of time accelerated the rapid withdrawal of capital by local financial institutions from the corporate sector. It created a vicious cycle of credit crunch, massive bankruptcies of small- and medium-sized firms, and additional non-performing loans (NPLs) in the financial sector. To meet the new financial regulations, industrial investments were contracted, and companies in need of capital had to sell their brightest assets at bargain prices to mostly foreigners who were the only buyers with enough capital for purchasing those assets in such a situation (cf. Han & Chang, 2003).

Banks and Transnational Shareholders

Meanwhile, domestic banks increasingly pursuing profit-maximization after the crisis have been addicted to lending for household consumption or to rich clients, and corporate financing is less of a priority, thus transforming the pre-crisis problem of corporate debts into the post-crisis problem of household debts (Table 1). Big businesses also have come to prefer equity-financing through the stock market to debt-financing through banks for their operation reducing their dependence on banks which was typical in the old Korean model (Table 2).

In this way, the stock market has become more important than ever in the working of the whole economy. Since the ceiling of company stock ownership by foreigners was lifted according to post-crisis reforms in May 1998,

TABLE 1. TRENDS IN LENDING PATTERNS BY COMMERCIAL BANKS (TRILLION WON)

	Late 1997	Late 2000	Late 2001	Late 2002	Late 2003
Household lending	48.1 (32.6%)	90.3 (39.9%)	133.0 (49.1%)	189.2 (52.9%)	214.7 (52.9%)
Corporate lending	95.5 (64.5%)	131.0 (56.5%)	132.2 (48.9%)	162.8 (45.5%)	184.5 (45.5%)

Source: *Hankyoreh* 21 (9 December 2004).

Note: The percentage in a parenthesis is that of lending made by the domestic currency.

TABLE 2. EXTERNAL FINANCING OF THE CORPORATE SECTOR (BILLION WON)

	1996	1997	1998	1999	2000	2001
Total	118,769	118,022	27,664	51,755	66,531	51,939
Indirect Financing	33,231	43,375	-15,862	2,198	11,391	1,185
From Banks	16,676	15,184	259	15,525	23,348	3,381
From NBFIs	16,555	28,191	-16,550	-13,267	-11,997	-2,377
Direct Financing	56,097	44,087	49,496	24,792	18,996	36,838
CPs	20,737	4,421	-11,678	-16,116	-1,133	4,210
Stocks	12,981	8,974	13,515	41,137	20,806	16,504
CBs	21,213	27,460	45,907	-2,827	-2,108	11,761
Foreign Borrowing	12,383	6,563	-9,809	11,537	15,765	2,283
Others	17,059	23,997	3,839	13,228	20,380	11,633

Source: Shin & Chang (2003: 114)

Note: CP is corporate paper. CB is corporate bond. Others include corporate loans, government loans and so on.

foreigners' share-ownership in the domestic stock market has dramatically increased. The majority shareholders in so-called 'blue-chip' companies and major banks have become transnational institutional investors (TIIs).¹⁶ Among the biggest and best-known Korean companies with a significant proportion of foreign-owned shares are POSCO (former Pohang Iron and Steel), Samsung Electronics, SK and Hyundai Motor. The percentage of foreign-owned shares in those companies reached 67.3%, 59.5%, 54.1%, and 50.8% respectively in February 2004, which had been 20.8%, 24.2%, 13.7%, and 23.6% in November 1997 (K. K. Lee 2004: 68).

As Figure 2 shows, in terms of market capitalization, the ratio of foreign-owned shares in the Korean stock market increased from 12.97% in 1996 to 40.02% in 2003, while domestic surplus money remains elsewhere, such as in banks or real estate putatively due to the underdevelopment of domestic institutional investors in the stock market (*Hankyoreh* 21, September 24, 2003; *Hankyoreh*, October 30, 2003).¹⁷

Free from traditional business relationship in the domestic economy, foreign investors tend to prefer high and fast returns on their investment based

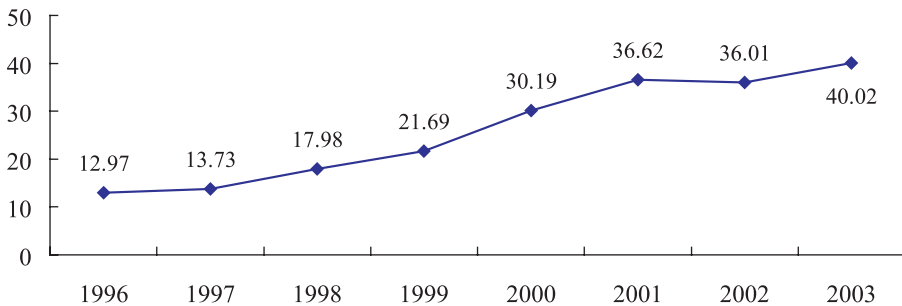


FIGURE 2. MARKET CAPITALIZATION OF FOREIGN-OWNED STOCKS IN KSE, 1996-2003 (%)
Source: Korea Stock Exchange (Website).

¹⁶ In 2003, the value of the stocks which foreigners hold in the ten largest chaebols was up to 44% of the whole stock price of the groups (*Hankyoreh*, October 8, 2003), which increased almost up to 50% in April 2004. This change makes incumbent CEOs in chaebols increasingly vulnerable to the possibility of hostile M&As, as was shown in the SK case in 2004. This condition has become one main reason of chaebols' inside cash-holding for defending existing management against potential M&A attempts.

¹⁷ The most significant cause of such spectacular increase in foreigners' stock-ownership seems to be not only the underdevelopment of domestic institutional investors, but also the decrease of the government-ownership in accelerated privatization of public enterprises since 1998. The government or public stock-ownership decreased from 19.72% in 1998 to 5.66% in 2002 (*Hankyoreh* 21, September 24, 2003).

mainly on a financial rationale.¹⁸ In this way, conservatism and profit-maximization in business for higher shareholder returns have replaced active investment for new industrial ventures which was one of the main characteristics in the past development framework, thus leading to *structurally*-lowered economic growth. With such transnational investors who are currently dominant in the domestic stock market, but tend to cross massively and freely national borders seeking higher returns, instability and fluctuation in stock-price movement also have increased compared to the pre-1997 levels. The transnationalization of the Korean stock market with the sizable presence of TIIs represents one of the most significant links between the demise of the developmental state and the deeper global integration of the domestic economy produced by neoliberal restructuring in South Korea since 1998.

Chaebols

Disclosing 'mission creep' in Korea, the IMF even demanded changes in the private corporate sector for the first time in its history, criticizing the structure of chaebol-like 'business grouping' as the main cause of inefficiency and moral hazards. *Chaebols* thus were forced to reform corporate structures and practices according to new regulations and standards. As an exemplary punishment to disobedient cases, Daewoo, one of the top four *chaebols*, was eventually dismantled in June 1999 with its abnormalities, writing a new record of the biggest bankruptcy in a world business history until then.

Being business latecomers in the global economy, *chaebols* are now losing their old leverage, as affiliate firms which formerly belonged to the same business groups while sharing and mobilizing scarce resources like capital, technology and labor among them in new ventures at the group level, are becoming independent companies by the post-crisis corporate reforms.¹⁹ Neoliberal policy-makers and opinion-shapers in Korea, who pushed *chaebols* for such reforms, were obsessed with their idealized version of 'efficient corporate governance' based on the 'global standards' (i.e., the Anglo-

¹⁸ Regarding 'financialization' in corporate governance, see Dore (2000), Lazonick & O'Sullivan (2000), Fligstein (2001), and Crotty (2003).

¹⁹ Hyundai's entry into shipbuilding industry and Samsung's foray into semiconductor industry in the past were the successful examples, which were possible by such leverage (cf. Amsden, 1989: Ch. 11; Kim, 1997: 65-77). Samsung's venture into the car industry, however, was a negative case, which occurred when the state's industrial coordinating role was largely dismantled in the 1990s (Wade, 1990: 311; Shin & Chang, 2003: 38). In the corporate restructuring process, public attention has been paid mainly to the negative cases.

American corporate model) that they did not see that their model might be different from real-world cases, as seen in the recent US case of Enron's bankruptcy.

In corporate management of 'blue-chip' companies, such as investment decision or profit distribution, CEOs now should pay more attention to their shareholders, whose majorities have become transnational institutional investors since 1998. Under the pressure of recently popularized shareholder-value ideology in the country, CEOs have come to see growth in their companies' stock prices or in dividends to shareholders as a business priority. Such changes in attitude and practice among CEOs expectedly have exacerbated labor downsizing and job instability in South Korea in recent years, as witnessed in 'actually-existing' neoliberal economies (cf. Lazonick & O'Sullivan, 2002 for a critical analysis; Fligstein, 2001; Fligstein & Shin, 2005 for a critical view of the US case). With neoliberal reforms and more global integration, not only the pattern of business investment, but also that of employment seen in the past developmental-state has currently been transformed in this way (Table 3).

The reforms toward transnationalization in share-ownership and financialization in corporate control and structure have constrained resource mobilization for new investments at the organizational level as mentioned earlier.²⁰ In fact, the contraction of investment in the economy has been exacerbated since the 1997 crisis to the extent that the disparity between the amount of liquidities companies hold and their low investment has come to reach record levels in recent decades. It is the case even though their debt-equity ratios currently have become low.²¹ According to one study, the tendency in domestic business investment represents both a moderate fluctua-

TABLE 3. RATIO OF REGULAR AND NON-REGULAR WORKERS, 1995-2003 %

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Regular Worker	58.14	56.81	54.33	53.14	48.45	47.87	49.15	48.39	50.4
Temporary Worker	27.89	29.60	31.60	32.87	33.60	34.49	34.60	34.45	34.7
Day Worker	13.97	13.59	15.07	13.99	17.64	17.64	16.24	17.16	14.9

Source: Shin (2003: 43).

²⁰ Neoliberal emphasis on shareholders' value combined with their demand for the larger amount of stock dividends also can be considered one of the main causes constraining potential industrial investments. The percentage of stock dividends to investment in the facilities of listed Korean companies has increased from 3.7 % in 1998 to 6.6% in 2000 to 22.4% in 2002 (*Hankyoreh* 21, November 13, 2003).

²¹ The Ratios of Gross Domestic Investment during the last decade show the trend of drasti-

tion among big businesses and a large fall among SMEs, exacerbating polarization between two groups in investment (Yoo 2004:81). It is plausible to expect that the above changes in business environment have long-term constraining or negative effects on both groups' industrial investment and R&D spending in general. On the other hand, the ratio of stock dividend to investment in the facilities of listed Korean companies also increased from 3.7% in 1998 to 6.6% in 2000, and to 22.4% in 2002 (*Hankyoreh* 21, November 13, 2003).

CONCLUSION

In addition to the globalization drive of the mid-1990s, neoliberal restructuring since the 1997 financial crisis has accelerated financialization and transnationalization in the South Korean economy, completing the demise of the developmental state as of the present. In the course, the roles, functions, and inter-relationship of three institutional actors, namely, the state, banks, and *chaebols*, in the old developmental state have largely been transformed.

First, compared with the developmental role in the past, the Korean state has played the regulatory role of the neoliberal state in transforming the domestic economic structure in an 'investor-friendly' way and integrating it deeply into the global economy. Second, domestic banks, many of which have become foreign-owned since 1998 and independent of the government's industrial concern over the whole economy, now do their business exclusively according to the rationales of profit-maximization preferring the rich as their clients and consumer financing as their major business area to commoners and corporate financing.²² Third, *chaebols* are currently losing their old structure of business groups as their affiliate firms become independent, and they have become conservative in new investment depending more on equity-financing than on debt-financing.

cally declining investment after reaching the peak in 1996: 35.4% (1993), 36.5% (1994), 37.3% (1995), 38.1% (1996), 34.4% (1997), 21.3% (1998), 26.9% (1999), 28.3% (2000), 27.0% (2001), 26.1% (2002) (BOK).

²² For example, three of the eight largest nation-wide banks (Korea First bank, Korea Exchange Bank, and Citibank Korea, that is, former KorAm Bank) have become foreign-owned since the 1997 financial crisis. "Foreign banks now have a 21% chunk of the Korean market, an Olympic leap from the 4 % share in 1997 and a dash from 15.5% in 2003" (*Asia Times*, February 15, 2005). The proportion of foreign-owned shares in the other five banks is on average over fifty percent (*Hankyoreh*, October, 10, 2004; April 15, 2005). For example, in Kookmin Bank, the largest bank in South Korea, the proportion of foreign-held shares reached 75.4% in February 2004.

Transnational institutional investors' presence and influence in domestic financial and corporate sectors have spectacularly increased by owning the significant amounts of stocks in the sectors and thus by affecting management-decisions according to recently popular shareholder value ideology. This transformation into shareholder-centered 'corporate governance' has gone side by side with neoliberal labor-market reforms toward more labor flexibility since 1998 (Chang & Chae, 2004; Kim, 2004). Borrowing Chalmers Johnson (1982)'s analogy of MITI in Japan, TIIs, not state bureaucracy, now have become the "commanding heights" of South Korea's economy, turning the state into a post-developmental one. The answer to whether or not the developmental state in the country as the "state-banks-*chaebols* nexus" can survive in the wake of globalization and neoliberal restructuring, thus, seems to be negative as of the present with the transformation of major institutional actors, their functions and the relationships among them.

Our discussion of the transformation of the Korean developmental-state here has focused mainly on conditional factors like globalization and restructuring since the 1990s, engaging above all external actors and the state. Meanwhile, it should be noted that the growing power of domestic non-state actors like the *chaebol* or labor vis-a-vis the state also has contributed to such transformation (Evans, 1995; Kim, 1997). The "government-banks-*chaebols*" nexus was an outcome of historical evolution, not something unchangeable. Thus, since it has often been argued that since state- and *chaebols*-led development over the past decades in South Korea had exclusive characteristics vis-à-vis domestic civil society (e.g., labor), the old development-model should have been transformed at any rate. But it is true that neoliberalism, which is currently prevalent as a historically transforming force in post-crisis South Korea, cannot be a desirable alternative to the old developmental-state for resolving its contradictions and problems.

While Weiss (1999) notes that the developmental state is not necessarily based on coercive power, but rather on infrastructural one in the state, the combination of the developmental state with military-authoritarian regimes in Korea's past history has made such a conceptual and analytical distinction difficult especially on the part of pro-democratic actors in civil society (Lim, 1998: 421). In the eyes of the public, therefore, any attempt to transform the old developmental state into a neoliberal state is often considered a politically 'democratic' movement against the authoritarian past of the country, because it appears to be a challenge to or a radical departure from existing institutional arrangements (Kapur & Naim, 2005). This kind of 'politics of confusion' in neoliberalization recently has been criticized (cf. Bourdieu, 1998; Nederveen Pieterse, 2005).

An analysis defines the changing historical characteristics of the Korean state as follows: (1) the “repressive” developmental-state in the pre-1987 period, (2) the “transitive” developmental-state between 1988 and 1997, and (3) “democratic” developmental-state in the post-1998 period (Cho, 2003: 447). The characterization of the Korean state since 1998 as “democratic” makes a critical examination of the issue of “which democracy?” more important than before (cf. Song, 2003: 121; Abrahamsen, 2000). Another analysis even suggests that there has been a change in the characteristics of the Korean regime from being “pro-*chaebol* and anti-labor” until 1997 to being “anti-*chaebol* and anti-labor” since then (Choi, 2002: 164-5).

Here exists a crucial dilemma. How should the progress of political democracy deal with socio-economic neoliberalization? There is no doubt that the state will become undemocratic as the problems of labor flexibility and social inequality become exacerbated with ongoing neoliberal reforms.²³ Insofar as the ‘substantively-democratic’ state, a form of post-developmental state in South Korea, is more desirable in the current challenges presented by globalization and neoliberal reforms, we should not only pay attention to the drawbacks and dangers in both the old developmental state and the new neoliberal one, but also be able to imagine new ways of constructing “a national community with a kind of moral ambition” (Loriaux, 1999: 252).

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²³ The ratios of compensation of employees to national income between 1995 and 2002 show that the ratio of 2003 (59.7%) is lower than that of 1995 (61.3%) with that of 1996 (64.2%) as the peak (BOK). This means that the *quality of employees' work* has severely worsened with neoliberal flexibilization of labor, which includes the increase of temporary or day workers.

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